DISCOURSES OF RISK IN INTERNATIONAL FINANCIAL REGULATION

GOVERNING AN UNKNOWN FUTURE:

DISCOURSES OF RISK IN THE INTERNATIONAL REGULATION OF THE FINANCIAL SERVICES SECTOR

By

HEATHER McKEEN-EDWARDS, B.A., M.A.

A Thesis

Submitted to the School of Graduate Studies

In Partial Fulfilment of the Requirements

For the degree

Doctor of Philosophy

McMaster University
2009

DOCTOR OF PHILOSOPHY (2009) (Political Science)	McMaster University Hamilton, Ontario

TITLE:	Governing an Unknown Future: Discourses of Risk in the International Regulation in the Financial Services Sector
AUTHOR:	Heather McKeen-Edwards, B.A. Hons. (University of Manitoba), M.A. (McMaster University)
SUPERVISOR:	Professor Tony Porter

NUMBER OF PAGES: 300, vii

Abstract

International financial regulation has increasingly focused on 'risk-based' management over the last decade. In general, risk is a term embodied with the notion of an uncertain future and a belief that the use of rational and calculative practices can reveal, measure, and manage these potential futures. This dissertation argues that at the macro level financial governance is permeated with a tension between two overarching discourses of risk – risk as an economic necessity and risk as a danger or threat. These two macro-discourses influence and/or legitimize various courses of action in a general way that in some respects is similar to the role played by ideas in other approaches. However these macro-discourses do not only guide the regulatory actors involved. By drawing out the links between these discourses and the performative risk practices they constitute, this dissertation reveals how risk discourses operate in an ongoing way through the practical implementation of regulatory strategies, which implicitly or explicitly play one macro-discourse off the other. Moreover, the risk practices created, which include mundane, routine, and highly technical activities, work to construct the everyday performance of financial governance and the identities of those actors included and excluded from the system.

To examine this relationship, the dissertation looks at the international governance efforts of three financial areas: banking capital adequacy requirements, reinsurance and collective investment schemes. In the process, it reveals that the focus on risk in regulation creates some generalities across the realm of financial governance, but also that the micro-practices, identities and power produced in each arena are distinctive. It argues that by interrogating the macro-discursive constructions of risk and the practices and identities constituted through them, key tensions are revealed which, at least in part, explain the structure and goals of international financial regulation.

Acknowledgements

This dissertation is the outcome of a long and challenging process. I would like to thank all people who have helped and inspired me during my doctoral study.

I especially want to thank my advisor, Tony Porter, who has been a never-ending source of encouragement, guidance an immense knowledge from the initial semester of my Masters degree to the final version of this dissertation. It has been an honor for me to work with you for all these years.

I am also grateful to the rest of my PhD committee, William Coleman and Robert O'Brien for their time and energy throughout the pursuit of this degree. Their insightful comments and hard questions have improved this dissertation project at every phase. Furthermore, this degree would not have been possible without a SSHRC Graduate Doctoral Scholarship, which allowed me to focus primarily on the intellectual work at hand rather than how to pay for it.

A graduate degree is a bigger experience then just a dissertation. My fellow PhD students at McMaster were a source of friendship, advice and the occasional couch. My thanks to Ian Roberge, in particular, for all his collaboration, feedback and advice over the past 8 years.

There are many other unnamed people at both McMaster and Bishop's University who have offered intellectual, financial or emotional assistance along the way. I am grateful to each for their time and support.

Finally, my deepest gratitude goes to my family and husband John for their unwavering love and support, especially during the periods when this project seemed like it would never be completed. This dissertation would have been simply impossible without them.

Table of Contents

List of Illustrations, Charts, Diagrams

Acronyms

ABA	American Bankers Association
AMA	Advanced Measurement Approaches
ART	alternative risk transfer
Basel I	International Convergence of Capital Measurement and Capital Standards (1988); also referred to as the original Basel Accord
Basel II	International Convergence of Capital Measurement and Capital Standards (2005); also referred to as the new Basel Accord
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAT	catastrophic (financial instruments)
CIS	Collective Investment Schemes
EAMA	European Association for Asset Management
ECAI	External Credit Assessment Institution
ECB	European Central Bank
EFAMA	European Fund and Asset Management Association
EC / EU	European Commission / European Union
FBE	European Banking Federation
FSA (UK)	Financial Services Authority – United Kingdom
FSF	Financial Stability Forum
G7/8	Group of Seven / Group of Eight
G10	Group of Ten
G20	Group of Twenty
G30	Group of Thirty
HLI	Highly Leveraged Institutions
IAA	International Actuarial Association
IAIS	International Association of Insurance Supervisors
ILSA	International Lending Supervision Act
IRB	Internal Ratings-Based Approach
IMF	International Monetary Fund
IOSCO	International Association of Securities Commissions
IPE	International Political Economy
LTCM	Long-Term Capital Management
MPT	Modern Portfolio Theory
NAV	net asset value
OECD	Organization for Economic Development and Cooperation
UCITS	Undertakings for Collective Investment in Transferable Securities
UK	United Kingdom
US	United States
VaR	Value at Risk
WTO	World Trade Organization

CHAPTER 1
Introduction

One does not need to look far to see that risk and finance are inherently linked in today's financial services marketplace. A look at any financial publication is littered with references to risk and risk management. However, the language of risk extends beyond the financial marketplace and increasingly marks international financial regulation. All the main international governance organizations: the Basel Committee on Banking Standards (BCBS), the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS), have increasingly focused on risk and 'risk-based' management tools in the last ten years. Moreover, the Joint Forum (composed of the BCBS, IOSCO, and IAIS) expanded its mandate to focus explicitly on risk assessment and management issues in 2002. In doing so, it set up working groups in risk-aggregation, operational risk management, credit risk management, disclosure of financial risks, and cross-sectoral implications of extreme exogenous shocks among others.[1] On a system level, the Asian Crisis (1997-1998) created space for the emergence of bodies like the Financial Stability Forum, which looks specifically at 'systemic risk' and makes recommendations for regulatory practice based on this concept.

Yet, in many explanations of 'risk' and its relationship to regulation in financial services, the constructed nature of risk is left largely unquestioned. A conventional story of financial governance in light of 'risk' goes something like the following: Risk is an

---

[1] Wood, Duncan (2005), *Governing global banking: the Basel Committee and the politics of financial globalisation*, Burlington, Vt.: Ashgate, p. 119

exogenous, necessary feature of the financial marketplace in order to achieve economic growth. However, there are instances that arise where some of these 'risks' pose a threat or danger for society or, as more often argued, the financial system itself. In this story, at some specific but usually vaguely defined point, the discourses of risk shift from constructing the activity or instrument as primarily a positive economic feature to primarily a source of insecurity and danger. It is a nice condensed story that provides an easy frame for the why and how of financial regulation. However, one wonders what happens to it when the questions 'What is risk?' and 'What becomes possible under the name of risk management?" are asked.

This dissertation focuses on these questions. Looking at the arena of international financial services governance, it asks - what is the relationship between risk and the international governance of finance if one destabilizes the natural qualities we ascribe to the notion of risk? To examine this question we must step back from simply identifying 'risks' and ask what risk is. In doing this, it becomes clear that risk is used in multiple ways, denoting an object, a situation or an action at different times. One can try to measure a risk, or be 'at risk', or one can 'risk' everything. In the first two cases, the tendency to treat risk as a noun also creates a tendency to ontologize it into an objective fact. At the core of this dissertation is the belief that risk should not be objectified. Rather it is better thought of as a particular way of constructing and understanding the world around us… it is part of knowledge. In doing so, I accept de Goede's assertion that we should not conceive of international finance as either an autonomous source of power or architecture. Instead, it is a collection of performative practices that are constituted in relation to discourses, like risk, which make order of the material realm and understanding it possible.[2]

Therefore, the overarching argument made in this dissertation is that important insights into international financial governance become visible by examining the discourses performed within it, particularly the discourses around risk. Risk is a discourse embodied with the notion of an uncertain future and a belief that the use of rational and calculative practices can reveal, measure, and manage these potential futures. However, the following chapters will also show that the relationship between risk and financial governance is more complicated than a simple argument that risk is an important or unified frame. By interrogating the discursive constructions of risk and the emerging practices and identities, key tensions are revealed which, at least in part, explain the structure and goals of international financial regulation currently.

Financial regulation must navigate the complex tensions between two distinct discursive structures of risk. In the first construction, 'risk' is identified as necessary to the functioning of business and economic growth. The second discursive construction of risk is as a potential future misfortune, or more often the probability of this event occurring. While the former is prominent in the financial market itself, manifesting into complex processes of investment and securitization, the latter is prominent in financial regulation as a justification for regulatory efforts. Therefore, 'risk' is one key aspect of the construction of finance as an activity marked with "long-established practices of conjuring multiple futures, both glorious (to entice investment) and catastrophic (to

[2] De Goede, Marieke (2005) *Virtue, Fortune and Faith: A Genealogy of Finance*, Minneapolis, MN: University of Minnesota Press.

'prepare' for crashes and panics)".[3] The interaction between these two discourses creates a tension within financial governance between allowing for (or even encouraging) prudent forms of risk and discouraging (or eliminating) hazardous forms of risk.

However, this division is not the only important tension around risk in international financial services regulation. Although it is a necessary condition for international financial governance efforts that risk be articulated and linked with potential future misfortune, this again is a too simplistic reading of risk in financial governance. If it were this clear, then any activity framed as a risk in the negative context would be the subject of regulation. However, this is clearly not the case. Instead, in the articulations around risk as danger there is further variation that affects the construction of the governance assemblage. The first is when one destabilizes assumptions about the subject and asks what the subject of risk is – the individual or corporation, the international financial system itself (i.e. systemic risk) or society writ large. Similar questions can be asked about these constructions concerning responsibility for failures (or successes) around risk management.

The post-structural analysis centered on risk discourses utilized in this dissertation reveals important developments in international financial governance. A focus on risk discourses highlights how the discourses of risk and the techniques and performances that compose it affect how activities, events, and individuals are made subjects capable for governance. There are three key arguments about international financial services

[3] De Goede, Marieke (2008) "Beyond Risk: Premediation and the Post-9/11 Security Imagination" *Security Dialogue,* Vol. 39, no.2-3, p. 157 Also see: Martin, Randy (2004) "America as Risk/Securitizing the Other", *Interventions,* Vol. 6, no. 3, pp. 351-361

governance presented in this dissertation. First, it will show how links between activities or actors and 'risk' construct them as particular subjects for management and regulation.

However, it is not simply that risk matters. In interrogating international financial regulations there is an interesting interplay between two different discourses of risk. First, a discursive construction of these risks as dangers is important for the legitimacy of international governance. However, the discourse of risk as economic necessity, omnipresent in the financial services sector, also remains important. The tension between these discourses affects governance in distinct ways and makes them receptive to particular performances of governance. The tension between these two conceptions creates a frame of risk as something to be managed or mitigated but not something that can (or should) be completely eliminated.

Second, it is argued that the impacts of 'risk' upon entering into the larger discursive domain of financial governance are performed and this performance is made visible by looking at the collection of rationalities, techniques, practices (along with their attached moral and political values) that constitute it. Regulatory initiatives are documents and standards that emerge from a large discursive field that defines the possible and thinkable. Moreover, the governance assemblages that emerge from these performances often embody elements of sovereign, disciplinary and governmental power.[4] They function discursively to rearticulate how particular activities, events, individuals, and

[4] In this choice of terms, reference is drawn from discussion on the triangle of sovereign-disciplinary-governmental power that is present in modern society. Sovereign power refers to the power of the sovereign/government to coerce compliance and action based on the position as sovereign control. Disciplinary power begins to step away from pure sovereign power into the context of the administrative state. It occurs when the governance and surveillance is internalized. However, the role of surveillance by the state bodies is still central. Governmental power, governance comes from the subject (individual) empowered but further distanced from the state.

groups can be governed and the shifts in performative practice that emerge from this. Yet this has more impact than a technical reorganization of the tools or pieces of governance. Different groups and processes gain or loss power, voice and agency in these shifts. This is an important addition to move the analysis beyond highlighting that 'risk' is a powerful 'idea' that rational actors use to influence the international governance of finance. It highlights how the constitutive power symbolized in 'risks' affects not only what is governed, but also how, when and who has the authority to do so. This reconstitutes different actors and processes in ways that can affect their identities, roles, and authority in a reflexive relational process.

In doing this, the dissertation will also show how the historically contingent nature of 'appropriate' forms of risk management and the techniques that they embody provide the foundation for what types of regulation are considered efficient and effective. This argument runs counter to a rationalist public goods approach to understanding why certain regulations develop. In that approach, differences in regulatory structures emerge from the decisions of actors trying to achieve their interests and the most efficient and effective form of regulation to manage public or collective goods. What is visible through this dissertation is that regulatory decisions are based on the articulation of a financial activity/product around three aspects: whether the activity in question articulated as a potential threat (risk as danger), which subject(s) are articulated as 'at risk', and who is articulated as bearing the responsibility for the future event, whether it is glorious, mundane or catastrophic.

Moreover, it highlights an important element of international governance overlooked in many International Political Economy studies – the articulation and/or re-articulation of different identities and activities that occur within performances of financial governance. In particular the reinforced, and possibly increased, governance role for experts – or more specifically, groups and individuals who claim, or are granted the status from expert knowledge in particular aspects of risk measurement, mitigation and management. This argument runs counter to Ulrich Beck's assertion that the reflexivity around risk leads to a decline in the salience of experts and their opinions to the lay population. Instead, the overarching performances of risk identification, measurement, and management which are legitimized in this sector, particularly in calculative and/or mathematical form, create a place of privilege for those constructed as possessors of legitimate expert knowledge. The centrality of rationalism and calculation in the discourses of 'risk' further legitimate the structure of these actors.

The third argument emerges from the elaboration of these international governance arrangements. Through this research frame, one can better understand that the regulatory schemes that emerge are not homogenous, framing both human and non-human elements in unique and distinctive ways. This nuance is largely missing in many rationalist approaches and their focus on negotiations between rational actors who possess various degrees of instrumental power and defined interests. Therefore, differences between sectors around who is at risk, who is responsible for that risk, who is 'qualified' to deal with this risk, etc are all considered part of the pre-defined interests of the actors. Moreover, traditional studies of international financial governance tend to look for similarities and patterns that allow us to generalize when studying international governance. By focusing on the similarities, important nuanced differences can be overlooked. The importance of risk to international financial regulation is clear across all of the cases. There are clear broader commonalities between the distinct case studies: the increasing use and legitimation of risk modelling, the continued supervisory role of government regulators and the increasing reference to private sector risk measurement and management to name a few. However, there are also clear variations that occur in international financial governance. Through the three cases studied, important areas of similarities and differences are apparent in the different performances.

Therefore, the dissertation will focus on interrogating the discursive constructions around risk in each of the different cases to make visible the tensions in international financial governance. However, in addition to this large argument, a secondary discussion has emerged in this study. Throughout this dissertation, the notion of 'risk' as a natural and real phenomenon is destabilized to examine the contingent nature of governance arrangements. At the same time, however, a space was revealed where questions about the practices and understandings in the international regulatory projects emerge. These challenge the implicit construction of the specific regulatory standards as largely technical and apolitical, either because they are common sense or natural. It highlights that the 'truth' which is articulated is both contestable and a form of power[5] which allows for a deeper, more fundamental questioning and critique of these elements and their effects. Moreover, it highlights the exclusions that are legitimized under the frame of

---

[5] Deuchars, Robert (2004) *The International Political Economy of Risk: Rationalism, Calculation and Power*, Burlington, VT: Ashgate Publishing Ltd, p. 4

technical non-political policy that marks financial regulation in general, and international financial governance more specifically. The structures and performances of governance and risk management have not only reinforced the legitimacy of voice for those constructed as 'experts' but also at the same time served to minimize the voice of those who make claims based on other forms of knowledge or purpose. This argument is made in the context of the overall lack of a powerful, active critical social movement to counter the input of business in many areas of financial services internationally, at least outside of the work of the International Monetary Fund and the World Bank.[6] Yet, at the same time, we can see an increasing downloading of responsibility for governance onto private actors and the individual in the governance structures. To reconcile these two trends, there has been a clearly visible focus on practices of disclosure and 'education'. All of this is particularly problematic given the place of the financial sector in the economy overall. Decisions and practices can have real world impacts, as the current financial crisis serve to remind us. The final substantive chapter will further elaborate on the themes that relate to the belief that the linking of international financial services governance with the discourse of risk, expert knowledge and techniques of risk management serves to depoliticize it.

[6] See the work of Jacqueline Best (2005) on the focus on legitimacy in these bodies. Also one can look at the Jan Aart Scholte and Albrecht Schnabel's (2002) edited volume on the increasing presence of civil society in finance focusing largely on the IMF.

Contributions of Study

This dissertation adds to the academic literature in a number of empirical and theoretical ways. First, it elaborates a more central role for discourse in the study of international economic governance arrangements – in this case the discourse of risk. Until recently the role and impact of discourse has remained largely under-explored within the subfield of IPE.[7] The majority of analyses of global financial governance in IPE advance primarily through institutionalist, class, or interest-based avenues where emphasis tends to be placed on material power, prior institutional structure, and/or the functional demands of the problem being addressed. For the most part, the study of discursive patterns and relationships are often overlooked or subsumed, leaving unquestioned the way discourse and the techniques, practices, programs that it is linked to shapes the different financial services industries (including the boundaries they draw between inclusion and exclusion and responsibility/ accountability and growth). This dissertation draws out some of these oversights, adding to this small but growing area of IPE. In doing this, it provides an interesting alternative to explaining why international governance in this sector emerges the way it does from theories that emphasize rational choice, capture, and ideology approaches.

In doing so it works in the same vein as some of the work done by two IPE scholars (Marieke de Goede and Robert Deuchars) focusing on risk and international finance from a

[7] This is not only the case in the study of international finance. Post-structural insights and analyses have been largely missing from the study of IPE in general and in contrast to the much more noticeable ways that they have been engaged in other areas of International Relations like securities studies.

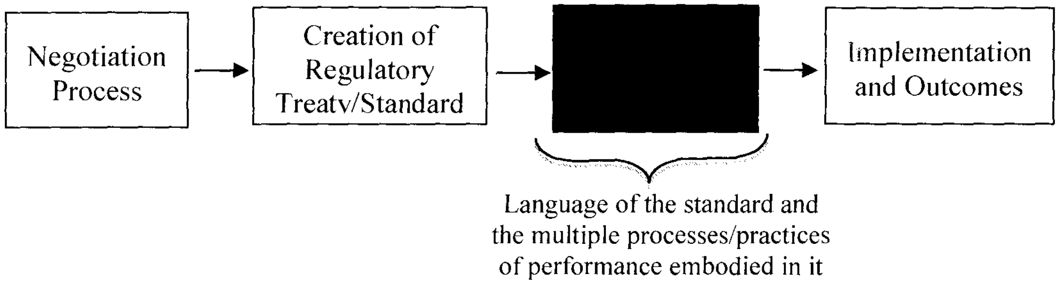
discursive angle.[8] Along with providing nuanced genealogies of finance and risk respectively, these works create the opening in the field in which this dissertation can situate itself. However, the study here adds to the discussion started with these works in two ways. First, it explores an area not explicitly focused on by either scholar – the intersection of discourses of risk as an economic positive and risk as a possible negative in the regulatory arena. Second, the dissertation has a more explicit focus on the international regulatory and governance arrangements in the financial services sector - banking, securities, and insurance - instead of looking at international finance more broadly.

Second, by focusing on regulatory programs from the view of performance, a number of important advantages can be gained. First, studies of international regulation tend to 'black box' the small performances that compose the actual regulatory process on the ground. In many studies, particularly in the case of intergovernmental regulations, there is substantial detail on the negotiation and creation phase of the regulation and possibly or the process that achieved the sought outcome. However, often how the actual techniques, practices, and identities that are rearticulated in the written set of instructions (which is admittedly a less flattering way to present regulatory agreements) are left largely unquestioned. In many cases, these studies only look at the national implementation processes, if they are questioned at all. Yet the practices of governance occur at many other levels, from inside the firm, to within the industry, the specific

[8] Both of these authors focus on elaborating genealogies of finance and risk and some of the implications for this to the current structure of international finance. For Deuchars (2004) risk is a way the neoliberalism has become centralized and also an ordering element of society somewhat similar to Beck's risk society. For de Goede (2001, 2004, 2005) the focus has been more explicitly on the relationship between 'risk' and the evolution and governing of financial markets and elements of them. Interaction with the processes of securitization and what activities and governance practices become possible through this is also a key focus in her work.

financial sector, national arenas and the international realm. This analysis forces a shift in terrain. It does not focus on the national-international relationship; rather it connects the regulatory practices that are constituted in regulation to industry and firm level governance and some of the implications this has for practices and identities.

Figure 1a: Focus in the Examination of a Potential International Intergovernmental Regulatory Initiatives



Moreover, by focusing on the discursive language and practices the subject is decentred—the ontological assumption about which actor is key is problematized rather than being taken for granted. This allows the discussion of each case to range between different political levels and the public and the private sectors without fear of capture by the methodological statism that can constrain many studies of international governance. In tracing discursive practices, focus can shift from the constitution of the individual to system wide trends. In the context of public and private, there have been long-standing debates about the roles that the 'private actors' play in the governing of society in IPE in particular. This type of analysis can reveal the importance of understanding how discourse combines with a unique and delicate balance between groups and individuals in both the public and private arenas to create, maintain, and depoliticize portions of the governance process. This focus allows for a much deeper and more central critique of these processes. It highlights that arguments that are sometimes made about the need to pull governance back to public actors may not achieve what they intend to.[9]

Third, this project seeks to contribute by elaborating the understanding of the role of expert knowledge in the structure and nature of international financial governance for IPE. In this study, the focus on power/knowledge means that expert knowledge is more than simply a tool or resource to be used by actors in achieving predetermined goals. Instead, it involves asserting a position based on the relation between power and knowledge more broadly. Moreover, through this process the inherent political and moral basis of 'expert' knowledge comes into view. In an area of finance where expertise and expert knowledge often achieve a veneer of neutrality this is an important improvement. This conceptualization is significantly more nuanced. Moreover, it moves substantially beyond the most commonly used conception of experts and expert knowledge in International Relations – epistemic communities. This term, although useful in opening a space to discuss experts in International Relations, assumes too much homogeneity in the expert community and tends to frame these actors as interlocutors for government action without focusing enough on them as independent sources of governance. Moreover, in the discussion of credit rating agencies in the Basel II regulation discussed in chapter 5, we see a case where expert knowledge is integrated despite the fact that these actors where explicitly concerned and wary about this decision.

[9] There are a number of different arguments in the discipline that assert that finance would be repoliticized and more secure if there was increased government or public control. For example, strains of this argument can be seen in the calls for a global regulator for international finance [see Eatwell and Taylor (2000)]. However, if this global regulator perceives governance as a form of risk management then one must question whether simply shifting to the public sphere would repoliticize it.

Finally, this project contributes to the study of international finance in that it provides an entry point to discussing a number of important social tensions in this process and its outcomes. At the very basic level, one can see that actors involved in the definition of risk and responsibility are actively engaged in a contest to gain the symbolic power this act bestows.[10] Therefore, how different actors benefit and which lose in the continual process of governance is made visible. Yet the discussion of social implications of governance moves beyond this focus on actors in important ways. This work also highlights how the discourse and other narratives imbue the governance mechanism in question with particular understandings of how the world works and should work. These often become so ingrained in the process that they become unquestioned 'common-sense'. This dissertation's approach allows one to destabilize these assumptions and understandings, revealing their inherently constructed nature. In doing so, it allows another entry point into opening up important questions about the purpose and bases of governance, particularly in areas of 'technical' regulation that have been depoliticized for the most part. These discussions are central to the purposes and study of political science.

Moving beyond the study of finance, this dissertation also makes a smaller contribution to the study of International Political Economy more generally. This work is clearly in concert with an emerging group of scholars in IPE who take the impact of the discursive realm seriously. Along with the work of de Goede and Deuchars discussed above, there have been a number of developments indicating a general shift toward engaging this area of theorizing in the last few years. The publication of the edited

[10] Garsten, Christina and Anna Hasselström (2003) "Risky Business: Discourses of Risk and (Ir)responsibility in Globalizing Markets" *Ethnos*, Vol. 68, no. 2, June, pp. 249–270

volume *International Political Economy and Poststructural Politics* (2006) highlights the increasing efforts towards engagement.[11] Therefore, this work adds to this small but growing group of studies.

The development of this theoretical stream also connects to a thriving discipline wide debate about the relative importance of non-material versus material institutions in governance throughout the discipline. Studies on the importance of language and linguistic institutions have grown in recent decades. The work on ideas in public policy, norms in mainstream international relations and discourse have emerged to become identifiable research areas. However, these studies have maintained an analytical separation between these the material realm and that of language and the ideational. The post-structural focus on discourse used here collapses this distinction between the material world and the language. It rejects the notion that language and representation are simple transparent vehicles of communication that can be separated from the material realm.

Who would this work be of interest to?

More specifically, this work would be of interest to those who wish to learn more about the field of global finance, particularly its international governance. Given global finance is a key mechanism in the functioning of other areas of the economy, the greater our understanding of it and its governance the more we will be able to understand how to shape it. Moreover, the following work is part of a growing literature on the importance

[11] De Goede, Marieke, ed. (2006) *International Political Economy and Poststructural Politics*, New York: Palgrave Macmillan

of risk as a defining feature of society and governance in a globalizing environment.[12] Its specific focus highlights how 'risk' fits into specific practices, techniques and rationalities of governance, particularly in the international financial services sector. As such, it would of interest to any individual or group who seeks to understand the relationship between risk and the processes of governance. Given the focus on risk and discourse, the dissertation may be of interest to those involved in the debates about the potential of discursive studies in understanding the world of governance more broadly.

This project may also be of interest to those who want to explore the importance of expert knowledge in governance outside of the concept of epistemic community. In undertaking this type of examination, this research is able to discuss the ways that experts are legitimated and granted power through their possession of expert knowledge, the competition that occurs between the claims of different 'experts' and the role that their status can play in producing the sector. Moreover, by looking through the lens of discourse it also highlights how these understandings of experts are inherently political and contestable. Finance lends itself to the study of 'experts', however there are many other areas of society where the examination these issues here could prove useful.

Outline of Dissertation

Clearly, this dissertation has a number of broad aims and areas for discussion. Prior to elaborating on how the remaining chapters are organized, there is an important

[12] Studies which focus on risk are widespread looking at risk in the context of childhood, crime, health care, law, nuclear power, and finance among many others.

limitation of this study to address. The purpose of this dissertation is to look at the discourses of risk in the creation, content, and performance of international financial regulation and governance. The choice has been made to limit and focus the analysis on transnational or global governance instead of national level regulation. This does not mean that national regulations and governance are considered irrelevant for understanding the functioning of the sector, or even the implementation of international governance. In fact, there are instances where particular national policies are referenced and integrated. However, the choice made was to focus on the international realm. The nature of financial markets, products, and actors is increasingly stretched beyond the traditional borders of the state. In concert with these developments, governance has begun to follow to both the international and transnational realms. These have occurred through harmonization of national standards or the creation of specific transnational policies and accords. These developments mark the emergence of a large and particularly relevant space for one to look at how finance is governed in its own right.

That said, there is still a substantial amount of material to be addressed. To organize the relationship between risk discourses, expert knowledge and international financial governance the text is divided into eight additional chapters. The following chapter will broadly review previous analyses of international financial services sector regulation and expert knowledge. Chapter 3 begins the dissertation's analysis by elaborating the theoretical foundations this study draws on. It provides more detail on the theoretical foundations that underpin this dissertation and lays out how each case is assessed. Chapter 4 turns to 'risk' itself and the two key discourses of risk and management in the financial services sector that are relevant for this study. First, a brief introduction to other approaches to conceptualizing risk is briefly outlined. Following this section, the 'conditions of possibility' that have underpinned the emergence of risk in its discursive construction as something calculable and predictable will be briefly reviewed. This examination is a dissertation in itself, therefore in this work these conditions are condensed to include: the emergence of the possibility of foresight that comes about with the advent of virtu, the emergence of rationalism and the separation of risk from uncertainty, and the related links to calculative rationality. I will then turn to elaborating on the different discourses of risk that emerge and the implications of them for regulatory efforts.

The three chapters immediately following are the cases that compose the second part of the dissertation. In all three cases, the connections between the discourses of risk and the emergence of international regulation at the international level are explored.[13] However, each of the three case studies illuminate some of the different ways that discursive narratives of risk and risk management intermingle with historically contingent developments altering the projects in the different areas of financial services governance. To begin, in Chapter 5 there is a study of the governance efforts in the banking sector, specifically focusing on the Basel II Capital Adequacy Accord, as it has been the main focal point of the transnational regulatory arena for a number of years. By focusing on

[13] In each of these cases there an emphasis on the role of risk in intergovernmental projects and initiatives. I realize that governance is much more complex and diffuse than this. There is an attempt to bring in other less formalized governance initiatives as much as possible. However, given the limitations of the size of the dissertation in terms of pages, the decision made was to focus more explicitly. Moreover, by focusing on the international intergovernmental standards it is possible to examine the governing performances of different actors and how this reconstitutes their identities and the practices in governance.

both Basel Accords, the different ways elements of international financial regulation are made visible become clear. Next, in chapter 6, is an analysis of the transnational regulatory efforts that have been undertaken around Collective Investment Schemes (CIS) (such as mutual funds). A study of the continuing development of regulation for reinsurance will be the topic of the final case in chapter 7.

These three chapters are not intended to be 'compared' in the sense that is often meant in the discipline of Political Science. Each of the chapters connects to broader themes of this work and to each other in multiple interesting and complex ways. Due to this approach, these cases are discussed in relation to each other to highlight some more general points in the final two chapters. However, they are not, nor are they intended to be, comparable in the comparative method sense of the term.

In chapter 8 (the final substantive chapter of the dissertation) the focus will be on drawing out the inherent depoliticizing of governance choices through the discourse of 'risk' and some of the implications of the emergent practices and performances of management for questions of voice and exclusion. At the same time, it will draw out how the decisions made have also placed important regulatory responsibilities on individuals and the private sector, an inherently political decision that fits with the trends of the neoliberal political economy.

Finally, Chapter 9 will conclude the work with a short review of what the dissertation has argued about 'risk' and its discursive importance in governing the international financial services sector. In particular, it will focus on highlighting how even though there is an overarching discourse of systemic risk in all these cases, there are important divergences between the sectors which have influenced the way that international regulation has emerged and been performed in each area.

Conclusion

This dissertation is interested in understanding the implications of international financial governance. It is necessary to step beyond the limiting analytical frame of pre-existing, exogenous actors using power (in instrumental forms) to achieve their interests to accomplish this task. Instead, the examination shifts its focus to discourse – particularly the discursive systems that emerge around notions of risk. However, the importance of risk extends beyond its role as an idea or frame; instead one must examine the performances, practices and identities that it makes possible or impossible. Moreover, it highlights that while these discursive frames are common throughout financial governance, they also manifest into a diversity of governance arrangements. To draw this point out, the dissertation analyzes three international governance domains in the financial services sector focusing on the insights provided through a focus on the different narratives of risk and its relationship with expert knowledge.

This chapter has sought to introduce the general basis of this project and the arguments it will draw out. It has highlighted why this point in time provides an ideal time to pursue this type of project, what it contributes to Political Science scholarship, and some of the different groups which may find it useful in the process. The next chapter will undertake a literature review looking at some of the other studies in this area.

CHAPTER 2:
Attempts to Understand International Financial Services Regulation and Expert Knowledge – A Literature Review

The study of the regulation of international financial services is a well-trod area of academic research. There are a number of diverse studies that examine the sector from detailed analyses of individual regulations, treaties and institutions to broader abstract works that focus on general trends and the relationship between these markets, governments and societies. This chapter is intended to provide the reader with a basic overview of the theoretical approaches that form the basis to analyzing understanding international financial governance in the discipline of IPE. It will focus on elaborating the approaches that have not been utilized in this study. Chapter 3 will focus directly on laying out the critical or post-structural discourse approach used in this study.

The work done on international governance in this sector can be divided in an almost unlimited number of ways. This is not an attempt to provide a complete detailed presentation of all the nuances of other studies to international finance and its regulation. To do so would be another dissertation on its own. That being said, clearly one must also know the terrain upon which one is walking. Therefore, the first part of this chapter will look briefly at two categorizations of approaches to explaining international financial governance that are challenged by the approach used here – Rationalist State-focused approaches and Transnational Capitalist Class/Market-based approaches. The discussion of each category highlights some of the various arguments and focuses of previous work. These categories are clearly only analytical devices to help organize this section of the dissertation. It is recognized that there are important differences and debates between studies that are presented within the same category and that they are more porous and intermingled than this distinction presents. As with all processes of categorization, important nuanced differences within each group are minimized or ignored. This is the downside to providing a literature review on such a well-studied area. However, it is the best way of proceeding for the purposes of laying out the main ways that scholars in the field have studied international financial governance.

The second part of this chapter will focus on the different analytical approaches to the relationship between expert knowledge and the governance of finance that have been conceived and elaborated on. More specifically, it will briefly look at approaches that focus on pressure groups and lobbying approaches, the epistemic communities approach and the risk society approach to the role of experts and expert knowledge. As with the previous section, the same caveat applies.

Approaches to Explaining International Financial Governance.

There are two broad approaches that tend to be utilized in the study of global financial governance in the field of IPE – rationalist approaches and transnational capital class or market-based ideology approaches. Moreover, there is an emerging set of approaches, labelled public-private governance that will also be briefly highlighted.

Rationalist state-focused Approaches

The most common explanatory approaches that one sees utilized in the study of global governance are variants of rationalist approaches. This section will try to briefly discuss the large range of approaches that now fall in this category based on some of their commonalities. First, these analyses tend to place emphasis on or attribute significant power to the role of states. States are viewed not only as the chief architects of the international financial system but as having official control over the two key instruments – monetary policy and fiscal policy.[14] Using approaches that highlight the importance of institutions, interests or power, these studies share a common link in that they focus on explaining the international financial regulatory regime through the role that state actors have in it. In general these approaches are united in their focus on autonomous actors, in many cases states, that are self-interested and goal-seeking and which possess varying degrees of power. The motivation of each actor is the maximization of their own utility.[15] Many analyses in this stream are grounded in the theoretical tradition of liberalism, although there are some that have clear links to the Realist and critical streams of IR theory.

For many scholars in international political economy more broadly, the key actor in international financial regulation is the state. One early example of this type of approach which emerged in the 1970s is found in the work of Keohane and Nye around

[14] Pauly, Louis W. (1997) *Who Elected the Bankers?: Surveillance and Control in the World Economy*, Ithaca: Cornell University Press
[15] Hansclever, Andreas, Peter Mayer and Volker Rittberger (1997) *Theories of International Regimes*, Cambridge: Cambridge University Press, p. 23

interdependence. For these authors the growing level of interconnectedness among states in the international economy creates incentives for states to both cooperate and compete. As the states in question become more economically dependent on one another the cost-benefit analysis changes leading states to tend to seek greater levels of cooperation because they are increasingly vulnerable. Therefore, interdependence redefines politics and power relations between states.[16]

Looking at financial regulation more specifically, recent work by David Andrew Singer on international financial harmonization also fits within this stream.[17] Singer's argument about international financial services regulation focuses on the international regulatory harmonization in this sector as the outcome of the policy positions of states, particularly large powerful financial actors like the United States and the United Kingdom. Financial regulators seek international regulations to address domestic political pressures and the dual pressures of stability and competitiveness. Moreover, these state actors are treated like rational actors who have a set of interests regarding particular harmonization initiatives outside of the international negotiation process.

Another variation of a more state-centric focus is the work of Eric Helleiner. Although there are elements of Marxist-inspired concepts in his work, Helleiner's work conceptualizes states as having been of central importance in financial governance. Helleiner's study highlights the importance of looking at state decisions and non-decisions in explaining the nature of financial markets and financial governance that can

---

[16] Keohane, Robert O. and Joseph Nye (1977). Power and Independence. World Politics in transition, Boston & Toronto : Little Brown

[17] Singer, David Andrew (2007) *Regulating Capital: Setting Standards for the International Financial System*, Ithaca: Cornell University Press

be seen currently. They not only permitted the growth of global financial markets but also encouraged a particular structure of governance arrangements through liberalizing initiatives and not implementing more effective controls on the movements of capital.[18] Looking at the development of capital controls, the importance of state decisions (or non-decisions) is highlighted. In the immediate post-war system most advanced industrial states employed extensive versions of capital controls, strictly regulating the movement of money for states to use to promote national economic goals which existed without any serious challenge throughout the 1950s. However, he argues that the 1960s marked the beginning of the end for these systems of capital controls, initiated by the rise of the Euro-dollar market. This market was essentially an "offshore" market, not subjected to the state's control, making capital controls less effective. The collapse of the dollar standard began an increasing movement toward the liberalization of these controls. Not long after, in the 1970s, there was the first indication that even if a state sought to return to capital controls, it was not necessarily an option. In 1976 the British government decided to accept an austerity program after serious debate led to the realization that reinstating capital controls was simply not viable.[19]

Louis Pauly has also highlighted that states can continue to be of importance in the modern financial system. Pauly asserts that globalization has not radically diminished/decreased the power of states, particularly the American state, even given the increasing role of markets and market solutions. Current global financial structures and

[18] See Helleiner, Eric (1994) *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s*, Ithaca: Cornell University Press or Helleiner, Eric (1995) "Explaining the Globalization of Financial Markets: Bringing States Back In" *Review of International Political Economy*, Vol. 2, no. 2, Spring, pp. 315-342

[19] Helleiner, Eric (1995)

processes are even encouraged by some states because they obscure distributional issues, particularly in democracies. In these instances, states have a complicit role in the shifting of state authority to the market. Furthermore, because a functioning financial market requires a stable political and institutional base, markets can only act as a tool for government policy, not a true substitute. When markets threaten to (or actually do) fail regulatory power is shifted back to public authorities.[20]

A related area of analysis focuses on the significance and importance of states and public actors through the impact of some international intergovernmental institutions. Since the 1980s there has been an relatively consistent trend toward active international policy coordination to enhance stability in the financial and monetary system, particularly through the roles of a variety of international institutions. These include the Bank for International Settlements (BIS), the International Monetary Fund (IMF), the Group of Ten (G10), the World Bank, the Group of Seven (G7) and other less formal organizations.[21] Porter's analysis of the BCBS and IOSCO highlights the important role that both these bodies play in their respective areas, even if their structures and methods are different.[22] The major international regulatory organizations in the financial area, dealing with banking, securities and insurance, "were created informally," and have evolved to highly structured, albeit soft law, institutions.[23]

[20] Pauly, Louis W. (2002) "Global finance, political authority, and the problem of legitimation", in Hall, Rodney Bruce and Thomas J. Biersteker (eds.) *The Emergence of Private Authority in Global Governance*, New York: Cambridge University Press, pp. 76-90

[21] Woods, Ngaire (2000) "Globalization and International Institutions" in Woods, Ngaire, ed. *The Political Economy of Globalization*, New York; St. Martins Press, pp. 202-223

[22] Porter, Tony (1993) *States, Markets and Regimes in Global Finance*, New York: St. Martin's Press

[23] Key, Sydney J. (1999) "Trade liberalization and prudential regulation: the international framework for financial services," *International Affairs*, Vol. 75, no. 1, pp. 61-74

One variant of these types of analyses focuses on a set of international intergovernmental organizations that have received attention in recent years—the G7/8 and some of the other key "G's". The G7/8 is composed of the finance ministries of the leading industrialized states. This organization has been active in the attempting to direct financial governance since the 1970s. Although the actual role of this institution is ambiguous, some scholars argue that it is an important part of this sector's governance.[24]

Some take the argument about the importance of international intergovernmental organizations further to argue in favour of developing a global regulator. It is argued that national regulatory regimes are increasingly inadequate given the global nature of the financial system and the potential occurrence of systemic risk. Due to this, a global regulator is necessary to ensure the formation of minimum standards of prudential regulation, monitor the compliance of states, and to address these regulatory gaps.[25] It should be noted however that the scholars arguing for this realize that there are significant territorial, sovereignty and legal issues that would need to be addressed before a true global regulator could emerge.

---

[24] Culpeper, Roy (2003) "Systemic Reform At A Standstill: A Flock Of "Gs" In Search Of Global Financial Stability" in Albert Berry and Gustavo Indart (eds.) *Critical Issues in International Financial Reform*, New Brunswick: Transaction Publishers, pp. 203-236; Baker, Andrew (2003) "The G7 and architecture debates: norms, authority and global financial governance" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 324-342; Baker, Andrew (2006) *The Group of Seven: Finance ministerial, central banks and global financial governance*, New York: Routledge

[25] For more on the need for a single global regulator see Alexander, Dhumale and Eatwell (2006) *Global Governance of Financial Systems: The International Regulation of Systemic Risk*, Oxford: Oxford University Press; Eatwell, John (2001) "New Issues in International Financial Regulation" in Ferran, Eilis and Charles A.E. Goodhart (eds.) *Regulating Financial Services and Markets in the Twenty First Century*, Portland: Hart Publishing; Eatwell and Taylor (2000); or Alexander, Kern (2001) "The Need for Efficient International Regulation and the Role of a Global Supervisor" in Ferran, Eilis and Charles A.E. Goodhart (eds.) *Regulating Financial Services and Markets in the Twenty First Century*, Portland: Hart Publishing

There are a number of concerns that emerge with this kind of approach however. First, it confines the focus on governance to the negotiation process that occurs between different actors. In some cases these relationships involve both public and private actors but historically the emphasis has been on negotiations between states. There are problems with over-emphasizing the role of the state. Key to this is the concern that little attention is paid to the independent governance role of private actors. It is clear even in briefly looking at the international financial services sector that these actors do have an important role to play. In addition, these approaches tend to lack an explicit theorization of how knowledge matters in the processes of regulation. Focus is placed instead on the power and authority of the state, particularly in the context of questions of sovereignty.

Beyond the state focus there are a number of other concerns with these approaches. First, there is an explicit or implicit assumption of rationality in these studies, yet few fully examine what the it is. Rationality is assumed without necessarily problematizing the assumption about the preferences of actors. This is particularly apt when given the tendency to apply a theory of individual rationality and action to an institutional body like a state.[26] Moreover, there are reasons that actors may not act according to the assumed structure. This has led Odell, for example, to argue that we should really only ever discuss these processes and actor preferences as bounded rationality.[27] Finally, as we will see in the next chapter the conceptions of knowledge and

[26] Hansclever, Mayer and Rittberger (1997), p. 25
[27] Odell, John S. "Bounded Rationality and the World Political Economy" in Andrews, David M., C. Randall Henning and Louis W. Pauly, eds. (2002) *Governing the World's Money*, Ithaca: Cornell University Press, pp. 168 – 1

power are much more fully fleshed out in a discursive approach like the one undertaken in this dissertation.

Transnational Capitalist Class and Neo-liberal Ideology

The second category of explanations of the governance of international finance begins from a much more critical stance. Emerging from a more critical Marxist tradition, this type of analysis focuses on finance at least in part from a Neo-Gramscian or historical materialist lens.[28] Drawing from Antonio Gramsci, these types of studies argue that a class-based hegemony emerges when the ruling class persuades other groups in society to accept its organizing principles. One must look beyond trying to understand governance in terms of state decisions when trying to capture the nature and importance of international financial governance. Instead, one needs to assess these structures in relation to the "'transnational capitalist class' of corporate leaders and technocrats in government and international institutions." This class, which institutionally takes the form of a "nebuleuse", acts as the driver in the increasing globalization and liberalization of the capitalist system.[29] Neo-liberal markets and the nebuleuse are enshrined through either blocking the development of regulation or entrenching the non-interference of the state in markets. Given this, regulation and governance emerge because they are in the

[28] In terms of this dissertation, there are substantially more overlap and links between some Gramscian approaches and the post-structural lens than between rational actor and post-structural approaches.
[29] The term 'nebuleuse' comes from Robert Cox's work "Global perestroika" published originally in Ralph Miliband and Leo Panitch, eds. (1992) *Socialist Register 1992*, London: Merlin Press, pp. 26-43. This article was republished in Robert W. Cox with Timothy Sinclair (1996) *Approaches to World Order*, New York: Cambridge University Press. A slightly amended version was published as "Global Restructuring: Making Sense of the Changing International Political Economy" in Richard Stubbs and Geoffrey R. D. Underhill, eds. (1994) *Political Economy and the Changing Global Order*, Toronto: McClelland and Stewart, pp.45-59

interest of capital. The ideology of neo-liberalism and the material benefits it provides to the transnational capitalist class drive the international governance process. For example, Stephen Gill draws on this concept, pointing to a number of actions taken by states to institutionalize disciplinary neo-liberalism including the growing surveillance role of the state in his book *Power and Resistance in the New World Order*.[30]

This approach presents a potential avenue to begin to address the issues that are central to the dissertation. However, a problem with using this approach is the strong focus on class and neo-liberal ideology, which limits other options for fully exploring the myriad of ways that discourses can matter in governance. Moreover, while power and knowledge are both present they are much more constrained notions. First, in this type of approach power is largely instrumental and ideological wielded by the elite to create a 'false consciousness' among the rest of society. Where power is not instrumental, it is seen as structural. This runs counter to the understanding of discourse which is utilized here, where power is seen in relational terms. As Langley points out, this approach "may help us to understand the creation of particular subject positions, but it cannot account for acting subjects".[31]

While Gramscian approaches tend to focus on class and capitalism, there are additional studies which highlight the power of markets and market actors. There are a number of studies that begin to highlight the important role that the market, in particular

[30] Gill, Stephen (2003) *Power and Resistance in the New World Order*, New York: Palgrave Macmillan. For another analysis integrating this concept of the nebueluse see Brian Hocking (2004) "Beyond Seattle: Adapting the Trade Policy process" in Hocking, Brian and Steven McGuire, eds. *Trade Politics: International, Domestic and Regional Perspectives*, London: Routledge, p. 5

[31] Langley, Paul (2006) "The making of investor subjects in Anglo-American pensions" *Environment and Planning D: Society and Space*, Vol. 24, pp. 919- 934

international financial markets and global multinational corporations, has in explaining international financial governance currently. Sometimes framed under the notion of state-market relationships[32], these studies highlight the decreasing power of states in governing finance (and in sometimes the economy as a whole). Emerging out of analyses of the implications of the collapse of Bretton Woods, this line of study has focused on the changing control relationships between these two types of actors given the increases in capital mobility and economic restructuring. This increasing mobility has created significant constraints on governmental actors. For example, some have argued that state roles have now shifted so that it can only act as a facilitator and enforcer of market principles for the most part.[33] The processes of capital liberalization between the 1970s and 1990s, which were driven by the rapid growth in international financial markets (combined with the globalization of production), increased firms' abilities to evade government controls.[34]

One example of this type of analysis is the work of Suzanne Soederberg examining the role of international bodies like the G7 and the G20 in the establishment of governance for the global financial system. She argues that neoliberalism has reinforced a belief in market discipline that has led to a "resignation that the interests of transnational

[32] Hudson, David (2005) "Locating and understanding the marketplace in financial governance" IPE, interdisciplinarity and multi-level governance" in Baker, Andrew, David Hudson and Richard Woodward (eds.) *Governing Financial Globalisation: The Political Economy of Multi-Level Governance*, New York: Routledge

[33] Cerny, Philip G. (2002) "Webs of Governance and the Privatization of Transnational Regulation" in Andrews, David M., C. Randall Henning and Louis W. Pauly, eds. *Governing the World's Money*, Ithaca: Cornell University Press, pp 194–216

[34] Goodman, John B. and Louis W. Pauly (2000) "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets" in Frieden, Jeffry and David A. Lake, eds. *International Political Economy: Perspectives on Global Power and Wealth*, 4th edition, New York: Palgrave. These authors speak specifically about this process in the context of France, Germany, Japan and Italy.

financial players must be catered to or else they will engage in disciplinary strategies such as investment strikes and capital flight".[35] Her work highlights how this understanding becomes 'common sense' reinforcing the perception of governments as defenceless, while at the same point examining the detrimental consequences that this has on development and social justice.[36] Stephen Gill has also provided insights into economic governance from the neo-Gramscian stream. His work highlights how markets are reinforced through the emergence and reinforcement of disciplinary neo-liberalism, and its role of surveillance serves to normalize the market and market practices.[37] The prominence of this in international governance is further enhanced by the similarity in social, ideological and educational background between public and private actors in the financial governance community.[38]

We can see a different type of market-centered approach in the work of Susan Strange. Like Helleiner, Strange is hard to categorize. Some of her work has been claimed by the rationalist state-based approaches and other elements fit better within this one. Moreover, Strange's firm and explicit aversion to focus on theory has meant that her work is claimed by the theoretical traditions of Realism, Liberalism, as well as the more critical theories like neo-Gramscianism. She argued that markets have moved beyond the

[35] Soederberg, Susanne (2004) The Politics of the New International Financial Architecture: Reimposing Neoliberal Domination in the Global South, New York: Zed Books, p. 69
[36] Also see Soederberg, Susanne (2003) and Soederberg, Susanne (2005)
[37] Gill, Stephen (2003)
[38] See Gill, Stephen (1990) *American Hegemony and the Trilateral Commission*, Cambridge: Cambridge University Press. Also see Tsingou, Eleni for a more comprehensive look at public-private relationships in international banking regulation (2004) and securities regulation (2003).

control of public authorities at the national and international level.[39] Equating the lack of regulation of international financial markets to the functioning of a large casino, she argues, "progressive liberalization is eroding the remaining bulwarks of national systems of control faster than they can be replaced by new international systems".[40] From this view, in each of these areas the growth and international integration of markets have created a situation where states cannot easily govern the system for fear of encouraging market crisis or collapse. She finds this development particularly alarming because of the potential political and social consequences for the 'average' person and she is not particularly interested in focusing on the technical elements of the international market and its efficiency. Her concern is for the consequences, as the state is increasingly becoming the proverbial handmaiden to international capital flows and financial actors.[41] Yet, it is Strange's lack of interest in elaborating on the details of the international financial regulatory arena which makes an approach like this inappropriate for a study like this one which is interested in the details and nuance of the regulatory arena. Looking at these types of analysis overall, the focus on the power of markets can tend to present state action as ineffective and unimportant, overlooking the role that states can still play in governing global finance.

---

[39] Strange, Susan (1986) *Casino Capitalism*, Oxford: Blackwell Publishers; Strange, Susan (1998) *Mad Money: When Markets Outgrow Governments*, Ann Arbor: University of Michigan Press

[40] Strange, Susan (1998), p. 140

[41] Arguments like this are not without detractors. Some scholars, Sachs et al., argue that capitalist-led development works and the failures that are attributed to it are actually the fault of 'meddlesome' governments and loose fiscal policy. Therefore, the more state action is constrained the more the market is able to work efficiently. (see Sachs, Jeffrey D., Aaron Tornell, Andres Velasco, Guillermo A. Calvo and Richard N. Cooper (1996) "Financial Crises in Emerging Markets: The Lessons from 1995", *Brookings Papers on Economic Activity*, Vol. 1996, no. 1, pp. 147-215.); Strange, Susan, (1998), p. 11

Governance through public-private relationships

Although there are clear divisions and differences between the two previous areas, there are two key ways that they are similar. First, both conceive of an inherent separation between 'the state' and 'the market'. This inherent state/market dualism can be traced back to the beginning of IPE as distinct field of study in Political Science. The arguments disagree on whether the state or the market is becoming more powerful but they work from the same terrain – a regulatory world composed of state (public) actors and market (private) actors that are two separate entities. Second, for both these approaches the state is a central reference point in international finance. 'Power of the market' arguments may highlight the increasing power of the market transactions and actors in governance, but this is still done largely in relation to the state.

The perception that the market itself is full of modes of governance lead some scholars in the field to conceive of the market side of governance of the economy not as simply abstract market forces, but as composed of mixtures of private actors and institutions which were also important when trying to understand governance. There are a number of studies beginning from the frame of the "public" and the "private" as inextricably linked in the process of governing. Although many of the studies above seem to recognize this, at least implicitly, there is no explicit attention to theorizing the relationship and roles of these different categories of actors.

Some studies of finance have tried to move beyond the state-market dichotomy and theorize governance as the outcome of the relationships that exist between public and private actors, sometimes spread across multiple levels of analysis. The broad collection of approaches below provides some efforts in this area. I have separated them here because their focus is not specifically on elaborating the role of the market in constraining states or the power of state decisions but on how governance is spread between public and private sectors. The focus is often on illuminating the relationship and connections between these groups within the policy-making or governance process.

Many of these studies assert the possibility of contributions from both market actors and governmental bodies to the realization of the objectives of international governance. In many cases these approaches begin with an assumption that financial markets have become increasingly globalized, making sovereign jurisdiction and authority increasingly unclear and creating a space for private interests to contribute to (some would argue potentially control) financial governance. Through this shift private interests have emerged as powerful actors in a potentially strong position to govern.[42] One can see this type of argument about the declining governance ability of states in light of market growth in Benjamin Cohen's discussion of monetary policy. He argues that monetary sovereignty is now minimized by increasing levels of market-driven currency competition. This shift has dramatically altered the structure and shape of monetary governance - the state still remains influential but its role is transformed and authority is shared with market actors.[43]

Another conception of this mixture of public and private actors is in the work of Philip Cerny. He argues that there has been a fundamental shift in the form of

[42] Underhill, Geoffrey R.D. and Xiaoke Zhang (2003b) "Global structures and political imperatives: in search of normative underpinnings for international financial order" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, p. 85

[43] Cohen, Benjamin (1998) *The Geography of Money*, Ithaca: Cornell University Press, p. 5

governance to a mix of market, hierarchy and network-based involving both the public and the private spheres. Both formal and informal private organizations and relationships set standards and shape practices (including processes like 'benchmarking') that are "transmitted in a feedback process at domestic, transnational and international levels through both private *and* state action operating in mutually reinforcing ways".[44] Due to these shifts, governance in the sector increasingly involves practices rather than hierarchical forms of authority. The state plays the role of the prudential supervisor and enforcer, an important but not determinant actor. It furthers liberalization through Type II re-regulation, enforcing market outcomes (although providing some compensation for those who lose). Moreover, markets also act as governance structures. They are institutions that structure the activity within them and the rapid development of international markets has lead to the development of transnational and social networks where private regulatory institutions of high significance have emerged.[45]

Moreover, some studies have advocated that the roles of private actors could be a potentially positive contribution to the governance process. For example, Vojta and Uzan argue that private sector actors should be incorporated into the setting of minimum standards for acceptable financial management and corporate governance.[46] They argue that as markets have moved beyond the state's ability for monitoring and regulation, private actors have played increasing roles in setting market norms and rules. Due to this

---

[44] Cerny, Philip G. (2002), p. 202
[45] Cerny, Philip G. (2002), pp. 194–216
[46] Vojta, George and Marc Uzan (2003) "The private sector, international standards and the architecture of global finance" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 283-304

role private actors, while presenting a number of problems for legitimacy and accountability, can provide important insight into international regulation of the sector.

Finally, one can look to the international policy network approaches as an additional way to understand the relationship between public and private actors in a more formalized way. Policy network approaches are currently gaining more prominence in parts of IPE as an analytical tool to describe governance. A policy network based approach envisions both public and private organizations as linked in varying degrees to the policy process.[47] Neither the public or private are dominant in all cases, the roles and powers of actors varies depending on the type of network that emerges. William Coleman defines a policy network as

> a set of informal and formal interactions between a variety of usually collective public (state) and private actors, who have different, but interdependent interests. Operating in a more or less institutionalized setting, these actors are engaged in horizontal, relatively non-hierarchical discussions and negotiations to define policy alternatives, or formulate policies, or implement them.[48]

In some cases, the relationship between public and private in the network is still very heavily slanted toward state actors, although not necessarily rationalist, with the other actors largely in roles that seek to influence state decisions. An example of this can be seen in a study of gender mainstreaming by True and Mintrom. They look at the advent of state level bureaucratic organs for gender mainstreaming in place in over 100 states at

[47] This approach has been very fruitfully applied to governance at the domestic level in much of the past work and has recently been expanded to look at the international and European arenas. The authors listed above represent only a few of the scholars that are working within this concept. Furthermore, the works selected are also primarily focused on the transnational arena. For applications and theorizing of this approach see Coleman, William D. and Anthony Perl (1999) and Borzel, Tanja (1998)

[48] Coleman, William D. (2002) "Policy Networks" *International Encyclopaedia of the Social and Behavioral Sciences*, Oxford: Pergamon, p. 11608

the beginning of the century and argue that the driving force for the creation of these bodies and the policy diffusion of gender mainstreaming has been transnational networks. These networks of largely non-state actors and international organizations serve as 'conduits' for both information and knowledge about perspective and alternative policy strategies.[49] Yet the state that retains its position as the central actor and decision-maker and its place of privilege is reinforced as these other network actors' role is dependent on the state, encouraging it to make the policy decisions that are considered favourable. However, in other cases the relationship between the members of the network is less clearly divided. In this case the role that different public and private actors will play in both the creation of policy and its implementation is varied based on the network that emerges and the area being regulated.

This focus on 'the network' is a significant step out of the market/state dualism. While actors are still largely placed in one category or another, the different structure and relationships in each network mean that these categories are also broken down into smaller units, which can all act independently on governments. Therefore, the treasury and the central bank – both state actors – can be seen connecting to different groups of actors in the network and working within that network to achieve their specific, and possibly contradictory, goals. Moreover, they potentially allow one to escape a hierarchical conception of the relationship between the different levels of analysis. One can look at the roles of specific individuals, transnational private organizations, government departments and large international organizations, like the WTO at the same

[49] True, Jacqui and Michael Mintrom (2001) "Transnational Networks and Policy Diffusion: The Case of Gender Mainstreaming" in International Studies Quarterly, Vol. 45, pp. 72-57

time. On some level this may allow one to challenge the methodological nationalism which can be easily slipped into when studying international regulatory arenas.

There are again similarities between the systems found in discourse and public-private governance. However, the key break that occurs with some of them is the shift from focusing the actions and constraints on rational actors (whether they are states or other actors) to look at how these actors are constituted in governance.

Theorizing Expert Knowledge in Governance

A different way to explain international financial governance and regulation in IPE is to look at the role of experts and expert knowledge. Many studies in the governance of finance refer to notions of experts and expertise. However, few of them actually elaborate exactly how these elements are important in any systemic way.[50] This second part of this chapter will focus on how other studies in IPE theorize knowledge, more specifically how expert knowledge matters for governance. It will be shown in this study that many of the groups and individuals who gain authority and legitimacy in governance through beliefs in and claims to expert knowledge are in the private sector. Due to this focus in the dissertation it is important to understand how the roles of expert knowledge and those who have claimed authority and legitimacy based on it have been theorized. This section will focus on three alterative understandings of the role of 'experts'

[50] For example: Porter (2005: 231) argues, "The language of accounting and accountability are increasingly displacing the language of democracy and representation, reflecting both the perceived failures of democracy and the perhaps excessive elevation of technical expertise relative to political deliberation."

The term 'expert knowledge' is consciously used, as opposed to 'expertise'. This choice has been made for a number of reasons. First, one needs to recognize the use of the latter term in the areas of artificial intelligence, cognition and skill performance in fields like psychology and computer science. The change in terminology is useful in avoiding any potential confusion given that these are fundamentally different foci than that undertaken here. Moreover, the term expertise is inherently linked to the scientific realm of objectivity. It can imply that this 'expert' knowledge is a true and politically neutral way to capture reality. It may also imply superiority over other forms of knowledge that are more explicitly linked to moral and political positions, like religion. Using the term 'expert' knowledge is intended to destabilize the claim to 'truth', and in some cases superiority, that can come with the word expertise, recognizing that each type of 'expert knowledge' is both inherently contestable and political in nature.

Lobbying and Policy Capture

One potential way to conceptualize experts' roles and practices within governance is through a more traditional approach to analyzing of private interests focusing on the role of experts in the impact of pressure groups, lobbying and policy capture. For example, Willett's discussion of pressure groups argues there is an important role of business in lobbying policymakers to create favourable policies.[51] In international governance, this type of role for lobbying can be seen in Jennifer Clapp's work on the

[51] Willetts, P., ed. (1982) *Pressure groups in the global system: The transnational relations of issue-oriented non-governmental organizations*, London: Pinter

lobbying of states by corporations and industry associations around the 2000 Cartagena Protocol on Biosafety and the 2001 Stockholm Convention on Persistent Organic Pollutants.[52]

Work on expertise related lobbying is most developed (and also the most studied) in the context of the European Union. The relatively constrained European Commission is charged with drafting potential policy proposals in the EU governance process. This constraint impacts upon their ability to independently build the relevant expertise to formulate many of these policies. Therefore, interest associations are able to utilize their claim to different forms of expert knowledge. In providing this information, the groups also gain access to the Commission regarding their particular policy goals and hope to influence the policy formulation.[53]

Some scholars go so far as to argue that there has been a process of capture of the regulatory process. This is the case where the decisions of government are highly influenced by a particular actor to the point where they make decisions that are not necessarily in the best interest of the society they represent. Duncan Wood comes to this conclusion after looking at the form of the new Basel Accord and the historical process of its creation.[54] Zhang and Underhill also highlight this trend when looking at the policy

---

[52] Clapp, Jennifer (2003) "Transnational corporate interests and global environmental governance: negotiating rules for agricultural biotechnology and chemicals" *Environmental Politics*, Vol. 12, no. 4, pp. 1-23

[53] There are numerous examples of this kind of activities. In the case of European finance in particular see Bouwen, Pieter (2002) "Corporate Lobbying in the European Union: The Logic of Access." *Journal of European Public Policy,* Vol. 9, no. 3: 365-90. OR Bouwen, Pieter (2004) "Exchanging access goods for access: a comparative study of business lobbying in the European Union institutions." *European Journal of Political Research,* Vol. 43, n. 3, pp. 337-369.

[54] Wood, Duncan R. (2005), Chapter 1

responses of the South Korean and Thai governments to the aftermath of the Asian financial crisis.[55]

However, focusing explicitly on expert knowledge through the lens of lobbying or pressure groups creates a number of important concerns. First, the expert knowledge is subsumed into a much broader discussion about the relationship between public and private roles in governance. Although some private actors may utilize claims to expert knowledge, others may call on different attributes in order to influence governance, like material wealth and power. Claims to expert knowledge are only one of multiple tools at the disposal of different private actors who seek to influence the outcome of regulation. Moreover, the assumption, whether acknowledged or implicit, in these analyses often seems to be that it is the private sector actors who rationally utilize their claims to expert knowledge. This focus can minimize the ways that expert knowledge is found on the other side of the equation, the public sector bodies.

The role of expert knowledge can also enter the regulatory process in ways other than trying to influence the preferences of governmental regulators through lobbying. The advantage the policy networks approached discussed earlier in the chapter has over some of the more traditional lobbying explanations is an analytical framework which allows scholars a way to meaningfully conceive of and include the expert knowledge of private actors into governance independent of their ability to influence states and other public authorities.

---

[55] Zhang, Xiaoke and Geoffrey R.D. Underhill (2003) "Private capture, policy failures and financial crisis: evidence and lessons from South Korea and Thailand" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 243-262

One concern with these types of approaches is more fundamental - the impact of the 'expert' is limited to what can be seen and explained through interest-based rational interaction. Yet, the implications of 'expert knowledge' are not limited to only rational actor interactions between governmental actors and those in the private sector. Recent studies of learning and norms have begun to stretch these.[56]

Epistemic Communities

One way some studies have sought to overcome these constraints is by taking an epistemic communities approach to understanding the impacts of expert knowledge. This approach asserts that technical experts, particularly scientists, share consensual knowledge and a common political project to alter specific areas of policy. Consensual knowledge encompasses the sum of technical information about an issue and theories that emerge around it which create sufficient agreement to create a guide for public policy.[57] Stone argues that one of the main impacts of these communities is as part of soft forms of policy transfer through their links to global policy networks and transnational advocacy networks, often acting as a form of norm entrepreneur.[58] Studies that highlight the potential impact of an epistemic community are clearly an example of a broader conception of policy network that incorporates an understanding of learning and norms. This is clearly a step in overcoming a weakness of interest based approaches in that it has

[56] See for example – Stone, Diane (2000, 2004); Keck, M. and Sikkink, K. (1998); Sabatier, Paul A. (1998) and Sabatier, Paul A. and Hank C. Jenkins-Smith (1993) For an example of ideas as more instrumental elements (like focal points) see Goldstein and Keohane (1993).
[57] Hasenclever, Mayer and Rittberger (1997), chapter 5
[58] Stone, Diane (2000, 2004)

a more explicit theorization of knowledge as constitutive. However, this study extends beyond the epistemic communities literature in a number of ways. First, it deals with a weakness in this literature by more explicitly theorizing the relationship between knowledge and power.

Although the epistemic communities literature does make important contributions to the roles that scientists and other 'experts' can have in affecting governance arrangements, its focus is on the importance of consensus, a necessary element for continued authority. It is argued in this literature that if consensus is lost the salience of the experts is diminished.[59] However, one must question whether the salience of expert knowledge actually is decreased when there is conflict between different groups of experts. One can agree that the interaction of experts in the system will affect the ability of some knowledge to become neutral or 'naturalized'. Key shifts in the attainment of expert status of different groups and individuals will emerge and recede depending on the outcome of the interaction between knowledge and power in a given governance system. The existence of experts creates boundaries around certain claims to knowledge, creating new or simply re-enhancing distinctions between inclusion and exclusion in the governance discussion. To reduce this complex interaction to a single relationship between consensus and salience is oversimplified.

Moreover, it is at these points of conflict where the political, contested, and historically dependent nature of these different forms of knowledge becomes visible and

[59] Adler, Emanuel (1992) "The Emergence of Cooperation: National Epistemic Communities and the International Evolution of the Idea of Nuclear Arms Control", *International Organization,* Vol. 46, no. 1, pp. 101-145; or Haas, Peter (1992) "Introduction: Epistemic Communities and International Policy Coordination" *International Organization*, Vol. 46 no. 1, pp. 1 –35

questionable. In cases of consensus these elements are subsumed and depoliticized and the expert knowledge in question can attain the appearance of being not only 'neutral' and/or 'objective' but also 'natural'. By focusing on whether consensus has emerged and not deconstructing the conflicts around it, an important piece of understanding expert knowledge and its roles is lost.

Risk Society

Before we can turn to the task of outlining the discursive approach taken in the dissertation, one final alternative approach to understanding the role of experts in governance must be addressed. The approach referred to as 'risk society' is a grand theory about current society and the condition of reflexive modernity. Emerging in the discipline of sociology, it had become more prominent in some studies of international relations in the last ten years. This approach argues that while early modernity was organized around the distribution of wealth and class/scarcity conflicts, late modernity is organized around the distribution and mitigation of risk. In this environment, risks have become unmanageable – increased in scale and scope, territorially and spatially debounded, and largely imperceptible to the senses.[60] Society is increasingly threatened by risks of our own making – particularly those created through attempts to deal with the side effects of previous risks. Due to this, the management and governance of the processes of modernity are no longer perceived as generally creating social 'goods' but

[60] See: Beck, Ulrich (1992) *Risk Society: Towards a New Modernity*, London: SAGE Publications and Beck, Ulrich (1999) *World Risk Society*, Cambridge: Polity Press

instead as producing important dangers/risks (side effects) that threaten the very existence of society.

Beck's conception of a global risk society displays a clear normative position on the role experts should play in risk management and governance. He argues that the important role played by expert knowledge, particularly scientific knowledge, in attempts to manage risk is problematic and should be minimized. The essential argument is that experts cannot provide solutions because scientific and expert knowledge is only geared toward supplying factual information not assessing the level of acceptability of the provided solutions.[61]

This approach is useful in that it moves beyond simply explaining the roles that expert knowledge can play in governance processes to critiquing it. Like some technocracy arguments the roles of experts themselves are questioned but in addition to this there is a recognition that expert and scientific knowledge can provide a myriad of different solutions. This involves an implicit acknowledgement that the implementation of different policy choices/potential solutions to problems will have different impacts on the social world and there is a need to critically assess the level of acceptability of these outcomes. This implies that there is recognition that these forms of knowledge are not politically neutral.[62]

Yet there are some elements to this argument that prove problematic for the study of financial governance. The risk society argument asserts there has been a shift in the

[61] Beck, Ulrich (1999) *World Risk Society*, Cambridge: Polity Press, p. 42
[62] This dissertation agrees with the claim in Beck's work that judgements and decisions around risk may appear neutral and technical (i.e. "value-free") but they are actually moral statements. (1992, p. 176)

conflict between experts in a reflexive society revealing the emptiness of claims to value-neutral universal 'truth' often attached to this type of knowledge. In this context, "experts are relativized or dethroned by counter-experts." causing a general decline in the saleability of expert knowledge.[63] Boyne continues to develop this theme, arguing that the spirit of scientific critique has allowed the lay public (via the media) to pass judgement on expert knowledge and to construct their own counter-expertise.[64]

Although often considered together this point marks an important distinction between the work of Beck and Anthony Giddens. In the latter's understanding, the rise of expert systems marks a process where some elements of social life are disembedded, creating a group of 'abstract others' or experts.[65] This creates a society where trust is inherent and required for an individual's ability to rely on expert knowledge systems where they largely cannot undertake direct oversight. Lupton sums up the distinctions between Beck and Giddens' understanding of experts and expert knowledge systems. She argues, "For Giddens, reflexivity takes place through expert systems and is reliant upon lay people's trust in expertise. For Beck, reflexivity is a critique of expertise, based not in trust but distrust of expert systems".[66] However, in contrasting these two approaches, it is apparent that the continued salience of expert knowledge is at least partly determined by the level of trust placed in experts by the 'public' in different sectors.

[63] Beck, Ulrich (1999), p. 79
[64] Boyne, Roy (2003) *Risk*, Philadelphia: Open University Press
[65] For Giddens abstract others are individuals that one never meets but who none the less have a direct effect on their life. Trust placed in people one knows personally (intimate others) creates different understandings of risk and trust. (see Giddens, 1990)
[66] Lupton, Deborah (1999) *Risk*, New York: Routledge, p. 82

Following this, there are a number of concerns about whether Beck's overarching argument of decline in salience and trust in experts is occurring in all areas of governance. Mythen, for example, points out that the relationship between the lay public, scientific agencies and knowledge is more complex then conceived within the risk society approach.[67] Horlich-Jones argues that the failing of professionalism in the media has actually led risk management discourse to shift away from trust based in professionalism, experience and skill to practices based on modeling systems intended to avert failure at the minimum cost.[68] In this case, the movement away from overt trust in expert knowledge is not toward lay counter-expertise but toward more transparent auditable practices. This can create a simple shift from salience experts in one area (primarily based on to claims to professional experience and judgment) to experts in another (in defining what qualifies as acceptable transparent auditable practices and what identities and technologies are necessary in the functioning of it). Through assessing the three cases in this dissertation, it appears that Beck's argument regarding the salience of experts is misleading. Given the limitations of all these forms of analysis there is a need to elaborate a different theoretical and analytical frame.

Conclusion

This chapter is intended to provide an overview of the terrain of the discipline that the dissertation is situated in. First, it laid out two opposing ways that one could explain

[67] Mythen, Gabe (2004) *Ulrich Beck: a critical introduction to the risk society*, London: Pluto Press
[68] Horlich-Jones, Tom (2004) "Experts in risk? ... do they exist?" Health, Risk & Society, Vol. 6, No. 2, June, pp. pp. 107-114

international financial service sector governance – rationalist state-focused and Transnational capitalist class/market-based. It also turned to examine some previous work to conceive of governance in the context of public-private relations. Following this discussion, the chapter turned to some of the key ways that the roles of experts and expert knowledge have been theorized in the discipline. In the process it laid out how the impacts of experts can be subsumed into understandings of lobbying/policy capture and technocracy and policy networks and the insights associated with an epistemic communities approach in recognizing that experts can play constitutive roles. Both these approaches however, were also found to be lacking, particularly in fully understanding the role of expert knowledge. The third approach discussed was that of Ulrich Beck's risk society. In this case the depoliticizing effect that expert knowledge had was questioned although there was a need to go further and to address the historically contested and political nature of the knowledge itself in greater detail. Moreover, Beck's arguments regarding the continued salience of expert knowledge are questionable, particularly in abstract areas like international finance.

Although each of these approaches has its strengths, in terms of the problem that motivates this dissertation, all prove to be not quite right. Given these limitations, a discourse-based analysis is useful to capture and deconstruct international financial integration and how this is expressed in the different identities, roles, and practices of those that are governed. It inherently overcomes the tendency toward methodological nationalism and the analytical separation between state and market. Moreover, a discourse-based analysis does not only address the power and roles of individuals and groups possessing 'expert knowledge' but also the very nature of that knowledge itself. The following chapter will lay out the basis of this approach along with a more complete discussion of the research questions which guide this dissertation.

Chapter 3
Theory and Approach

From the previous chapter it is clear that there is a variety of approaches available to someone attempting to better understand international governance in the financial services sector. However, all of them have been unable to fully address the role of knowledge and discourse in this process. The first section of this chapter will outline the theoretical basis and approach used in the study of discourses of risk, expert knowledge and international financial services governance in the rest of the dissertation. The second half of the chapter will draw out how this dissertation will relate the study of discourse to global financial governance more specifically.

Understanding Discourse

Discourse is a term that is used so broadly it could easily become a meaningless concept. The term appears in different contexts across various fields of inquiry spanning the disciplines of linguistics, sociology, cultural theory, social psychology and computer science, etc. Along with this multidisciplinary nature, there are multiple definitions and frames for study for discourse that have been developed and that also contribute to its breadth.[69] Work on discourse ranges from the specific, highly formalized analysis of conversations and social interaction to the focus on broader social contexts. The more

[69] For example, in a general reader on discourse Margaret Wetherall identifies six distinctive areas of research which occur in discourse analysis: conversation analysis, discursive psychology, Foucauldian research, critical discourse analysis and critical linguistics, and Bakhatinian research. (Wetherell, Margaret (2001) "Debates in Discourse Research" in Margaret Wetherell, Stephanie Taylor and Simeon J. Yates (eds.) *Discourse Theory and Practice: A Reader*, London: SAGE Publications, pp. 380-399)

post-structuralist approaches conceive of discourse in a way that is a distinct break from previous views which see language and representation as simple expressive and transparent vehicles of communication. These lines of theorizing view language as "a system with its own rules and constraints, and with its own determining effect on the way individuals think and express themselves".[70] It argues that language cannot objectively express something because it impacts what can be thought about and how it can be thought of. This project draws from these post-structural approaches to discourse, particularly the assumption that the language and concepts used to define, explain or categorize an event or activity also reconstitute it and how we understand and attempt to govern it. Therefore, discourse matters in ways that are more integral than traditional approaches that focus on ideas.

For the purposes of this work, discourse is understood as a 'system of representations' – a group of statements which provide a way of talking and knowing about a particular topic at a particular historical moment. A discursive structure is identifiable because of the systematicity that appears in the concepts, opinions and ways of thinking and acting in a particular context.[71] Drawing on Foucault's understanding of discourse, it involves the "delimitation of a field of objects, the definition of a legitimate perspective for the agent of knowledge, and the fixing of norms for the elaboration of concepts or theories".[72] Moreover, discourse encompasses both language and practice. All practices have a discursive aspect as they all have meaning circulating through them.[73]

[70] Mills, Sara (2004) *Discourse*, New York: Routledge, p. 7
[71] Ibid.
[72] Foucault, Michael (1981) "The Order of Discourse" in Robert Young (ed.), Untying the Text: A Post-Structuralist Reader, London: Routledge, p. 48
[73] Hall, Stuart (2001) "Foucault: Power; Knowledge and Discourse" in M. Wetherell, S. Taylor and S. J. Yates (eds.) *Discourse Theory and Practice: A Reader*, London: Sage Publications, p. 291

Discourse or Ideas?

For many traditional IPE analyses, discourses tend to be problematically reduced to ideas functioning in a system of cost-benefit rational calculation. In these studies there are independent and autonomous actors that utilize ideas in order to gain power and authority. In this case the ideas act like focal points or instruments that can be used by the autonomous actor. Even in cases where ideas can influence and potentially construct actors, the separation between them as objects and the actors as subjects is maintained. In this case, an actor can learn from an idea or they can change their preferences. The power of ideas as tools of rational actors is well illustrated in Political Science and International Relations literature, particularly Sell and Prakesh's work on the strategic role of ideas in the intellectual property regime.[74] However, the possibility that an actor or activity is re-constituted in relation to knowledge tends to be minimized. In much of the International Relations literature on norms, the importance of norms occurs when exposure to the norm reshapes the understanding, interests, and behaviour of actors.[75] Finnemore and Sikkink provide a useful illustration of this assertion by highlighting the mechanisms of norms throughout their life cycle. In the first stage (norm emergence) the process is driven by norm entrepreneurs and persuasion. In the second stage, there is a process of socialization where these entrepreneurs try to create norm followers through the dynamics

[74] Sell, Susan K. and Aseem Prakash (2004) "Using Ideas Strategically: Examining the Contest between Business and NGO Networks in Intellectual Property Rights", *International Studies Quarterly*, Vol. 48, no. 1, pp. 143-175

[75] Finnemore, Martha and Kathryn Sikkink (2001) "TAKING STOCK: The Constructivist Research Program in International Relations and Comparative Politics" Annual Review Political Science, Vol. 4, pp. 391–416; Katzenstein Peter J., ed. (1996) *The Culture of National Security Norms and Identity in World Politics*. New York: Columbia University Press

of imitation, attempting to create a norm cascade. Norm internalization is what occurs in the third stage where they become 'taken for granted': part of a society's beliefs and therefore, its members' preferences.[76]

Discourse, on the other hand, requires that the conception of the subject be destabilized. As Foucault argues, "What is important to me is to show that there are not on the one hand inert discourses, which are already more than half dead, and on the other hand, an all-powerful subject which manipulates them, overturns them, renews them; but that discoursing subjects form a part of the discursive field".[77] Therefore, the subject is not autonomous or all-powerful but in the same process of constant articulation and re-articulation as the other elements of the discursive realm. Through this process the nature of how and what to govern is altered but also the very identities of actors and their accepted range of activities We will see this later in the dissertation through a variety of ways. Just to elaborate here, one example is the articulated responsibility of the individual in hedge funds versus collective investment schemes within the securities sector. In both instruments, the individual is, at least in the abstract, the ultimate bearer of responsibility for risk, including financial gain or loss (outside of cases of fraud or other forms of malpractice). Therefore, the individual is a subject who is seen to have at least some agency in investment choices, legitimating their burden of responsibility for investment decisions. Yet in CIS a certain amount of regulatory action or practice is deemed legitimate, while for hedge funds (or highly leveraged institutions) there has been

[76] Finnemore, Martha and Kathryn Sikkink (1998) "International Norm Dynamics and Political Change" *International Organization*, Vol. 52, no. 4, Autumn, pp. 887–917

[77] Foucault, Michel (1968) "Politics and the Study of Discourse" in Burchell, Graham, Colin Gordon and Peter Miller, eds. (1991) *The Foucault Effect: Studies in Governmentality*, Chicago: University of Chicago Press, pp. 53 – 72 (originally translated to English 1972), p. 58

little interest in the need for regulation until recently.[78] This is an odd distinction to make until one looks at the constitution of the individual, and whether they are constituted as a 'sophisticated' market participant. In the case of hedge funds, there is widespread agreement that these investors are financially knowledgeable and capable of making informed investment decisions. In the case of CIS, this articulation as knowledgeable is more tenuous and in order to maintain the responsibility on the individual, practices need to be introduced to increase their knowledge. These practices becomes tangible in the form of investor education programs and corporate reporting rules. Discourse permeates and constitutes both objects and the subjects creating complex overlaps. Therefore, discourse exists beyond the realm of the ideational. Visible through performative practices, it is both material and ideational at the same time.

In using a Foucauldian understanding of discourse, we can also draw on his notion of problematization to analyze the different discourses of risk (and risk in finance more specifically). Problematization "is the ensemble of discursive and non-discursive practices that make something enter into the play of true and false and constitute it as an object of thought (whether in the form of moral reflection, scientific knowledge, political analysis, etc)".[79] In recognition of this, the analysis attempts to change how we understand a situation, shifting the focus to "'a question' whose formation and obviousness must itself be subject to analysis" from 'a given' which generates problems

[78] Even now, the calls for hedge funds regulation are made more on the grounds of systemic risk, rather than any risks to the individuals directly.
[79] Michel Foucault quoted in Rabinow, Paul and Nikolas Rose (2003), p. xx

that must be resolved.[80] Furthermore, the analyst's task is not to judge the usefulness of the various solutions presented, but find their root that has made them possible. Essentially, the analyst seeks to discover what made possible the transformation of difficulties and obstacles into a general problem.[81] In the case of this research, a frame of problematization occurs around 'risk', particularly 'systemic risk'. Therefore, the assessment is not about the perceived success or effectiveness of the different regulatory assemblages that emerge. Instead the focus is on what relations of power and knowledge become visible when one questions the notion that risk is natural rather than a discursive frame that is applied to different events or activities—a frame that articulates and rearticulates them as 'risks' that must be governed in particular ways. This conception of discourse is very holistic and it raises a number of important points about discourse. These will be largely addressed in the following sections.

Discourse and the Material World

Although the questioning of discursive structures built around risk is the central theme of this work it is important to remember that this focus is not attempting to argue that nothing exists except the discursive. There is a reality which exists external to humans and a material element to events and experiences. However, the only way to apprehend this material existence is through discourse and the discursive realm. An

[80] Rabinow, Paul and Nikolas Rose (2003), p. xx

[81] Foucault, Michel And Paul Rabinow (1997) "Polemics, Politics, and Problematization: An Interview with Michel Foucault", in Rabinow, Paul (ed.) *The Essential Works of Michel Foucault - Ethics: subjectivity and truth (Volume 1)*, New York : New Press, pp. 111-119

elegant illustration of this connection between the real and the discursive has been coined by Laclau and Mouffe. They assert,

> An earthquake or the falling of a brick is an event that certainly exists, in the sense that it occurs here and now, independently of my will. But whether their specificity as objects is constructed in terms of 'natural phenomena' or 'expressions of the wrath of God' depends upon the structuring of a discursive field. What is denied is not that such objects exist externally to thought, but the rather different assertion that they could constitute themselves as objects outside of any discursive condition of emergence.[82]

It is through different discourses that we can understand and explain events and objects. Moreover, this illustration also provides a second important insight into the discursive realm. It highlights that there are always multiple different ways in which events and objects can be constructed. Turning to the project at hand, this means that nothing is in itself a risk, at the same time *anything* can be a risk: it all depends how the object or event is/can be considered or understood.[83]

However, this is not to argue that these connections between the discursive and the material are unidirectional. There is reflexivity between the real and discursive realms. Although discursive structures frame the real and make it knowable, it is also important to remember that external shifts and events may also affect both thought and behaviour in the longer time frame. One can see this in the interaction between technological advances and the increased use of complex, computer-based modelling to measure, and in the process constitute, risk In each case, the practice of modelling

[82] Laclau, Ernesto and Chantal Mouffe (1985) *Hegemony and Socialist Strategy: Towards a Radical Democratic Politics*, trans. by Winston Moore and Paul Cammack, London: Verso, p. 108

[83] Ewald, François (1991) 'Insurance and risk', in Graham Burchell, Colin Gordon and Peter Miller (eds.) *The Foucault Effect: Studies in Governmentality*, Chicago, IL: University of Chicago Press, pp. 197–210.

probabilities of risk is increasingly present in the regulatory language and legitimized in supervisory standards.

Finance and Performative Practices

In addition to discourse being our way of constructing the world rather than just ideas or language it is also important to realize that discourse is performed. Following from de Goede, finance is not an architecture or system – although we often apply these analytical frames to it. Instead one must conceive of finance as a discursive domain composed of a myriad of performative practices which are continuously rearticulated. In shifting our frame of reference, the faulty separation between the material (or real) financial structures and that of knowledge and interpretation is dismantled. As de Goede states "Understanding finance as a performative practice suggests that processes of knowledge and interpretation do not exist in addition to, or of secondary importance to, "real" material financial structures, but are precisely *the way in which 'finance' materializes.*"[84] Following from this we can see that the material structures of finance are also constituted through the performance of power/knowledge and are historically contingent.[85] Moreover, these practices will be altered if the dominant discourse is proven

[84] De Goede, Marieke (2005) *Virtue, Fortune, and Faith: A Genealogy of Finance*, Minneapolis: University of Minnesota Press, p. 7 (emphasis in original)
[85] Donald MacKenzie presents a similar discussion of finance but draws more explicitly on Actor Network Theory to examine the importance of economic modelling on creating markets. (MacKenzie, Donald (2006) *An Engine, Not a Camera: How Financial Models Shape Markets*, Cambridge, MA: MIT Press)

to be incapable of addressing a problem that emerges since pressures for the alteration of that discourse or the elevation of a new one will occur.[86]

Re-conceptualizing Power

The importance of discourse is not simply its existence but also in how it is connected to power and disciplines. Disciplines are the "techniques for ordering bodies" which take a discourse and put it into social reality. They are not only repressive but also productive, constructing a particular understanding of what are 'normal' activities and conditions in the process.[87] This distinction is important for a number of reasons. First, the discourses that become dominant are not simply the outcome of "free-floating signifiers" or "unconscious desires" but rather are linked to power.[88] This conceptualization requires a re-examination of the concept of power.

In many studies of finance power is conceived in the instrumental way one sees in many conventional International Relations analyses. Marxist and Gramscian approaches expand this to include an understanding of the structural power of capital. Yet power is still largely captured through the frame of enabling or constraining. However, power is actually conceptualized here as substantially more amorphous and exercised through 'net-

[86] Keeley, James F. (1990) "Toward a Foucauldian Analysis of International Regimes" *International Organization*, Vol. 44, No. 1., Winter, p. 97
[87] Keeley, James F. (1990)
[88] Mottier, Veronique (2005) "From Welfare to Social Exclusion: Eugenic Social Policies and the Swiss National Order" in David Howarth and Jacob Torfing (eds.) *Discourse Theory in European Politics: Identity, Policy and Governance*, New York: Palgrave Macmillan, p. 256. For Mottier, this difference distinguishes a Foucauldian analysis from Derridian deconstruction (in the case of the former) and psychoanalytic approaches (in the case of the latter).

like organization' than these other types of analysis.[89] It flows through the discourse domain, not only enabling or constraining different actors or actions but also constructing them in ways that include or exclude them from view in governance.

Some guidance is provided in Foucault's conception of "power/knowledge". This conception of power locates it in networks of social interaction. Keeley argues, "The network of relations in a society is the field within which a discourse is articulated in practice and has its productive effects. Knowledge and power are connected, since knowledge defines and organizes structures of relations yet at the same time is implemented and therefore becomes a social reality through them."[90] Mottier provides an interesting frame of reference to capture these relations through her conception of the two aspects of discursive practice that Foucauldian approaches imply. These are: a set of 'language games' ("statements or constructions of meaning") and a set of 'strategic games' ("exploring the ways in which these constructions of meaning produce, reproduce, sustain, or subvert relations of social and political power").[91]

This focus on discourse in relation to power provides two key advantages to the study of finance. First it creates an opening to look beyond international agreements as rational negotiations to how the particular techniques and projects of the governance are performed within networks of relations. This lens reminds us that these networks are not uncontested and actors may attempt to exercise different forms of power to create, reinforce, alter or even destroy the outcomes of the specific connection between

---

[89] Foucault, Michel (1980), "Two Lectures" in Colin Gordon (ed.) *Power/*Knowledge, Brighton: Harvester, p. 98

[90] Keeley, James F. (1990), p. 96

[91] Mottier, Veronique (2005), p. 257

power/knowledge. Given the importance of experts in this field it also captures how discursive performances construct these actors in ways that are more or less powerful.

Examining the Discourse of Risk in Financial Governance

The first section of this chapter has discussed the role of discourse and discursive analysis more broadly; the following sections will look more explicitly at the relationship between discourses of risk and global financial governance as they will be developed throughout the dissertation. At the core of the argument is the assertion that international financial governance is inextricably constructed in the current era within discourse(s) or risk, particularly the conflict between risk as a necessary element of finance and risk as a danger or threat. In order for international governance to emerge, risk as danger is clearly articulated as a form of justification. However, in the performance and practices of international financial governance, risk as economic necessity also influences the legitimized practices and rules. The interplay between these two constructions and how they are articulated in relation to sector specific characteristics affects what is perceived as the subject or object at risk and who is the bearer of responsibility for that risk. Moreover, these various tensions are not only linguistic but emerge through the practices of governance, including the mundane micro-practices that are often overlooked in broader studies of international financial governance. These elements will be drawn out in substantially more detail in the following chapter.

This dissertation will show that emphasizing discourses of risk as central to analysis is a superior way to understand the complex power/knowledge dynamic contained within international financial regulation as compared to rational choice accounts. The key weakness of rational choices approaches is the assumption that information is a neutral resource that is acquired and used by actors who already know their interests. A rational choice approach would argue that governance emerges from the decisions of actors trying to achieve the most efficient and effective forms of regulation. However, how they understand what is 'efficient and effective' is itself a product of the discursive construction of the issue at hand. This discursive construction does not only occur at the level of frames, but also in the mathematical and legal languages that constitute risk models and financial contracts. By analyzing financial services through a discursive lens that problematizes risk, one can see, question and critique information, techniques and practices that are seen as objective and/or neutral. Throughout the dissertation there are multiple examples which show where the linking of activities or events with risk discourses were not universal or consistent, their measurement was questionable and served in part to construct the risk in question, and where the performance of risk management was legitimated and the identities (not just the interests) of the actors involved were constructed.

Moreover, although there are clear overlaps between the study here and some Gramscian studies, this study is able to avoid some of the weaknesses of Gramscian theory, in particular the tendency to overgeneralize to class. In the cases presented, there is clearly variation that can be lost in some of the less nuanced Gramscian analyses.

Related to this, Gramscian approaches assume an unproblematic link between structural power of capital and the practical developments in an issue area. Post-structural approaches, like the one used here, enhance these proposed links by highlighting that they need to be performed and these performances can unexpectedly fail or vary.

There are three cases examined in the following chapters to elaborate the importance of risk discourses in the international governance of finance. Each will show three key things. First, it will be shown that the two risk discourses were central to the debate and decisions around international governance and the inherent tension between the two key discourses of risk will be highlighted. One way this is visible is in the evolution of activities or events to become 'risks' when they were not perceived as this before. Second, it will be shown how the interaction in these risk discourses rearticulates how particular activities, events and individuals and groups can govern and be governed and the shifts in performative practice that emerge from this. It will become clear that the performances of risk management are not simply technical measurements identifying pre-existing natural dangers. Instead, there is a considerable degree of construction in the activities or events identified as risks. For example, the degree to which sustained efforts were needed to create the mechanisms to make risks measurable and the less than certain quality of those measurements can be seen in all the cases. Third, each case reveals that the risk discourses constructed new or reinforced previously existing roles and identities of both public and market actors. This highlights that actors are not always 'already there' as assumed in rational choice approaches.

The three different case studies undertaken – the Basel II Capital Adequacy Accord, the international regulatory arena of collective investment schemes and attempts to create international regulations for reinsurance – were chosen for a couple of reasons. First, they are each important areas of the financial services sector. Moreover, when combined they cover all three main sectors of finance (banking, securities markets and insurance respectively). This is intended to address a potential failing of discussing developments in 'international finance' while looking at only one particular subfield. Finally, the selection of these cases allows for highlighting important similarities and differences around the overarching discourses of risk and the impact of expert knowledge in finance. In each of these three cases there are multiple similarities, including the presence of both macro-discourses which enhances the search for precision in risk measurement, the increasing acceptance and importance of private and internal forms of risk management and measurement, and the continued construction of the public sector in supervisory roles. When looking across all the cases there is substantial variation in how governance reconstitutes actors and practices in each sector. This difference is often lost when the discussion is focused around the power of interests or markets. This variation provides important insights into how different areas of financial services are governed differently at the international level and an important caution to the tendency to make sweeping generalizing claims about the governance of the sector.

A secondary point also emerges from the analysis of all the cases, which highlights the usefulness of this approach in understanding experts and the role of experts in international financial regulation. This group of actors is one of the most consistent sources of the practices of risk and risk management in the international financial governance. Therefore, constitute groups and individuals as experts and imbue them with additional disciplinary power. Looking at the financial services sector, claims of expert knowledge are an important element of understanding how the sector is governed. For Foucault, expert knowledges "are integral to the reflexive techniques and practices of subjectification, or the formation of certain types of subject".[92] It is through these guidelines and norms that populations are surveyed by, compared to, trained to conform and therefore, made productive, and these knowledges become essential to governmentality.[93] In some cases, expert institutions utilize these discourses to filter information, which reinforces dominant norms and deflects ones that are in opposition.[94] The risk discourses around finance reinforce particular expert knowledges and at the same time make this knowledge appear neutral and things constructed by it natural.

Moreover, how do the practices of governance that emerges related to risk discourses, minimize the ability of the general public to meaningfully influence the international governance of the financial services sector. Even through a cursory look, the engagement with financial services governance by the general population is low. Yet, the calculative nature of legitimated risk management techniques further reinforces this relationship.

[92] Lupton, Deborah (1999), p. 86-87. It is also important to remember that unlike the risk society approaches they cannot act as a transparent means to reflexivity.
[93] Lupton, Deborah (1999), p. 84-102
[94] Mythen, Gabe (2004), p. 168

Methodology

In order to make discursive structures visible and question the underlying performative practices which are at the core of international financial governance, a careful analysis of a broad range of governmental, industry and media documents has been conducted. This cache of texts included the texts of key international regulatory initiatives, available policy documents and other material produced in the process of their creation, as well as academic and trade journal coverage and some government testimony, public speeches and published interviews.[95] The focus was on understanding international level governance rather than any specific national level initiatives. Analysis of these documents utilized two techniques, and was supplemented with a thorough review of academic literature for each of the areas in question.

First, the primary method involved assessing the documents in a guided reading around seven focusing questions, listed in Appendix A. These questions are intended to problematize the technical language of much of this analysis, as well as draw out the constructions and relationships of actors, objects, and techniques that emerge.[96]

Second, thirty-five of the most specific documents for governance - international standards, codes, working papers, and consultation drafts (where available) – were re-examined using a predicate analysis to further understand the links that are drawn between the language of risk and other elements represented in the text. These documents are indicated by a * in Appendix A. Predication or predicate analysis is a form of discourse

[95] A list of the specific policy documents and reports assessed is provided in Appendix A.
[96] The guided questions will not be addressed in any formalized way in the cases. However, the information that they provided will be built into a consistent chapter about the discourse of risk in each.

analysis that focuses on identifying patterns in language, where attention is paid to identifying the adjectives, adverbs, and verbs that predicate particular subjects and objects ('things').[97] These elements serve to construct subjects in particular ways and imbue actors with different political identities, choices, and actions. These processes work to legitimate or prohibit certain actions, as well as construct activities and events as natural or unavoidable.

To further explain the method we can take an example from an IAIS initiated issues paper on the reinsurance industry regulation, where the following conclusion was drawn, "Fraud risks and systemic risks may occur in the complex markets of risk transfer products because of insufficiently transparent (retro)cession processes, jeopardising the financial interests of consumers anywhere in the world."[98] A simple focus on this single phrase, while clearly not comprehensive of the entire literature, is useful to illustrate this type of analysis. In this case, the key predications around risk are:

- both fraud and the financial system are as constructed as 'risks' to the system
- the condition that creates these risks is 'insufficiently transparent (retro)cession markets'
- the subject at risk are 'consumers' (as opposed to 'society' or the 'financial system', etc)
- these consumers are global in geographic location

In this statement, it is evident that although risk is not a 'subject' but an object or potential event, its articulation and construction were clearly part of international efforts and the

[97] In International Relations, Jennifer Milliken and Roxanne Lynn Doty have been prominent in their use of this form of analysis. See Milliken, Jennifer (1999); Milliken, Jennifer (2001); Doty, Roxanne (1993); Doty, Roxanne Lynn (2003)

[98] Bakker, R.C.L. and D.N. Davies, et al (2000) Reinsurance and reinsurers: relevant issues for establishing general supervisory principles, standards and practices An Issues Paper on reinsurance initiated by the IAIS, pvk studies 20 (Stichting Pensioen- & Verzekeringska-mer te Apeldoorn), p. 9

resulting mundane or micropractices.[99] Moreover, the key articulation of risk is clearly in a negative light, a potential situation that contains a threat or harm. Yet, the phrase 'risk transfer products' alludes to a different, less negative and more necessary role for risk in financial markets. While lack of transparency creates the conditions, the key sources of this risk are fraud and the interconnection of the financial system. It is interesting to see these two aspects addressed together. Fraud is the result of clear human agency, whereas the agency in systemic risk is substantially less clear. In fact, this term is often articulated as structural in nature. The term 'consumers' is also an important construction. In this case it is a broad category, and it is left to the reader to determine exactly who these 'consumers' are. The consumers would likely be reinsurance firms, particularly with the reference to retrocession (reinsurance for reinsurers), or insurance companies (ceding insurer) that purchases the original reinsurance. This has little explicit connection to the individual that purchases the original insurance from the ceding insurer. Moreover, even if the connection is extended to the level of the individual, their articulation as a consumer frames the individual as an economic actor whose identity and actions are inherently connected with another set of market-based discourses and disciplinary power. From this very brief example of one statement, we have begun to highlight larger patterns of articulation and construction. In the process of compiling all these different predications, these broader discursive constructions are made visible.

[99] This fits with Milliken's (1999: 232) assertion that 'predicate analysis is not in principle limited to the study of subjects'. In this case the space, articulation and construction of international financial regulation was the arena of study. Given the predominance of the language of risk in this documentation, focus was placed on the predication involving this.

This choice to utilize an additional research method in addition to guided questions on these key documents was intended to provide additional understanding and strength to claims made about how risk is discursively constructed and constructing in governance initiatives. Supplementing the more fluid and flexible analysis through guided questions with this more structured method is intended to draw out the strengths and mitigate any potential weaknesses of each on the most important standards and codes.

One final caveat: there is some complexity in the linkages around risk between these sectors visible in both these methods. In the banking and CIS literature, risk is primarily linked with signifiers (the object/event/person) which can 'cause' this potential future situation, for example credit risk, counterparty risk. The object at 'risk' was largely implied as the organization, and the implied risk was to its financial situation/health. In other situations, the link is more explicitly connected to the subject/object/identity that will be altered in the future event – reputation risk for example. In this case, the risk is not from the organization's reputation but to it. In between these two extremes is systemic risk which is a construction that at times is articulated with the international financial system as the potential cause of risk or danger and in other cases it is primary subject that is at risk. These two discursive articulations were also present in reinsurance but in addition 'risk' is also clearly constructed as the necessary central object of the industry. This makes sense when one considers that 'risk' is the object purchased and sold at the center of insurance markets. Moreover, there are a number of activities that relate to risk --- risk management, risk weight categories or measures – that were also highlighted. These articulations of risk serve to reinforce the claim in the next chapter that 'risk' is articulated as something manageable, and even more specifically manageable through quantitative and calculative methods. Moreover, there are also some instances where risk is used as a transitive verb ('to risk', risking, risked, etc.) or an adjective (risk-sensitive, high risk, etc). In the official governance documents (standards and codes) the use of risk as a verb is very rare. Instead, risk is primarily an object/event, connecting it to the actions that cause future events but not necessarily attributing it to the direct agency of an individual group.

Conclusion

The purpose of this work will be to identify various risk discourses at play around the development or ignoring of different regulatory arrangements examined in the course of the dissertation. The first section of this chapter has outlined the intentions in the use of the term discourse. The dissertation's focus is on developing and supporting the claim that risk is not natural but a variety of discourses that interact in finance, highlighting through points of problematization. More specifically, it will show the role of risk discourses in articulating and rearticulating specific techniques, practices, and identities – in three specific intergovernmental governance assemblages in the financial services sector. The next chapter focuses on elaborating the discourses of 'risk' in a more comprehensive manner. In doing so, it will highlight not only the 'conditions of possibility' that were necessary for their emergence but also the inherently contested history of how the events we now re-articulate as risk are socially constituted.[100]

[100] A final caveat must be made at this point. Just as the actors do not exist outside the power/knowledge nexus, this work is also part of the same nexus. With that in mind, however, the analysis begins.

Chapter 4
The Discourse of Risk and the Financial Services Sector

Understanding 'risk' is important when seeking insight into the global financial services sector. Historically, money and finance are seen as an evolving set of complex practices of risk management, from the creation of money and the evolution of the international monetary system to the development and legitimation of financial markets.[101] Yet, there is disagreement on how risk is conceptualized in academia. In general, there are two additional key categories of understanding that will be discussed briefly below.[102] The third category, risk as discourse will inform the rest of the chapter. The rest of the chapter is divided into two sections. The first focuses on some of the discursive elements of 'risk', drawing out the conditions of possibility that are imbued in references to risk in the financial sector. The second section discusses the two key discursive constructions of risk that are prominent in the financial sector – risk as an economic necessity and risk as a danger.

Common Approaches to Risk

When one looks at the various ways that risk is studied, it becomes clear that there is a diverse range of approaches that one can take. In general, studies which do focus on risk tend to split into two very broad categories – those which treat risk as a external

[101] Porter, Tony (2005) *Globalization and Finance*, Cambridge: Polity Press
[102] These categories inherently minimize some of the distinctions that occur in each category. However, they are only intended to give a broad overview of the ways that risk has been conceptualized.

problem to which regulations attempt to respond, and those which treat risk in the much broader frame of social construction and discourse. In simpler terms, there are those investigations that view risk as an objective reality and those that see it as a subjective frame. Following the work of Lupton and others, I have divided the understandings of risk and risk management into three categories.[103]

Risk Analysis

The first category of studies on risk focuses on the control and management of 'real' risks. Many studies in fields like engineering, statistics, epidemiology, economics, and psychology, present risk as a potential outcome which can be objectively observed and managed through a variety of different techniques.[104] They treat risks as a potential given situation that needs to be solved or managed. Often technical in nature, there is a focus in these studies on techniques to correct or minimize the potential negative aspects of risk and compensate for those that cannot be addressed. In essence, a risk is simply a situation or object to be regulated.

The objective nature of risk leads to a focus on identifying risks, mapping their multiple causes, building models to predict risks and attempting to limit the effects of the risk in question by studies in this category.[105] Therefore, much of the work looking specifically at risk management also stems from this approach. For individuals,

---

[103] Lupton, Deborah (1999), p. 17-23

[104] For a defence and general overview of the basics of a risk analysis approach see: Campbell, Scott and Greg Currie (2006) "Against Beck: In Defence of Risk Analysis", *Philosophy of the Social Sciences*, Vol. 36, no. 2, June, pp. 149 - 172

[105] Ibid.

companies and governments interested in managing and limiting risk, this course of action is logical and practical.

However, these approaches overlook or minimize the inevitable element of human construction that occurs in the process of risk management. These management techniques approach risk as a phenomenon rather than from the point of view of the perceiver of risk who implicitly reifies risk as objective fact. This leads to a further assumption that technical analyses provide absolute instead of relative truth, a claim that is left largely unexamined.[106] Therefore, a shift to conceptualizations that begin to examine and break apart the ways risk is socially constructed is necessary.

Risk Society

The second category of studies that utilize notions of risk begins from the basis of social construction. This provides an approach to understanding risk which has a number of key similarities with the discursive approach taken here. These works start from the concept of risk society and global risk society put forward by Ulrich Beck. One of the key scholars to look at risk from a sociological perspective, Beck's understanding of why risk is important has inspired a notable amount of strong research across the social sciences.[107] At the core, Beck conceives of risk as "largely a negative product of

---

[106] Bradbury, Judith A. (1989) "The Policy Implications of Differing Conceptions of Risk", *Science, Technology, & Human Values*, Vol. 14, no. 4, Autumn, pp. 380-399

[107] For some examples see: Franklin, Jane, ed. (1998) The Politics of Risk Society, Cambridge: Polity Press or Adam, Barbara, Ulrich Beck and Joost van Loon, eds. (2000) *The Risk Society and Beyond,* London: SAGE or Ericson, Richard V. and Kevin D. Haggerty (1997) *Policing the risk society*, Toronto: University of Toronto Press

increasing technological sophistication and other 'improvements'".[108] Starting from the sociological tradition of reflexive modernization, he argues that late modernity has become increasingly organized around the distribution and mitigation of risk. However, at the same time risks have become unmanageable.[109] Therefore, our societies are increasingly threatened by risks that were created by the very actions seeking to reduce risk. In general, attempts to address these new risks are largely through the application of more science and technology – greater attempts to bring the possible future events into the realm of the calculable. However, "the main thesis of the theory of risk society is that this institutionalized program of making side effects calculable is being eroded away by the political, economic, social, and technological changes that result from the continuing radicalization of the modernization process".[110] Due to this, the management and governance of the processes of modernity are now producing important dangers/risks (side effects) that threaten the very existence of society instead of creating social 'goods'.

Some important elements can be drawn from a risk society approach, particularly in the notion of reflexivity. Moreover, Beck opens up the arena of risk and risk analysis to view and debate.[111] However, there are a number of elements of a risk society approach that do not fit particularly well with the questions of this work. First, there is a problematic tendency to conceptualize the beginning of a risk as something prior to the act of risk management, which then becomes reflexive through the different attempts to

[108] Deuchars, Robert (2004), p. 92
[109] See: Beck, Ulrich (1992) and Beck, Ulrich (1999)
[110] Beck, Ulrich and Johannes Willms (2004) *Conversations with Ulrich Beck* Cambridge: Polity Press (translated by Michael Pollak), p. 115
[111] Deuchars, Robert (2004), p. 100

manage it.[112] Therefore, Beck does have a conception that risks are socially constructed but there is also an objective edge to the conceptions. As Elliot aptly points out "it is the failure of simple, industrial society to control the risks it has created, which, for Beck, generates a more intensive and extensive sense of risk in reflexive, advanced modernity. In this sense, the rise of objective, physical, global risks propels social reflexivity".[113] To the extent that they are perceived and defined along with 'acceptable' forms of governance, risks are socially constructed. Nevertheless, in the same arguments, risks are perceived to exist outside of the process of construction…they are a real danger. For Beck the problem is that these dangers created by modern society are becoming increasingly ungovernable through scientific risk management techniques. This understanding is clear at the center of the transformation to late modernity for this approach where the conceptualization that risk was calculable in the first stage of modernity but has become incalculable currently. However, one questions whether the risks inherent to financial services have ever been truly calculable. Rather it seems that it is the performance of defining an activity or event as a risk may make it more or less amenable to calculative techniques and increase the belief that calculative techniques may actually capture it. The event may be real but that it is a 'risk' is a product of discursive constitution.

Second, Beck's conceptualization of risks is largely negative. Risks are a threat or danger. However, there is a second potentially more positive role of risk in finance,

[112] Dean, Mitchell (1999a) *Governmentality: Power and Rule in Modern Society*, London: SAGE Publications; Alexander, J.C. (1996) "Critical Reflections on 'Reflexive Modernization'" *Theory, Culture and Society* Vol. 13, no. 4, pp. 133–8; Elliot, Anthony (2002) "Beck's Sociology of Risk: A Critical Assessment" *Sociology*, Vol. 36, no. 2, pp. 293–315

[113] Elliot, Anthony (2002), p. 300

which I have named risk as economic necessity. This other conception will be discussed in more detail later in the chapter.

Finally, the focus on theorizing risk as a defining narrative of reflexive modernity in the risk society approach minimizes the more distinct and nuanced way that risk influences different arenas of social activity at any given moment. For a pure risk society approach, risk is an organizing feature of governance but there is less elaboration on the 'how' of this relationship.

Risk as Discourse

These drawbacks lead me to utilize a third approach to understanding risk. Studies within this category still focus on sociological elements of risk but draw on the discourse and the governmentality literature.[114] For some analyses in this stream, the realness of risks is not denied. However, they point out that questions like this are not very useful in comprehending the importance and roles of risk in our modern society.[115] A risk is not "an objective fact 'out there'" but is socially mediated and often heavily contested.[116] Therefore, in these approaches 'risk' is actually important through the modes of calculative rationality that they are understood through and the techniques and practices which are marshalled for its governance. Mitchell Dean maintains that what makes risk important is actually

[114] For many these approaches are not necessarily in conflict and are often combined in analyses of risk and governance.
[115] Dean, Mitchell (1999a), p. 180-183
[116] Deuchars, Robert (2004); p. 114

> the forms of knowledge that make it thinkable, such as statistics, sociology, epidemiology, management and accounting; the techniques that discover it, from calculus of probabilities to the interview; the technologies that seek to govern it, including risk screening, case management, social insurance and situational crime prevention; and the political rationalities and programmes that deploy it, from those that dreamt of a welfare state to those that imagine an image an advanced liberal society of prudential individuals and communities.[117]

In essence, it is not the 'risk' that is central to the analysis but the rationalities, technologies, practices and identities that are marshalled to govern in the name of risk. This means that what can be said and done about phenomena like risk is not only limited but also made possible through discourse.[118]

De Goede convincingly shows how the discourse of risk situated financial market transactions in the realm of human calculability, distinguishing them from gambling. This discursive shift serves as the most powerful defence of the legitimacy of financial trading, shifting the moral responsibility for controlling speculation to processes of risk management.[119] In modern finance, notions of risk have continued to integrate themselves with both the macro and micro levels of global markets. The dissertation shows that in all three of its cases there has been an increasingly complex and sophisticated relationship between the discourses around risk and techniques and practices of governance. These relationships have evolved into increasingly complex practices labelled as 'risk management'. Moreover, these practices spread across a range of actors from the strategies of largest multinational financial conglomerate to the

[117] Dean, Mitchell (1999a), p. 178
[118] Lupton, Deborah (1999), p. 15
[119] De Goede, Marieke (2004) "Repoliticizing financial risk", *Economy and Society*, Vol. 33, no 2, May. pp. 197–217

investment decisions of the smallest bank depositor. They have also spanned the broadest techniques of market discipline to the smallest actions of employees as operational risk.

Moreover, having the symbolic power to define risk is increasingly important, as the market is populated by some actors who take on the responsibility of different risks and others who attempt to place it onto "other individuals, organizations, or abstract systems".[120] In regulatory terms, the discussion of symbolic power of definition of risk and responsibility is also clear. In the case of Basel II we see large international banks respond to pressure to create more intensive and extensive regulation to manage risk by working to symbolically take ownership or control over those processes through processes of internal modelling. In collective investment schemes, the responsibility for risk remains on the individual, which means that regulators have less direct interest in the specific practices of risk management unless they become fraud or incompetence.

"Conditions of Possibility" for the Discourses of Risk discussed later in the Chapter

When one begins to destabilize and question the international governance of finance it quickly becomes apparent that invoking the language of 'risk' serves to define something as probable and calculable. However, in order to understand its implications fully one must recognize the fundamentally contested and fractured historical basis of risk in finance broadly and in the different areas of financial governance. This process not only reveals the contestable nature of 'risk', but also lays out the 'conditions of possibility' for these elements of risk. Beginning with early notions of Fortuna and virtù,

[120] Garsten, Christina and Anna Hasselström (2003), p. 250

it will become apparent that 'risk' is imbued with important political and moral elements that are subsumed under these appearances of objectivity. Moreover, this early frame creates a space where risk becomes associated with the potential for action or management. Following this, we will examine how this notion of management was reinforced by the advent of modernity and the rise of rationalism and calculation in social life more broadly. These two features underpin the current technologies of risk management in finance and how they can lay claim to being neutral and technical measures. The rest of this section will elaborate some of the main conditions of possibility for risk.[121]

Virtù and the Goddess Fortuna

Risk can be conceptualized as one relationship we have with an uncertain future. Therefore, a study focusing on discourses of risk should begin with an examination of how the relationship between humans and the future is conceptualized. Many pre-modern conceptions of the future are tied to discourses of fate not risk. One of the earliest conceptions of this belief can be seen in the notion of the Goddess Fortuna which appears in a number of philosophical works extending back to Aristotle. In general, Fortuna is responsible for the distribution of beauty, wealth and wellbeing. She is the representation of chance or fortune. Depicted as fickle, she is also impartial – living a 'good' life

[121] Given the material that this dissertation needs to cover and the limited space only key developments will be discussed. For a more comprehensive and detailed history of risk see genealogies by De Goede (2005) and Deuchars (2005), in addition to histories by authors like Bernstein (1998).

gathers no rewards from her.[122] This constructs a future is the providence of the divine and humans have little notion of foresight, much less control. Another example of this conception of Fortuna occurs in Dante's *Divine Comedy*. Here Fortuna is granted her powers from the divine and acts independently with little reference to humans; any pain and suffering or joy that is caused by her actions is unintentional. Moreover, Fortuna is a goddess whom humans cannot understand or defend against.[123] Again the future is constructed as the outcome of fate.

By the period of the Renaissance, however, this understanding was increasingly contested and beginning to be transformed. The idea that man (sic) had the ability to influence future events had emerged, shifting the relationship between time, nature and human agency substantially.[124] A clear example of this is in the work of Machiavelli. He made a conscious attempt to represent the world as a place where Fortuna can be made subservient through virtù - the belief that there is the possibility of action against the unpredictability of Fortuna.[125] The way that man could tame Fortuna was through knowledge and expertise, the use of "man's cunning" to foresee her changing moods.[126]

Yet this shift does not mean that Fortuna was completely conquered. Turning to Deuchars' reading of Machiavelli, Fortuna (or fortune) is still present in the analysis and

[122] A number of scholars have highlighted how these illusions to Fortuna highlight are an important part of the various ways that both finance and risk are gendered. Fortuna is generally represented in female form and is often represented through images that vary from cruel to a temptress. See Pitkin, Hanna Fenichel (1984) *Fortune is a Women: Gender and Politics in the Thought of Niccolò Machiavelli*, Berkeley: University of California Press; also Deuchars, Robert (2004); de Goede, Marieke (2004); de Goede, Marieke (2005)

[123] Cioffari, Vincenzo (1947) "The Function of Fortune in Dante, Boccaccio and Machiavelli" *Italica*, Vol. 24, no. 1, March. p. 3

[124] Deuchars, Robert (2004), p. 8

[125] Arguably Machiavelli was one of the first pre-modern European writers to do so. (Deuchars, Robert [2004], p. 18)

[126] De Goede, Marieke (2005), p. 32

still largely out of the control of humans.[127] However, Machiavelli does have a recognition "that continuous vigilance, and continuous peering into the future, could help to shape action in the present, and as a consequence, could help 'make' the future", however unclear it may be.[128]

The notion of virtù brought with it a moral argument. The notion of 'taming' fortune or chance is linked with an implicit argument that once this future is identified action *should* be taken in the present to mitigate or manage it. This element of Machiavelli is clear when he writes of Fortuna,

> I compare her to one of those raging rivers, which when in flood overflows the plains, sweeping away trees and buildings, bearing away the soil from place to place; everything flies before it, all yield to its violence, without being able in any way to withstand it; and yet, though its nature be such, it does not follow therefore that men, when the weather becomes fair, shall not make provision, both with defences and barriers, in such a manner that, rising again, the waters may pass away by canal, and their force be neither so unrestrained nor so dangerous.[129]

In this case the wrath of Fortuna may return but man, foreseeing this possibility, is able to take action to limit the damage. Therefore, these medieval period themes of *virtù* and the *Goddess Fortuna* embody these early underpinnings of modern notions of risk, the ability of man to foresee and potentially control the future. The temporal aspect of social life is somewhat altered through foresight. As Bernstein rightly argues, "Time transforms risk,

[127] For Deuchars this is because of Machiavelli's work is done in between two times - the modernist world of calculative practices which was to the come and the world of myth and superstition that was still present.
[128] Deuchars, Robert (2004), p. 33
[129] Machiavelli, Niccolo (1908) *The Prince*, translated with introduction by W. K. Marriott, New York: E. P. Dutton, chapter XXV

and the nature of risk is shaped by the time horizon: the future is the playing field".[130] One can see both the present and some of the potential futures.

Moreover, the notion of control or at the very least agency implied in virtù, we can see these articulations and performances of 'man's cunning' evolve with the introduction of rationalism. It is belief in taming chance through mechanisms, techniques and practices based on the human knowledge that forms the basis of risk management in the financial services today. Chance is no longer an unforeseeable whim of the gods but something that may be understood and controlled through human action. The rise of rationalism as a way of thinking is incredibly important in the further emergence of risk. Although risk began with these links to foresight long before the emergence of rationalism as the preferred way of thinking, this shift was crucially important to our current understanding of risk as it "sits inside modernist rationalist thinking".[131] Successors "took Machiavelli's quest to overcome *Fortuna*, imbued it with scientific method in attempts to regularize indeterminacy, and continued on this path to the present."[132] Green highlights this type of argument into the current period by arguing that "risk-management has replaced God as the primary response strategy to the unknown and the future."[133] However, in order for there to be this shift toward scientific conceptions of risk, there is also an increasing role for calculation, which we will discuss more in the next two sections

[130] Bernstein, Peter L. (1998) *Against the Gods: The Remarkable Story of Risk*, Toronto: John Wiley & Sons, Inc., p. 15
[131] Deuchars, Robert (2004); p. 99-100
[132] Ibid, p. 22
[133] Green, Stephen (2000) "Negotiating with the future: the culture of modern risk in global financial markets" *Environment and Planning D: Society and Space*, Vol. 18, pp. 77-89

Risk as a Rational Calculative Construction

This section will focus on a key distinction that had to occur for 'risk' in its modern form to emerge. However, to get to the modern conceptualization of 'risk', it enveloped the possibility of prediction. In this incarnation, risk is disentangled from the concept and discourse of uncertainty in modern economic thought. One can argue that an activity or event contains some degree of uncertainty in order for a risk to arise.[134] One of the most common and influential conceptions of uncertainty and risk is Frank Knight's book where he equates risk as 'measured uncertainty'. For more detail we can turn to Knight's own words, "Uncertainty must be taken in a sense radically distinct from the familiar notion of Risk, for which it has never been properly separated."[135] For him, the measured uncertainty that came with risk was so different from "immeasurable" nature of real uncertainty. With a notion of measured uncertainty or risk, however, forecasting became possible.

Through this argument, the intellectual constructs of risk and uncertainty are separated. Economists, for example, consider uncertainty incalculable due to incomplete information.[136] Uncertainty becomes that which is not statistically or mathematically predictable. In essence, uncertainty is a situation where there is no ability to determine

[134] Mythen, Gabe (2004), p. 14
[135] Knight, Frank H. (1964) *Risk, Uncertainty and Profit*, New York: Century Press, p. 205
[136] Deuchars, Robert (2004); p. 87. In this work Deuchars presents some problems with the assumption that uncertainty is about incomplete information. Specifically, he points out: (1) locates uncertainty primarily (if not completely) in the communicative frame (at least for decision making purposes); (2) assumes decision making is premised on rational calculation; (3) "dealing with a hypothetical individual as the primary unit of analysis".

the likelihood of an event's occurrence. Risk, on the other hand, implies the possibility of calculation and predictability.[137] This has led some scholars, like Ericson and Doyle, to assert that risk is surrounded by uncertainty.[138] Moreover, it leads others, particularly Reddy, to argue that these calculative aspects of discourses around risk are an important feature of modernity because they eliminate from view genuine 'uncertainty' making reality 'manageable' through myths of calculability.[139] For Reddy, returning to a discourse of uncertainty will open up the governance process to greater debate and critique, and to greater possibilities for democracy. Therefore, while creating an opening, uncertainty still presents a fairly constrained conception of knowledge.

However, not all studies agree that risk is simply a more calculable subset of uncertainty. Best, for example, sees both uncertainty and risk as different conceptual constructs that "foster a particular kind of individual liberal subjectivity; while risk encourages a rational and calculative orientation towards the unknown, uncertainty calls for a more common-sensical orientation".[140] In this case uncertainty is predictable, even if it is not calculable. However, there is still agreement in this case that risk involves a calculative approach to the unknown.

---

[137] Haufler, Virginia (1997) *Dangerous Commerce: Insurance and the Management of International Risk*, Ithaca: Cornell University Press

[138] Ericson, Richard V., Aaron Doyle and Dean Barry (2003) *Insurance as Governance*, Toronto: University of Toronto Press

[139] Reddy, Sanjay G. (1996) "Claims to expert knowledge and the subversion of democracy: the triumph of risk over uncertainty" *Economy and Society*, Vol. 25, no. 2, p. 237

[140] Best, Jacqueline (2006) "Ambiguity, Uncertainty and Risk: Rethinking Indeterminacy" Paper presented at British International Studies Association, Cork, Ireland, December, p. 14

Risk Measurement, Risk Modelling and Precision

It is clear then that in this sector the understandings of risk currently are linked with the development of rationalist-based calculation. In essence risk is a discourse that actually encompasses a set of ways for "ordering reality, of rendering it into a calculable form".[141] This combination takes the agency against the future conceptualized in virtù and connects it to the rise of probabilism – "the introduction and spread of calculative practices, and the use of probabilistic techniques for government proper" by various other bodies to constitute or control society – that occurred through rationalism in modernity.[142]

Care should be taken not to reduce the discourse of risk to the emergence of statistical and mathematical techniques.[143] However, the forms of risk measurement and management deemed 'appropriate' in the current environment have increasingly been used and created through mathematical risk management models, while at the same time reinforcing the connection between risk and calculability. For example, in today's financial markets new financial instruments can shift from being a mathematical model to the very basis of a market in a short time. First, these instruments become accepted as routine practices. After time many of these markets become taken as a baseline reality on which new practices and instruments are developed.[144]

---

141 Dean, Mitchell (1999b), p. 131
142 Deuchars, Robert (2004), p. 36
143 O'Malley (2000) does make important caveats highlighting risk as a rationality of government actually incorporates a number of diverse technical and moral configurations of which only some are statistical. In an area like finance, however, which has an inherent predisposition to numbers, the link between statistical and mathematical techniques of risk management in governance should not be understated.
144 Porter, Tony (1999) 'The late-modern knowledge structure and world politics', in Martin Hewson and Timothy J. Sinclair (eds.) *Approaches to Global Governance Theory*, New York: State University of New York Press, p. 142

Following this trend, the importance and complexity of risk management tools, particularly the numerous forms of derivatives, help to make the financial sector a driving force in the development of computerized modelling and data set collection.[145] One of the most common of these models used for the assessment and management of risk through derivatives is the Value at Risk (VaR) model. VaR measures are "confidence intervals of how much one can lose from holding a risky portfolio of assets over a set horizon".[146] This model, along with the many others available for the management of risk, has become central in the making of credit and investment decisions. This widespread use in corporate financial decision-making has been accompanied in the past decade with their growing inclusion into the regulatory structure of financial services.

It would be easy, but erroneous, to argue that risk is inherently complex and mathematical because an economy essentially requires these traits. The Greeks had a well-developed economic system but lacked a system of numbering that would allow for anything more complex than the recording of results.[147] Without the invention of a numbering system that moved beyond Roman numerals or Greek letters, the current numerically calculative forms of risk management could not have emerged. The first known attempt to measure risk was not until Girolamo Cardano wrote *Liber de Ludo Aleae* in 1525 and a theory of probability did not exist until the mid 1600s with the work of Blaise Pascal and Pierre de Fermet.[148]

---

[145] Garland, David (2003) "The Rise of Risk" in Ericson, Richard V. and Aaron Doyle (eds.) *Risk and Morality*, Toronto: University of Toronto Press, pp. 48-86
[146] Garcia, R., E. Ghysels and E. Renault (2000) "Econometric methods for derivative securities and risk management" *Journal of Econometrics*, Vol. 94, iss. 1-2, January-February, p. 1
[147] Bernstein, Peter L. (1998), p. 16
[148] Bernstein, Peter L. (1998), p. 54 and p. 62

Even looking only as far back as the later part of the 20th century it becomes clear that the connection of international finance to mathematic techniques is not natural. Prior to the 1960s, the field of finance was "almost entirely a descriptive discipline with a focus on institutional and legal matters. Financial theory was little more than a collection of anecdotes, rules of thumb, and shufflings of accounting data".[149] A shift toward mathematics, that also affected understandings of risk measurement and management, occurred in the mid-1960s. In the frame of the behavioural revolution in the academy, a shift occurred in financial research to a new focus on asset valuation models and models of individual and market behaviour that had an extensive reliance on mathematical and/or statistical analysis. It did not take long for these studies to creep into almost every article in finance journals.[150] Looking at the field of economics, similar developments are visible. The author of one of the most well known studies of financial crises in recent decades, Charles Kindleberger, serves as a useful highlight of 'newness' of this trend. Educated in the 1930s, Kindleberger considers himself to be "untrained" in the "more elegant – one is tempted to say 'fancier' – techniques" of mathematical economics, econometrics or 'new economic history.[151]

Again, however, there are some clear normative implications of the increased use of calculative techniques. In particular, increasingly complex and abstract forms of calculation articulate the practice of 'risk' measurement in ways that require particular

[149] Merton, Robert C. (1994)" Influence of mathematical models in finance on practice: past, present and future" *Philosophical Transactions of the Royal Society of London – A*, Vol. 347, p. 452
[150] Whitley, Richard (1986) 'The rise of modern finance theory: its characteristics as a scientific field and connections to the changing structure of capital markets', *Research in the History of Economic Thought and Methodology,* Vol. 4, pp.147–78.
[151] Kindleberger, Charles P. (2000) *Manias, Panics and Crashes: A History of Financial Crises*, Fourth Edition, Toronto: John Wiley & Sons Inc., p. 4-5

types of expert knowledge. Techniques like mathematics, probability and statistical modeling do not simply measure risk, they *define* it. To put this in more contestable terms: probability mathematics and statistics are discursive techniques that in their performance constitute some future events as risks and others as not. Even those potential events that are now considered 'risks' are further articulated against each other, creating a hierarchy of risks – based either on their probability of occurring or theorized consequences. Moreover, these mathematical and statistical techniques articulate these events in ways that lead to governing – of the 'risk' itself and also of other subjects in the network. The language of risk in this case serves to depoliticize the process and choice of governing technique and project. The argument is that a 'risk' has been uncovered that must be addressed, when in reality an event has been constructed as a risk allowing for governance to occur.

Yet, the discourse of risk management in finance has not been solely about the increasing use of calculative mathematical techniques and practices. Connected with this trend is a search for precision in identification, measurement, management and/or mitigation. In particular, the models that are currently in use for risk measurement are only seen as effective if they can claim to accurately capture all the relevant variables. One can also see the drive to increasing precision in the search for increasing levels of more detailed information and data.

Moreover, this precision can also be seen in the increasingly more sophisticated conceptions of risk in the financial sector. For example, Andrew Crockett, former

General Manager for Bank for International Settlements and Chair of the Financial Stability Forum states,

> Increasingly, however, risk is now seen as multidimensional. Advances in modern finance theory and information technology have identified and defined a multitude of risks, including - as well as market and credit risk - liquidity, operational, legal and reputational risk. Previously combined categories of risk, such as market risk, have been broken down into component categories.[152]

This increasingly complex conception of risk will be clearly apparent in the following chapter. Again however, this process serves to articulate different activities potential effects on future events as 'risks' and with this places them into the calculative paradigm above.

Modern Discourses of Risk in International Financial Services Governance

Through this admittedly brief review it is clear that 'risk' is a term that implies a distinct way of knowing the world and establishing our place within it. Although there has been greater attention paid to objectively identifying external risks, this is much more accurately conceptualized as a process where a potential future event or activity is constituted discursively as a 'risk'. In finance this has manifested itself in two distinct streams. First, risk becomes the center of modern financial activities including bank lending, securities market transactions, and insurance. In a capitalist economic system investment is necessary but investment also carries with it the possibility of loss. The

[152] Crockett, Andrew (2002) "Introductory Remarks" in Committee on the Global Financial System (2002) *Risk measurement and systemic risk: Proceedings of the Third Joint Central Bank Research Conference*, October 2002, (http://www.bis.org/cgfs/conf/mar02.pdf), p. 14

financial sector serves an important role in society by taking on the 'risk' that the capital it extends will not be returned. In doing this, the capital, which was sitting as unproductive savings, can be put to productive use encouraging overall economic growth. In this sense, risk is constituted as a necessary or essential part of the functioning capitalist system. At the same time however, a risk may result in a loss, financial or otherwise. This gives a different constitution of risk, in this case it is the essential process to mitigate against dangers or threats, at the very least loss of investment. Through this connection, 'proper' management of risk is articulated as attempts to manage losses or dangers, similar to what is discussed in virtù. The following two sections will focus on these two different, but related, discourses around risk and risk management.

Risk as Economic Necessity

The first discursive construction of risk is as a necessary element to the functioning of the market and economic development. We need only to look at current mainstream business literature to see this particular discourse influencing the performance of finance unquestioningly. Yet the understandings of risk as an essential part of the financial sector are not neutral. Looking at the advent of financial markets and the practice of speculation, de Goede highlights the important impact of the legitimation of speculators as professional risk bearers. This identity served an important political role in defending the activity of speculation and discursively separating it from the act of gambling. In the addition to legitimating the activity of speculation it also legitimated the tools and the risk in them as a natural part of business process. It constitutes a particular set of financial instruments as *natural business risks.* Moreover, it also established that someone, but not necessarily the business itself or its shareholders, must carry these risks.[153]

The practices of this notion of risk also encourage the risk management techniques employed in the financial sector in order to continuously make risk-taking more efficient. For example, looking at the financial markets one can point to the development and use of Modern Portfolio Theory (MPT). This "is an investment strategy aimed at achieving a specified level of return at the minimum investment risk. Portfolio managers utilizing MPT diversify their portfolios according to the MPT risk/return model. The investment portfolio is evaluated on the basis of its overall performance instead of performance of particular stocks."[154] In this discourse, risk is not something to be avoided but embraced.[155]

The connection between risk and reward means that governance options in finance which seek the complete elimination of risk (assuming that is even possible) are not seen as preferable, particularly in this field. Some actors use this strategy in argument that issues of risk management should be left to the market in order to ensure the most growth. The argument is that the market will arbitrate who or what is too risky and adjust to either (a) influence a shift in the organization's strategy and practices or

---

[153] De Goede, (2005), p. 83

[154] Karmel, Roberta S. (2004-5) "Mutual Funds, Pension Funds, Hedge Funds and Stock Market Volatility - What Regulation by the Securities and Exchange Commission is Appropriate?" Notre Dame Law Review, Vol. 80, p. 924ft

[155] Baker, Tom and Jonathan Simon, eds. (2002) *Embracing Risk: The Changing Culture of Insurance and Responsibility*, Chicago, IL: University of Chicago Press

(b) remove them from the market entirely. Yet, the pure neoliberalization that this approach to governance would create is not at the core of governance in the three international financial areas examined. For arguably the clearest regulatory statement on risk as an economic necessity in the context of regulation in these cases, one can look to the IOSCO *Objectives and Principles of Securities Regulation.* Under the third objective, the reduction of systemic risk, it states:

> Risk taking is essential to an active market and regulation should not unnecessarily stifle legitimate risk taking. Rather, regulators should promote and allow for the effective management of risk and ensure that capital and other prudential requirements are sufficient to address appropriate risk taking, allow the absorption of some losses and check excessive risk taking.[156]

In this statement we can see the notion that regulation is meant to address risk. However, not all risk is of concern – only excess risk-taking activities. Other risks are legitimate and should be accepted.

It is interesting to also examine this discourse of risk in the financial sector in the context of the assertion that risk management inherently creates new risks (and therefore new opportunities of commercialization). De Goede argues that the financial sphere is held up by a circular argument: "while pretending to eradicate uncertainty from business ventures, finance identifies and invents more and more possible uncertainties to be hedged".[157] Essentially, in the name of risk management, international financial markets often create new systemic risks that require new forms of management and potential for commercialization. These new "risks" will require new management

[156] IOSCO (1998) *Objectives and Principles of Securities Regulation*, part 4.2.3
[157] De Goede, Marieke (2004), p. 213

practices that may create a self-sustaining system of experts, as well as a continually diversifying market for these businesses to operate. Within this discourse of risk, the increasing diversification will begin to move toward what Merton refers to as the 'financial-innovation spiral'. In this understanding, the increasing level of innovation in the marketplace will eventually lead to a utopian situation of complete markets where the financial contracts available are infinite.[158] However, there is also the chance that this increasing diversification of risks through market instruments like this will lead to financial peril that leads nicely into the second discourse of risk.

Risk as Danger/Threat

The second discourse of risk that is present in the discursive domain of international finance is that of risk as a danger or threat (in essence risk as only or primarily a source of insecurity or of a negative outcome). Looking back at the discussion of ways risk is conceptualized earlier in the chapter, we can see that this discourse is what is framing the work of Ulrich Beck and the arguments behind risk society.

The 'risks' that society must be attuned to are the 'potential negative or crisis-like events' that may occur at the future date. However, as will become evident in the case studies, it is important to realize that this is a discursive construction. The perceived danger does not exist 'out there' waiting to happen) which is implied in the risk society approach. To get a better handle on this we can return to the work of David Campbell

[158] Merton, Robert C. (1994), p. 456

who, in his 1992 book *Writing Security,* shows us that danger is a collection of discourses which define who 'we' are by telling us what to fear ascribing, it as 'the other'.[159] Moreover, the economic growth discourse of risk is similarly a discursive construction in its own right. Financial risks are even easier to see as discursive than other issue areas because of the centrality of language, both alphabetic and numeric, in its mundane practices – reports, analyses, contracts, securities trades etc. Again, this discourse brings with it a different understanding of why governance is necessary. In this case, there is belief in an important prudential need to mitigate or manage these potential events. However, as we will see in the following chapters, the construction of the subject that is 'at risk' and the subject who bears the responsibility for those risks is also key to understanding international financial governance.

One variation on the discourse of risk as danger is the articulation of systemic risk. In this construction, the potential subject 'at risk' is the whole of the financial system. While the language of systemic risk emerged in the last few decades, system-wide financial or economic crises are not new. Even a cursory look at Kindleberger's examination of these types of events in historical perspective makes this point clear.[160] Moreover, previous governance efforts in the past have attempted to deal with systemic instability, most notably the development of Bretton Woods.[161] However, there has

[159] Campbell, David (1992) *Writing Security: United States Foreign Policy and the Politics of Identity*, Minneapolis: University of Minnesota Press

[160] Kindleberger, Charles P. (2000)

[161] Alexander, Kern, Rahul Dhumale and John Eatwell (2006), p. 22 - Among the structures they created to reduce systemic instability were interventionist central banks and powerful national regulatory structures.

been a discursive shift to conceive of crises and failures in the financial market as 'systemic risk'.

While almost unavoidable today, the term systemic risk really emerges only in the last two decades, gaining prominence about ten years ago. Running a search on the New York Times, the Wall Street Journal, and the Financial Times, there were fourteen articles published between 1984 and 1989 which used the term systemic risk, and almost two-thirds of the total (9) were in the Financial Times alone. In 1990 there were 13 articles alone. This began a trend throughout the 1990s, as the term's usage jumped throughout the decade to 346 articles.[162] With the emergence of the East Asian Crisis there is a clear increase. Between 1997-1999 there were 53, 97 and 44 articles published in each respective year. The crisis also spurred movement in the international regulatory sphere as it highlighted shortcomings in the international regulatory structure. International organizations, particularly the Financial Stability Forum, focused on this distinct understanding of risk. Specifically created post-crisis, the purpose of the Financial Stability Forum is "to co-ordinate the efforts of these various bodies in order to promote international financial stability, improve the functioning of markets, and reduce systemic risk."[163]

In many traditional studies, systemic risk is treated as 'real' like other 'risks' Yet just like other discourses and conceptions of risk, 'systemic risk' is discursive, historically contingent and open to contestation. It serves as a means to construct the

[162] For a breakdown by publication and year, see Appendix B. Articles identified through a search run on Factiva on June 25, 2008.
[163] Financial Stability Forum website (http://www.fsforum.org/home/home.html), Last access: 27 April 2006

particular events and activities and bring them into a particular understanding of the world. In this role it alters what is thinkable in terms of international regulation, in this case more specifically the context of an increasingly global financial market.

There is no generally accepted definition of what constitutes a systemic risk. However, for some it largely arises from two sources: problems with payment and settlement systems or a financial failure of some form that induces macroeconomic crisis.[164] In a more general understanding systemic risk is the potential for problems within a financial institution or region to spread, disrupting not only the entire international financial system but also potentially impacting on the real economy. Mundy argues that "maybe systemic risk can be more readily defined as risk that is both so extreme and so critical in its impact on society that governments are required to insure them, even at the cost of their own economic principles".[165]

This conception also maps with others who conceive of systemic risk as a negative externality that imposes costs on society at large.[166] According to the Oxford English Dictionary, an externality is "a side-effect or consequence (of an industrial or commercial activity) which affects other parties without this being reflected in the cost of the goods or services involved; a social cost or benefit."[167] Given this, a systemic risk could be conceptualized with a rational choice or public goods approach. Simmons, for example, argues that externalities are central to the framework she creates for

---

164 Dow, James (2000) "What Is Systemic Risk?: Moral Hazard, Initial Shocks, and Propagation" *Monetary and Economics* Studies, Vol.18, no.2, December

165 Mundy, Chris (2004) "The nature of risk: The nature of systemic risk - trying to achieve a definition", *Balance Sheet*, Vol. 12, no. 5, p. 30

166 Eatwell, John and Lance Taylor (2000)

167 Oxford English Dictionary online (n.d.) "Externality, <http://dictionary.oed.com/cgi/entry/50080908?single=1&query_type=word&queryword=externality&first=1&max_to_show=10>

international cooperation "because they determine whether regulators in the dominant jurisdiction have an incentive to pressure other regulators to conform."[168]

Externality, like systemic risk is a way of discursively constructing an effect of activity. Yet they are not entirely interchangeable. There is a key difference between the discursive construction of an externality and one of a systemic risk. As we saw from the discussion about the conditions of possibility around risk there is a historically contingent nature to each discursive frame. In the case of externality and its capture by the field of economics and rational choice this limits how one can understand it. Moreover externalities can be very small scale in their effects. Systemic risks, on the other hand, are almost always constructed as having very substantial impacts. Therefore, the articulation of an event or activity as a systemic risk brings with it an at least slightly different discourse than that of an externality.

The vagueness around systemic risk indicates its discursive character and the inherent mutability of these discourses. The phantom-like nature of systemic risk is captured beautifully in Sheldon and Maurer, who assert,

> Systemic risks are for financial market participants what Nessie, the monster of Loch Ness, is for the Scots (and not only for them): Everyone knows and is aware of the danger. Everyone can accurately describe the threat. Nessie, like systemic risk, is omnipresent, but nobody knows when and where it might strike. There is no proof that anyone has really encountered it, but there is no doubt that it exists.[169]

---

[168] Simmons, Beth A, (2001) "The International Politics of Harmonization: The Case of Capital Market Regulation" *International Organization,* Vol. 55, no. 3, Summer, p. 616

[169] De Bandt, Olivier and Philipp Hartmann (2000) "Systemic Risk: A Survey", *Centre for Economic Policy Research (CEPR) Discussion Paper No. 2634*, December, p. 7-8 -- originally in Sheldon, G. and M. Maurer, 1998, "Interbank Lending and Systemic Risk: An Empirical Analysis for Switzerland", *Swiss Journal of Economics and Statistics*, Vol. 134, no. 2, pp. 685-704.

Looking in relation to governance, this discursive construction of risk creates an onus on actors to act with foresight[170], as all who would be affected will likely have no ability to manage the risk individually. Management of systemic risk is a public good and as such it is often articulated as requiring some action from the larger community. In industrialized democracies this community is often the state; in the global realm this expands to include transnational and multilateral organizations and networks. This was echoed by Yutaka Yamaguchi, Deputy Governor of the Bank of Japan and Chairman of the Committee on the Global Financial System at a joint Central bank conference in 2002. He stated,

> In relation to policy responses to systemic risk, we have generally recognised the importance of both pre-emptive actions, i.e. actions aimed at preventing systemic problems, and after-the-fact measures to contain an unfolding crisis. In this regard, I see a greater rationale than ever for views that stress the importance of preventive measures. This is because globalisation of financial markets and consolidation of financial institutions have considerably raised the possible costs of dealing with actual systemic disturbances. To this end, the strengthening of market discipline as well as supervision would be essential, and the international community has made serious joint efforts.[171]

This focus on pre-emptive action reminds one very strongly of Machiavelli's quote used earlier in this chapter and it contrasts with discussion around financial crisis where the focus is on crisis management rather than prevention.

In regulatory language, the situation of systemic risk addresses that of a system-wide failure, and is seen to emerge from the transmission of a more specific risk

[170] This idea is inherent to discussions of risk.
[171] Yamaguchi, Yutaka (2002) "Triangular view of systemic risk and central bank responsibility" in *Committee on the Global Financial System: Risk measurement and systemic risk*, Proceedings of the Third Joint Central Bank Research Conference, Basle: Bank for International Settlements, October

management failure, through contagion or other means. Therefore, the majority of regulation focuses on the multiple, more easily instrumentalized conceptions of risk with the intent of preventing systemic risk through controlling smaller sub-areas or practices of the financial sector.

Conclusion

Although the terminology of risk is presented as neutral and natural, this chapter has sought to outline some the different conditions of possibility that were necessary in order to have the risk discourses that are discussed later in the chapter. By examining these conditions of possibility it becomes clear that some of the key features of 'risk' as discourse, and risk management are an outcome of a contested past. However, this development has emerged into an articulation of risk, which is clearly evident in current practices of risk management in the global financial sphere. In particular, the introduction of foresight and the notion of virtù opened up the possibility of a forward-looking way of thinking about risk. Moreover, the emergence of rationality as the most dominant modern way of understanding the world laid the foundation on which the calculative understandings of risk as we know them today could emerge. Finally, the division between risk and uncertainty is also important. Until uncertainty was separated there was a dualism between the known and the unknown. Separating uncertainty into the truly unknown creates a space for risk where the outcome is not necessarily known but could be measurable and not simply guessed at.

The last section of this chapter highlighted how references to risk actually encompass two different discursive frames. The first, found in most texts on economic progress and capitalism, constructs risk as an essential feature of the economic marketplace and it serves a positive productive role in 'normal' cases. In this discourse, risk taking, within rational limits, is encouraged. In the second discourse of risk in international financial governance, risk has negative characteristics. A 'risk' does not present the possibility for positive benefits but merely represents the potential for insecurity or catastrophe.... risk is a danger or threat.

However, this discussion of the two major "macro" discourses of risk as economic necessity and risk as danger must be put together with the discussion in chapter 3 that made clear that discourse is also micro and material. Without this step the analysis is too apt to simply treat risk as an idea and miss the full benefits of a discourse analysis. The two macro-discourses influence, inspire, mold and/or legitimize various courses of action in a general way that in some respects is very similar to the role played by ideas in other approaches. However by drawing out the links between these macro discourses with performative risk practices, that also involve mundane, routine, and highly technical practices which constituted by discourse, it is clear risk discourses are important for constructing the everyday practice of financial and the identities of those actors included and excluded from the system. The discursive aspects of these mundane practices or performances are particularly evident in the language and practice of risk modeling, financial contracts, or regulatory standards. Moreover, risk cannot be separated from the material. In finance, risk is constantly priced (unless markets break down), and the material value of the knowledge contained in risk practices can be measured in billions and trillions of dollars. Thus the macro-discourses do not on their own guide the actors involved. Instead they operate in an ongoing way through the practical implementation of regulatory strategies that implicitly or explicitly play one off against the other.

This dissertation's emphasis on risk discourses, then, facilitates an examination and understanding of the evolution of the practice of financial governance at the global level. It allows the examination of the inherent relationship between the macro and the micro elements of international regulation for governance within the same frame of reference. In financial markets and financial governance, details can be extraordinarily consequential, and this dissertation's discursive approach allows us to focus on those crucial details while drawing out their political and institutional significance, as well as their connection to changing identities and roles. The prevailing approaches that have been reviewed lack this capacity.

In the following chapters, it will be shown how the interaction between these two discourses creates an interesting tension in the governance process. Some of this tension is seen in the discussions around proper and efficient management - steering it, controlling it, minimizing its detrimental effects while making the most of its positive potential.[172] As the three cases will show, in the international governance of finance both of these discourses are important and it is how they are connected which can reveal deeper understanding. Each chapter will examine each sector to draw out the

[172] Garland, David (2003), p. 68

implications of the discourse of risk and its attached understandings of appropriate risk measurement and management. In the process the importance of these micropractices and mundane activities in constructing the financial sector and those active in it will also be made clear.

Chapter 5 – The Discourse of Risk and new Basel Capital Adequacy Accord[173]

There are few areas of the international financial services sector that have received more attention from Political Science than the Basel Committee on Banking Supervision (BCBS) and its work on the international capital adequacy agreement.[174] Although taking very different stances on the causes of the Accord and its implications, each study reaffirms that this is an important point of international governance for the financial services sector.

This chapter will re-examine the progress and final versions of the two international regulatory agreements around capital adequacy – now commonly referred to as Basel I and Basel II – and the related documents. In the process it will highlight how the construction of risk and risk management in the Accords has created and reinforced a host of micropractices and identities in the governance of banking. Through this discursive lens the complexities of the public-private nature of governance in the Accords is revealed, bringing into view a number of important performances in international banking governance. However before examining the relationship between risk and regulation, the next two sections will provide a general background on the international capital adequacy initiatives and review at some of the other key studies of the Basel

[173] Portions of this chapter, particularly the section on the emergence of operational risk, appeared in McKeen-Edwards, Heather (2007) "Calculated Risk and the Role of Expert Knowledge in Governing Global Finance: The Case of Risk and the International Governance of Capital Adequacy in Banking"; Paper presented at the Canadian Political Science Association, Saskatoon, SK. 30 May 2007

[174] See Kapstein (1989, 1991, 1994); Porter (1993); Oatley and Nabors (1998); King and Sinclair (2001); Simmons (2001); Singer (2004); Wood (2005)

Accord in the discipline. Although these studies reveal interesting aspects of the negotiation of the Accord, none explicitly interrogate the practices and identities articulated in the documents and their implications. Following this discussion, the focus will shift to examine how the discourses of risk are articulated in this sector and how they are connected to the search for increased precision in risk measurement and management. Finally, the chapter will examine how these discourses of risk are performed in the practices and identities of the sector.[175] It will look in particular at the techniques of capital adequacy and risk weighting, and the practices of risk buckets, credit rating, internal modeling, and the performance of operational risk.

Introducing the BCBS and the Basel Capital Adequacy Accords

In December 1974, the G-10 established the Standing Committee on Banking Regulations and Supervisory Practices[176], renamed the Basel Committee on Banking Supervision in 1989, at the Bank for International Settlements (BIS).[177] The committee was created to focus attention on developing an "international early-warning system" in light of the "international banking disturbances" that had arisen in the previous year.[178]

[175] It is recognized that Basel II contains three pillars. However, the majority of this analysis is focused on Pillar I, which discusses capital adequacy.

[176] Wood, Duncan (2005), p. 44

[177] In 1930, the Bank for International Settlements (BIS) was created in Basle, Switzerland to deal with financial issues resulting from World War I and German reparation payments. It has had numerous roles in international monetary policy over the years, including attempts to meet the goals of Bretton Woods. Moreover, its role has expanded to serve as the site where the G-10 central banks and financial regulators meet to address international banking and monetary issues. (for more information on the BIS see their website (http://www.bis.org) For a brief history of the BCBS see their website on the Banking for International Settlements site.

[178] Bank for International Settlements (BIS) (1975) *Forty-fifth Annual Report*, 1 April 1974-31 March 1975, Basle: Author, published: 9th June 1975, p. 149

These included a number of bank failures, most notably the failure of Bankhaus Herstatt in West Germany.[179] In this early construction of governance there were links drawn with systemic needs and danger from banks. In the beginning, the committee focused on trying to achieve international harmonization in banking supervision. Through the 1975 Basle Concordat (and its subsequent versions), in particular, the central bankers worked to establish a coordinated international supervisory framework that would ensure every bank would be properly regulated. However, the committee did not seek to create a regulatory system for international banks directly, only to harmonize national supervisory structures.

The impact of the committee as an international regulatory body was further increased when it released the regulation known as the *International Convergence of Capital Measurement and Capital Standards* (hereafter called the "Basel Capital Accord" or "Basel I") in 1988.[180] Although there have been a variety of arguments about why it emerged, it is widely accepted that the publication of the standard "marked a quantum jump" for the identity and role of the committee in terms of joint decision making.[181] This standard shifts from a sole focus on harmonized supervision, adding the creation of harmonized rules for the banking industry. In many ways, the creation and continuous

---

179 BCBS "History" – http://www.bis.org; Wood, Duncan (2005). There are numerous reasons given for these 'disturbances', including the petroleum price increases, the fluctuation in interest rates, the removal of U.S. controls on capital outflows in January 1974 and the internationalization of the private banking sector in the 1960s and 70s, and all likely played a role.

180 There has been substantial variation as to whether the accords are referred to as Basel or Basle. The BCBS has officially now chosen to refer to itself as the former. Due to this I will adopt the same and use it consistently across both accords.

181 Felsenfeld, Carl and Genci Bilali (2004) "The Role of the Bank for International Settlements in Shaping the World Financial System" *University of Pennsylvania Journal of International Economic Law*, Vol. 25, Fall 2004

strengthening of an international agreement on capital requirements for international banks has been the most successful initiative of the committee to date.

The 1988 Accord focuses on two elements – defining what qualifies as regulatory capital and providing a mechanism for the applicable banks to calculate the capital reserve needed to cover their credit risk. In the process, it sets the minimum level of capital reserves at eight percent of the risk-adjusted exposure of assets. In the first section the definition of what qualifies as capital for the purposes of the required reserve is laid out.[182] This is why we periodically see references made to 'regulatory capital', which highlights the more specifically defined category, as opposed to general 'capital' in economic terms. In the second section of the Accord, the mechanism to determine the capital reserve amount is elaborated. In this mechanism, the minimum capital required for each asset class is calculated by applying a system of risk weights to credit risk.[183] For example, capital in the reserve that is cash will have a risk weight of zero, as are claims on the bank's central government. However, claims on multilateral development banks are risk weighted at 20 percent and claims on the private sector are given a risk weight of 100 percent.[184]

---

182 In essence the Accord divides acceptable capital into two hierarchical categories. Tier 1, or Primary capital, must make up 50 percent of the total capital reserve and is composed of equity capital, i.e. issued and fully paid ordinary shares/common stock and retained earnings (disclosed reserves). The remainder of the reserve amount can be made up of secondary, or Tier 2, capital which is composed of particular combinations of undisclosed and revaluation reserves, general provisions or general loan-loss reserves, hybrid debt capital instruments, and subordinated term debt. Basel Committee on Banking Supervision (1988) *International Convergence of Capital Measurement and Capital Standards,* Basel: Bank for International Settlements, July 1988

183 Although the text of the Basel Capital Accord acknowledges that there are other forms of risk that banks face it only sought to account for credit risk at this point.

184 Basel Committee on Banking Supervision (1988)

If Basel I was considered a watershed in terms of international regulation – a highly complex and detailed international agreement[185]-- it paled in comparison to what would emerge in the next two decades. Throughout the 1990s, there were a number of amendments made to the original Accord. The amendments in November 1991, July 1994, and April 1995 made changes to the Accord as it was already structured. However, the amendment in 1996 made a more fundamental change, focusing on how banks should also adjust their capital based upon market risk, in addition to credit risk. The 1996 amendment serves as a clear representation of a fundamental expansion in the international governance of banking in the Accord – both what should be governed and what are seen as legitimate methods for governance. It is a moment where the discursive practices around risk management in capital adequacy shifted. The last amendment, made in 1998, resolved certain ambiguities contained in the 1996 Amendment.[186]

However, not long after the last amendment, the BCBS began to look at rewriting the entire Accord. Although it had been extremely successful in expanding in scope, applying to more types of banks from across the globe, complaints remained that it was not effective or efficient for banks or regulators. It was argued that the multiple amendments, although providing more nuance, had dramatically altered the Accord.[187] However, it was still criticized by both regulators and banks. Calls for renegotiation and

[185] Porter, Tony (1993); Wood, Duncan (2005)

[186] This appeared in the document, Basel Committee on Banking Supervision (2005) *Amendment to the Capital Accord to incorporate market risks,* Basel: Bank for International Settlements. (Updated November 2005)

[187] Wood, Duncan (2005), p. 127 -- This view was reinforced in a survey in *The Banker* magazine in 1998, which asserted that the Tier 1 capital held shrunk to an average of 4.48 percent of total assets in the top 1000 banks. According to the 1988 Accord, the absolute minimum that Tier 1 could be was 4 percent. (p. 129)

reformulation of the Basel Accords also asserted that the categories, or risk buckets, created were not sensitive or specific enough. In order to provide the most effective governance for stability and still recognize the role of risk in the future banking industry, the BCBS set about creating a new Accord.

The first attempt at a new capital adequacy framework, introduced in a June 1999 consultative draft, began the long process of attempting to rebuild the Basel Accord to make it more risk sensitive. The Committee sought to retain key elements of the 1988 capital adequacy framework, particularly the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets, the basic structure of the 1996 Market Risk Amendment regarding the treatment of market risk and the definition of eligible capital. However, there were also notable changes including the addition of two pillars, addressing supervision and market discipline respectively, to the Pillar 1 that was based on the original Accord. After receiving more than 200 responses, the Committee set to work on a second consultative draft.[188] Released in 2001, this version fleshed out more of the details that would come to form the Accord we see today. This second consultative package (including the Accord and its supporting documents) was more than 500 pages long. There were a number of differences between the two packages though, most notably the inclusion of more detail on Pillars 2 and 3, increasing the number of risk buckets on corporate exposures, introducing an additional internal model for credit risk and the focus on operational risk in Pillar 1.[189] This second version again

[188] Basel Committee on Banking Supervision (2001b) *The New Basel Capital Accord: an explanatory note*, Basel: Bank for International Settlements, July 2001, p. 1
[189] Wood, Duncan (2005), p. 137

received well over 200 comments and lead to a drafting of a third consultative version in 2003. This draft formed what was to become the final version of the renegotiated Basel Capital Accord (Basel II).

After years of debate among regulators and the banking industry, the new Accord was finally approved at the end of 2004. The *International Convergence of Capital Measurement and Capital Standards, a Revised Framework*, more commonly referred to as Basel II, creates a three-pillar approach for the governance of bank capital.[190] It is meant to apply primarily to internationally active banks although its underlying principles are seen as applicable to banks with varying levels of complexity and sophistication.[191]

Even in this brief history it is clear that the Accord in all its incarnations has been inextricably linked with the discourses of risk and the related performances of risk management. Later in the chapter the relationship will be examined in more detail. However, in the next section we will shift focus briefly to look at some of the other key academic studies of the Accord(s).

Other Studies: explaining the Basel Accord

There have been a number of previous studies assessing the politics of Basel I. The majority of these International Relations analyses tend to take a rationalist approach and focus on interests, power, and leadership. As the brief reviews of some previous studies below show, differing roles are assigned to interests and power of various actors

[190] See Appendix C for a brief chart-based representation of the structure and basic elements of Basel II contrasted with the structure and elements of the first Accord

[191] Basel Committee on Banking Supervision (2001b), p. 2

in the negotiation of the original Accord by these analyses. However, they also tend to address the negotiation of the Accords or whose interests are represented in the final document. There is little to no discussion on the constructive aspects of international banking governance that emerge in the articulation of actors and activities of the Accord itself.[192]

Most of these studies tend to agree that the Basel Accord is an outcome of the interaction between different states seeking to achieve international financial stability while at the same time considering issues of international competition in banking and the need to minimize the competitive implications of the capital requirement. Analyses by Kapstein, Nabors and Oatley, Simmons and Singer emphasize the role of United States in pushing forward the Accord in particular.[193] Looking at the emergence of original Accord, they notes that there was some prior interest in capital adequacy but that when it came to negotiating through the BCBS in the mid 1980s, both the German and Japanese regulators were less than convinced on international capital adequacy standards.[194] These studies assert that there was little direct movement toward a full Accord until the United States, feeling the effects of the debt crisis and the impacts of its federal International Lending Supervision Act (ILSA) of 1983, approached the United Kingdom to create a

[192] There are a number of economic studies on the implications of Basel I and II on all different elements of the banking industry.

[193] Kapstein, Ethan B. (1989, 1991, 1994); Nabors and Oatley (1998); Simmons (2001); Singer (2004). Each of these studies highlights the important role of US power and hegemony although their arguments do have important variations. Key among these is both Kapstein and Simmons highlight the important role of internationalizing financial markets and the competitiveness of national banks in driving the US interests. Nabors and Oatley place more emphasis on the need to negotiate different domestic political factors in their interests. For Singer, domestic interests are still predominant but the interests of regulators are determined by the confidence-competitive framework.

[194] Wood, Duncan (2005), p. 75 The Germans, in particular, had reservations about the potential for harmonization given their universal banking system.

bilateral agreement on capital adequacy requirements. This agreement in 1986, and the subsequent negotiation of a trilateral version with Japan, served as important catalysts for the Basel version of a capital standard. These studies also generally acknowledge the importance of a collective goal of financial system stability that the debt crisis revealed weaknesses in.[195]

Porter picks up this second theme and argues that the creation of Basel I was not primarily about US power, interests, and leadership driving the negotiations but a multilateral effort that is better conceptualized as an international public sector regime in banking. He still acknowledges the role of the US was driven by their interest in controlling their own banks and the international competition they faced. However, more emphasis is placed on the interest in improving capital adequacy standards that can be seen in various non-US G-10 states well before the emergence of the Accord and the emergence of the BCBS's "focus on capital adequacy standards as an effective tool for supervision of international banks" had begun by the end of the 1970s.[196] Some indication of these efforts made by the BCBS prior to the US-UK bilateral agreement is found in the 1985 Annual Report of the BIS. It stated that the committee,

> continued to pay particular attention in 1984 to the capital adequacy of international banks. This work has three principal elements: the construction of a framework of measurement designed to facilitate broad comparisons of capital adequacy standards among different international banks; the monitoring of international efforts to strengthen banks' capital positions and their provisions against risk; and consideration of new

---

[195] The article by Nabors and Oatley explicitly challenges the notions of joint gains which is visible in this functionalist logic of efficiency. They argue instead that the Basel Accord is better understood as 'redistributive cooperation'.

[196] Porter, Tony (2003), p. 62 See: (BSC, 1982:7) Porter also asserts that an additional element to this argument that is often overlooked is the role of the internationalizing banking sector as a whole.

> developments and techniques in the field of off-balance sheet business and their appropriate treatment in assessing capital adequacy.[197]

Moreover, Porter notes that the Accord which emerged looked more like previously existing European standards, making use of risk weighting not the flat rate that the US system used until the mid-1980s. These elements point to the emergence of the Accord as an important part of the growing international banking regime not simply US leadership.[198]

There are also a few studies that highlight interests in the making of the Accords, but focus on the power and influence of business interests and how their interests are represented in the negotiation and final text of the Accords. Wood's 2004 book on the BCBS and the two Accords, probably the most extensive study on the Basel Committee to date, does highlight the importance of US leadership in the creation of the Accord and its ensuing amendments and renegotiations.[199] However, it also integrates a discussion of the role that the powerful US banks played in these processes by influencing national interests and decisions regarding the Accords. Moreover, because of the benefits afforded by a longer study, Wood is able to draw out some of the long term developments in the Basel Accord processes. The key argument that emerges is that the Basel Accords, particularly Basel II, are best understood as examples of regulatory capture by large business interests. He argues that a number of elements and arenas included and excluded from the latter Accord are based on the power of big banks working to achieve

---

[197] Bank for International Settlements (BIS) (1985) *Fifty-fifth Annual Report*, 1 April 1984-31 March 1985, Basle: Author, published: 10th June 1985, p. 163-4
[198] Porter, Tony (1993)
[199] Wood, Duncan (2005)

their interests. For example, it is argued that the inclusion of internal ratings models for credit and operational risk was a concession to the large international banking organizations.[200] Although this explanation expands to the private sector, interests are still the primary frame of reference.

By focusing largely on the interests of the different actors and the strategic interactions between them, these studies tend to overlook the implications of the larger discursive shifts that occurred around the acceptance and articulation of capital adequacy as a technique of governance. The most comprehensive understanding of the role of knowledge in the original Accord is presented by Kapstein. He highlights a role of "consensual knowledge" in connection with US power in furthering Basel I.[201] Consensual knowledge is the name given to the growing awareness of the system-wide risks that emerged as the result of the two main bank failures that lead to the creation of the Basel Committee, Franklin National Bank and Bankhaus Herstatt, and the effects that debt crisis had on many international banks.[202] Yet for Kapstein, consensual knowledge of systemic risk is limited to its role influencing state actor preferences and interests. This conceptualization is a significantly more constrained understanding compared to this study because it does not extend beyond the realm of ideas into an examination of the practices.

The implications of the Basel Accords extend beyond the interests served in its negotiation. This chapter is not particularly interested in the negotiation of the Accords,

---

[200] Wood, Duncan (2005), p. 145. Wood acknowledges that smaller banks in the US were also able to assert some power to influence Congress.

[201] See: Kapstein, Ethan B. (1989) "Resolving the Regulator's Dilemma: International Coordination of Banking Regulations" *International Organization*, Vol. 43, no. 2, Spring, pp. 323-247

[202] Singer, David Andrew (2004). "Capital Rules: The Domestic Politics of International Regulatory Harmonization" *International Organization*, Vol. 58, Summer, p. 550. Also see Kapstein, Ethan B. (1989)

rather in the activities, practices and identities that are articulated within the Accord and its related documents. Pushing beyond a rationalist conception of knowledge as ideas and interests, the rest of the chapter will show how the performances of risk and risk management in the Accord are actually tied to constructions governance and identities. By extending the analysis beyond interests a much more comprehensive understanding of governance in this area can be seen.

This remainder of this chapter will draw out key aspects of the Accord that are constituted through particular understandings of risk and how these aspects serve to legitimize a set of particular micro-practices and identities. First, it will establish how the two macro-discourses of risk are articulated in the Accords and their related documents and standards. Second, focus will be turned to drawing out the connection between the search for precision or accuracy embodied in risk discourses and the increasing sophisticated identification of risks in the Accord. In this section, the expansion of what are 'important' risks for capital adequacy to include market and operational risk (and their related sub-categories of risk) will be examined. Following this discussion, the chapter will look at the performance of governance in the Basel Accords, beginning with the choice of capital adequacy as a method of governance and how its construction serves to place at risk measurement (and management) by the individual bank in a central role in the pursuit of systemic stability and soundness. Although there are strong practical reasons for choosing capital adequacy on a constitutive level, it also serves to construct the identity of banks as the primary risk manager in regulatory concerns. The final section will show how the quest for increased precision in risk measurement in the Basel

Accords has lead to a variety of different practices. It will focus on the four key micropractices legitimated in the Basel Accords: risk buckets, credit rating, internal modeling and operational risk measurement. In each of these practices, some of the important constitutive effects this has on power and identity will be addressed. Through this process, it will draw out how claims about risk measurement and management in the Accord are linked with claims of expert knowledge and have served to legitimize the substantially increased role of private actors in the governance process over time, whether this role was sought or not. It will also show how this is not a case of shifts toward neoliberalizing, purely private governance, but also reconstitutes public regulators in an evolving supervisory role.

Discourses of Risk in the Basel Accord(s)

It is immediately clear that the language of risk in the Accords is dominant as the term appears 84 times in the 30 pages of the original Accord and 1909 times in the 284 pages of Basel II. More importantly it is clear that governance of and through understandings of risk are at the center of the Accord. The 1988 Accord is clearly a political project that emerged in the context of the articulation of risk as danger, particularly systemic risks. The Basel Committee's explanation on the move to develop an international regulatory instrument articulates the international system as a source of risk. In its *History* the BCBS states,

> In the early 1980s, the Committee became concerned that the capital ratios of the main international banks were deteriorating just at the time that

> international risks, notably those vis-à-vis heavily-indebted countries, were growing. Backed by the Group of Ten Governors, the members of the Committee resolved to halt the erosion of capital standards in their banking systems and to work towards greater convergence in the measurement of capital adequacy. This resulted in the emergence of a broad consensus on a weighted approach to the measurement of risk, both on and off the balance sheet.[203]

Moreover, a report by the OECD Committee on Financial Markets Expert Group on Banking in 1985 uses the language of systemic risk explicitly to draw the connections between this the need for banking regulation and the instability of the increasingly global banking market, stating:

> Since the early seventies, greater economic and financial instability and growing interdependence of financial institutions and markets have led to increased vulnerability of banks to systemic risks. It is in this context that the importance of effective supervision has been re-emphasized as a vital element supporting the authorities in phases of crisis management.[204]

In both these instances changes in the international system is the source of risk to banks. Yet even between these two explanations one can see the construction around risk. For the BCBS, the explicit source of this 'risk' was the heavily indebted states in the 1980s. However, in the OECD description the cause is a more general financial instability and the interdependence of financial institutions beginning in the 1970s. Given that the OECD paper was published prior to the creation of Basel I, some variation is not surprising. Yet, each variation could also lead to potentially different regulatory structures. Risk based capital adequacy focused on credit risk does address risks with

---

[203] Basel Committee on Banking Supervision (2004c) *History of the Basel Committee and its Membership.* Basel: BIS. October 2004

[204] OECD (1985) *Trends in Banking in OECD Countries*, Report of the Committee on Financial Markets: Expert Group on Banking, p. 24

default and lending to heavily indebted states. However, if it is increasing overlap between different actors and areas of the financial market, then a primary focus on credit risk measurement, excluding market and other risks, is not as clearly warranted.

However, in both explanations the risks were exacerbated by the tendency of banks not to hold enough capital in reserve. It was this commonly accepted articulation that created the space for 'greater convergence' on the issue of capital adequacy and the creation of the Basel Accord.[205] Moreover, the OECD's explicit link to effective supervision reinforces the idea that governmental (or a recognized self-regulatory organization [SRO]) is a central actor in managing these risks.

The original Basel Accord also reflects a tension between the two key discourses of risk in its objectives.

> Two fundamental objectives lie at the heart of the Committee's work on regulatory convergence. These are, firstly, that the new framework should serve to strengthen the soundness and stability of the international banking system; and, secondly, that the framework should be fair and have a high degree of consistency in its application to banks in different countries with a view to diminishing an existing source of competitive inequality among international banks.[206]

The first objective makes clear links between danger in its references to soundness and stability. However, the second objective, competitive equality between states makes more implicit connections to discourse that risk is an economic necessity. Prior to the creation of the Accord, banks in different national regulatory frameworks were subject to different capital adequacy requirements. This affects the competitiveness of banking organizations as the amount of capital in reserve alters the amount of capital available for

[205] Basel Committee on Banking Supervision (2004c)
[206] Basel Committee on Banking Supervision (1988), p. 1

lending and investment and possibly where they occur. It also alters the efficiency of investment.

The role for risk as economic necessity is even more visible in Basel II. In this updated version, the identification of risk and the methods of risk measurement and management expand and become more complex. This has been explicitly framed in the context of allowing greater efficiency in banking. For example, the Explanatory Note for the 2001 draft version states, "Capital requirements that are more in line with underlying risks will allow banks to manage their businesses more efficiently."[207] This economic gain is attributed to the benefits from increased precision and sensitivity of risk measurement that the new Accord provides. Yet, the committee illuminates the pursuit of greater precision in risk measurement the discourse of risk as danger as well. The Committee's report to the G7/G8 in 2006 echoed the importance of safety and soundness stating,

> The publication in June 2004 of the Basel II Framework represented the outcome of a multi-year effort by the Committee to bring capital adequacy regulations, which are a key underpinning of the safety and soundness of the global banking system, up to date with current business realities and risk management practices.[208]

Therefore, the interaction of addressing and minimizing risk that is a danger while allowing for the 'efficient' taking of risks that are necessary for the market to function and grow is still central in the new Accord. In this regulatory system, the credit and market risks assumed by the bank do not necessarily have to be reduced but more precisely measured and linked with the capital reserves. Figure 5a, a table provided by

---

[207] Basel Committee on Banking Supervision (2001b), p. 2
[208] Basel Committee on Banking Supervision (2006) *Report for the G7 Summit on the activities of the Basel Committee,* June 2006

the BCBS in an Explanatory Note for the 2001 draft of the Accord, highlights the increasing complexity of risk measurement and management.

Figure 5a:
Rationale for a new Accord: need for more flexibility and risk sensitivity

The existing Accord	**The proposed new Accord**
Focus on a single risk measure	More emphasis on banks' own internal methodologies, supervisory review, and market discipline
One size fits all	Flexibility, menu of approaches, incentives for better risk management
Broad brush structure	More risk sensitivity

Source: The New Basel Capital Accord: an explanatory note (January 2001)

This table also gives some general insight into the micropractices and construction of identity that are established in the Accord, including the use of internal modeling, greater risk sensitivity, and supervisory review among others. However, the inherent performance and identity aspects of this construction of risk based capital adequacy will be addressed later in the chapter. The following section will turn to the increasing complexity and specificity in the identification of activities as risks from Basel I to Basel II.

'Identifying' Risks – From Credit to Operational Risk

Since its creation in 1988, the Basel Accord has served to define and constitute capital and risk for regulatory purposes in international banking.[209] Although there are interesting discussions one could have about the construction of capital and the creation of hierarchy between types of capital, for space reasons they will not be discussed here in any more detail. Focusing more explicitly on risk, the increasing breadth and complexity of risk is apparent between the two versions of the Accord. In Basel I, there are references to only six forms of risk, and the focus is clearly on credit risk. Section I, part i) of the original Accord states,

> There are many different kinds of risks against which banks' managements need to guard. For most banks the major risk is *credit risk*, that is to say the risk of counterparty failure, but there are many other kinds of risk - for example, investment risk, interest rate risk, exchange rate risk, concentration risk. The central focus of this framework is credit risk and, as a further aspect of credit risk, country transfer risk.[210]

In acknowledging categories as 'risks' they discursively construct the activities or events within them with the embodied elements discussed in the previous chapter. They become constructed as something that is rationally predictable and the potential for calculation and measurement become more viable options for addressing them. However, it is interesting to see that the original Accord articulates two key variations on risk. First,

[209] First, with the creation of the Basel Capital Accord, shareholders' equity and disclosed reserves are constituted as 'core' capital. According to the BIS, the reason that this type of capital, as opposed to multiple other forms, including other types of reserves, is preferred is that it is "recognized as the highest-quality capital, having a known, and relatively stable, nominal size and being available to absorb losses while a bank continues as a going concern." (Bank for International Settlements (1989) *59th Annual Report, 1 April 1988 – 31 March 1989*, Basle: Bank for International Settlements, p. 90)
[210] Basel Committee on Banking Supervision (July 1988), p. 2

this construction provides an implicit argument that the risk weighting at the center of the Basel Accord is not the most comprehensive risk measurement system. Second, it creates a hierarchy of risks, deeming credit risk the main activity requiring measurement and management through capital adequacy. The other 'risks' discussed are implicitly separated and constructed as not problematic or important enough to for capital adequacy to require measurement.

Instead the "individual supervisory authorities have discretion to build in certain other types of risk" to their national regulations and regulatory regimes.[211] Basel I and Basel II respectively assert,

> It should be stressed that the agreed framework is designed to establish *minimum* levels of capital for internationally active banks. National authorities will be free to adopt arrangements that set higher levels.[212]

> It should be stressed that the revised Framework is designed to establish *minimum* levels of capital for internationally active banks. As under the 1988 Accord, national authorities will be free to adopt arrangements that set higher levels of minimum capital. Moreover, they are free to put in place supplementary measures of capital adequacy for the banking organisations they charter.[213]

This provides an interesting type of agency to the national regulators. They have the ability to create a different arrangement but they still must be aware of the competitive disadvantage in international banking that comes with increased reserve requirements in choosing to adopt a more stringent form of capital adequacy. Yet adding to the capital

[211] Basel Committee on Banking Supervision (1988), p. 8-9
[212] Basel Committee on Banking Supervision (1998) *International Convergence of Capital Measurement and Capital Standards - A revised Framework*, Basel: Bank for International Settlements, July 1988, Updated to April 1998
[213] Basel Committee on Banking Supervision (2005) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework,* Basel: Bank for International Settlements (Updated November 2005), p. 3

reserve requirement can be contradictory to the objective of levelling capital adequacy to prevent competitive inequality. This gives some indication of the relative importance of danger and economic necessity, highlighting the default to addressing risk as danger.

The early amendments to the Accord are best explained as efforts to increase the precision of risk measurement and the accuracy of capital adequacy.[214] The first was in November 1991 and intended to provide greater precision to the definition of those general provisions that could be included in capital in regards to capital adequacy. In July 1994, changes were made to the definition of the risk category of OECD governments to allow for more distinctions in the group for risk weighting purposes. Then in April 1995, the committee made an amendment recognizing the effects of bilateral netting of banks' credit exposures in derivative products and also expanding the matrix of add-on factors.[215]

A more substantial re-articulation occurred in the 1996 and 1998 amendments, which officially introduced market risk into the Accord. In the 1996 Amendment, the BCBS noted,

> The objective in introducing this significant amendment to the Capital Accord is to provide an explicit capital cushion for the price risks to which banks are exposed, particularly those arising from their trading activities. Introducing the discipline that capital requirements impose is seen as an important further step in strengthening the soundness and stability of the international banking system and of financial markets generally.[216]

---

[214] The first amendment in November 1991 was intended to provide greater precision to the definition of those general provisions that could be included in capital in regards to capital adequacy.

[215] Basel Committee on Banking Supervision website - History

[216] Basel Committee on Banking Supervision (1996) *Overview of the Amendment to the Capital Accord to Incorporate Market Risks*, January 1996

The expansion to cover market risks again the discursive links with potential systemic instability were clear. The inclusion of a market risk measurement category is cannot be explained by a claim that they only emerged in the 1990s. In the first draft of the Accord it is already clear that the 'risks' that count for regulation in capital adequacy are constructions that involve normative choices about importance. Although there was an increase in the use of market instruments between 1988 and the 1996 amendment, the use of capital markets by banks existed and was recognized by regulators well prior to the original Accord. In 1985, the OECD reported,

> in recent years banks have begun increasingly to operate concurrently as seekers and providers of funds on the markets for certificates of deposit, repurchase agreements, bank debentures and other securities, guarantee facilities, swaps, financial futures, etc. This trend has been reinforced by the general process of internationalisation of banking and the increasing presence of large international banks in a variety of money, security and currency markets around the world.[217]

Under the category of market risk, the risks of concern in this articulation were "the risks pertaining to *interest rate related instruments* and *equities* in the trading book" and "*foreign exchange risk* and *commodities risk* throughout the bank".[218] The market risk amendment creates measurement methods for interest rate risk, equity price risk, foreign exchange risk, commodities risk and price risk for options. Again the assumption is that in calculating these subsets of risk and combining them, one can articulate an accurate level of market risk for capital adequacy purposes.

---

[217] OECD (1985) *Trends in Banking in OECD Countries*, Report of the Committee on Financial Markets: Expert Group on Banking, p. 26
[218] Basel Committee on Banking Supervision (1996), p. 1

In order to measure these risks and achieve accurate capital adequacy, two broad methodologies, subject to the approval of the national authorities, were developed - a standardised approach or an internal model approach (subject to the fulfillment of seven conditions and approval of the relevant supervisory authority). This latter method "allows banks to use risk measures derived from their own internal risk management models".[219] In legitimizing the use of internal models, the performance of the risk management became more complex, calculative and technical. Although credit risk measurement remained linked with the predefined risk buckets, market risk could be measured creating and using VaR mathematical formulas in internal bank models. Therefore, we see the language of risk, and the need to precisely measure it to manage potential dangers as driving the inclusion of market risk and the related micropractice of VaR internal modeling for governance purposes. In the process, this development legitimized the practice of risk measurement through (1) the process of quantitative modeling and (2) the ability of banks to model these risk internally and use the output as a legitimate foundation in the regulatory system. These practices associated with the inclusion of the technique of internal modeling will be discussed later in the chapter.

In Basel II the performance of risk management becomes even more complex. As with the original accord however, there are references to many other 'categories' of risk. Incorporated in these larger risk categories there are recognition of and/or measurements for: borrower risk, commodity risk, concentration risk, counter party credit risk, currency risk, default risk, dilution risk, documentation risk, equity position risk, force majeure

[219] Basel Committee on Banking Supervision (1996), p. 4

risk, foreign exchange risk, general wrong-way risk, interest rate risk, issuer risk, legal risk, liquidity risk, model risk, political risk, price risk, project risk, reputational risk, residual value risk, roll off risk, rollover risk, seller/servicer risk, specific wrong-way risk, strategic risk, and transaction risk, as well as references to systemic risk and material risk.

The increasingly technical focus of the accord meant that many of these 'risks' are incorporated under one of the three categories of Pillar I in the calculation of capital adequacy. Those risks that are not included in Pillar I are addressed in Pillar II, on supervisory review. In it, the BCBS asserts that,

> [t]here are three main areas that might be particularly suited to treatment under Pillar 2: risks considered under Pillar 1 that are not fully captured by the Pillar 1 process (e.g. credit concentration risk); those factors not taken into account by the Pillar 1 process (e.g. interest rate risk in the banking book, business and strategic risk); and factors external to the bank (e.g. business cycle effects).[220]

However, this placement also implies performance. In Pillar II, measurement and management systems are discussed for some risks. For the remaining sources of risk, the Accord states, "Although the Committee recognises that 'other' risks, such as reputational and strategic risk, are not easily measurable, it expects industry to further develop techniques for managing all aspects of these risks."[221] This constructs the banking industry as responsible for not only risk measurement, and risk management but in this case also innovation in these areas. This role in increasing pressure on banks to improve their ability to measure risks can also be seen in overview of Basel II's third draft in 2003. Here the Committee asserts,

[220] Basel Committee on Banking Supervision (2005), p. 162
[221] Basel Committee on Banking Supervision (2005), p. 166

> An improved capital adequacy framework is intended to foster a strong emphasis on risk management and to encourage ongoing improvements in banks' risk assessment capabilities. The Committee believes this can be accomplished by closely aligning banks' capital requirements with prevailing modern risk management practices, and by ensuring that this emphasis on risk makes its way into supervisory practices and into market discipline through enhanced risk- and capital-related disclosures.[222]

Why have these activities or events been articulated as objects in regulation, accessible to objective measurement and management techniques? In a rationalist explanation these risks are all included because the aggregation of all of these techniques and measurements will eventually lead to an accurate percentage or a number that will be an effective level of capital adequacy for banks. Yet, this explanation is not complete. First, each 'risk' type discussed is not an objective thing but a complex set of performances and practices.

A key development was the shift from focusing on two major categories of risk to three. The Accord places explicit focus on measuring and managing credit risk, market risk and also operational risk in the capital reserve calculation. Operational risk involves the conceptual recognition that losses could occur due to infrastructure, legal liability, business disruption or fraud. For the BCBS, operational risk is defined as "as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational

[222] Basel Committee on Banking Supervision (April 2003b) *Consultative Document: Overview of The New Basel Capital Accord,* Basel: Bank for International Settlements (Issued for comment by 31 July 2003), p. 2

risk".[223] The most commonly identified forms of operational risk involve breakdowns in internal controls and corporate governance, which can cause financial losses due to error, fraud, or failure to perform in a timely manner. Therefore, this development marks the shifting of not only expected but also unexpected events into the process of quantification for regulation. Moreover, operational risk highlights the normative decisions that underpin the identification of risk. Although legal risk is included with the other potential operational losses, strategic and reputational risk are explicitly excluded because they are not easily measureable. This again highlights a normative decision as operational risk measures by in large had not been measured prior to the introduction of a capital charge in the late 1990s during Basel II drafting.

The variation in what is included in operational risk is an important indication of the normative discursive character of risk. The BCBS was not simply identifying existing risks—it was taking a mélange of potential occurrences and conferring different labels on them. The process of labelling did not just involve the appending of a label to something that was already differentiated and visible. Rather the process of labelling was crucial in making reconstituting activities as differentiated and visible risks. As well, the choice of what to label was more driven by the potentially political process of creating mechanisms of control than by pre-existing dangers for which those mechanisms were logically or scientifically suited. In this case the construction of operational risk shifts activities, events and relationships explicitly into the calculation of capital.

[223] Basel Committee on Banking Supervision (2004), *International Convergence of Capital Measurement and Capital Standards: A Revised Framework,* Basel: Bank for International Settlements, June 2004, p. 137

A key claim of this dissertation is that each 'risk' type discussed is not an objective thing but a complex set of performances and practices. With the inclusion of an operational risk measure, it has been argued that the BCBS and Basel II were "not simply changing regulation to conform to well-established industry best practice, as it did in market risk. It [was] attempting to define best practice".[224] As late as the early 1990s, the idea of operational risk was not even that important a focus of the banks and regulators. Their efforts in risk management were focused on credit and market risk modeling.[225] It was only because of the work of the BCBS that a comprehensive industry movement to isolate operational risk as a distinct category of risk emerged in 1999.[226] Yet the inclusion of operational risk marks one of the most important new elements for the Accord in terms of the techniques of governing and the impacts that this process can have on identities. Moreover, the inclusion of operational risk in Pillar I offers an important challenge to claims about the power of market actors in the accord. In the early consultation paper, banks were not pleased with the inclusion of a capital charge for operational risk and lobbied for it to be included in the second pillar of the accord if at all.

Capital adequacy and the constitution of banks in governance

Within the language of the Accords, there are a multitude of identities constructed and activities legitimated and they have important implications for the sector. Some of

[224] Herring, Richard J. (2002) "The Basel 2 Approach to Bank Operational Risk: Regulation on the Wrong Track", *The Journal of Risk Finance*, Fall, p. 43
[225] Shirreff, David (2004) *Dealing with Financial Risk,* Bloomberg Press
[226] Egoavil, Marco (2003) "The intersection of corporate governance and operational risk", *Bank Accounting & Finance*, Vol. 16, no. 5, August, p. 43

these elements are visible in the choice of capital adequacy based regulation instead of other techniques. Capital adequacy requirements are regulations that set a minimum amount of capital, usually based on a set percentage of their assets, which banks must hold in reserve. The use of risk sensitive capital requirements is now largely seen as a central governance technique for the sector and its role in ensuring systemic stability is generally accepted within governmental bodies and the financial sector. Lastra aptly illustrates this conception asserting, "risk-based capital requirements have become the only true internationally accepted standards of bank soundness".[227] In essence, capital adequacy has now been enshrined as the predominant technique of governance. Yet, it is not the only regulatory technique that can be used to achieve systemic protection in banking.

The composition of capital adequacy is a contested technique of governance. Historically the shift toward capital adequacy as a widespread form of governance only emerged in the 1970s. It became a key regulatory technique or practice for banking in concert with an increasingly visible reconstitution of other traditional forms of governance, particularly the lender of last resort or government-sponsored deposit insurance measures. These alternate techniques became prominent during and after the Great Depression of the 1930s. However, they were increasingly being reconstructed as an important potential source of moral hazard, which can increase poor risk management in the system.[228] In a system where banks are in economic competition, the prudential mechanisms like deposit insurance and liquidity support that are intended to address

[227] Lastra, Rosa Maria (2004) "Risk-based capital requirement and their impact upon the banking industry: Basel II and CAD III" *Journal of Financial Regulation and Compliance*, Vol. 12, no. 3, August, pp 225-239

[228] In this case the moral hazard is created because the safety net provided by the deposit-insurance encourages excessively risky behaviour.

danger or threat can become incentives for banks to take on excess levels of risk in order to reap greater financial returns and make themselves more attractive in the marketplace.[229]

The BIS Annual Report in 1989 provides evidence that banking regulators were concerned with this possibility around during Basel I's creation. Addressing government level deposit insurance schemes and liquidity support explicitly, it argued that:

> by partially insulating bank creditors from some of the risks associated with banks' investment decisions, such government activities may tend to interfere with normal market forces. In particular, creditors may become less sensitive to the tendency for a profit-oriented bank to choose high-risk investment projects with the potential for high returns.[230]

First, one can see the problematic relationship that is constructed between risk and governance in these other options. In this case the risk-governance connection through the technique of deposit insurance will not discourage innovation but it will create moral hazard by not disciplining bank's risk exposures directly or even indirectly through market discipline. The BIS concern is with choosing a regulatory mechanism that simply protects and does not discipline the behaviour of banks, that it will cause banks to take more risk in pursuit of profit without altering their behaviour to take the potential costs into account. These costs are transferred to the safety net of the government.

Capital adequacy as it is articulated directly addresses this problem by requiring banks to calculate and retain an effective reserve level based on the type and quantity of risk that they take. Therefore, this technique is a way for the governance to walk the fine line between providing too much protection and encouraging moral hazard and not

[229] King and Sinclair (2003), p. 349
[230] Bank for International Settlements (1989), p. 92

providing enough control to effectively discipline bank investment decisions. In essence it is able to retain the benefits of financial risk taking, that are an economic necessity in banking, but also address the goal of stability and soundness by providing a natural or normal counterweight to excessive risk taking.

Capital adequacy is an acceptable practice of risk management here, not necessarily because it provides more protection than deposit insurance or other methods. Rather, it has the added implication of creating disciplinary power over banks to control their own risk-taking activities better. In focusing on the practice of capital adequacy, the applicable banks are reconstituted as more than the passive subjects of governance and regulatory constraints. Capital adequacy places the reserve burden on the bank encouraging 'sound management behaviour'.[231] These reserves serve as a way of altering the banks' investment decisions to avoid 'excessive' risk taking. Therefore, requiring minimum capital reserves is a technique that should discipline banks to be more responsible. If they do not adequately manage investment and market decisions, the capital that needed for the reserves would create a disadvantage in the market compared to better disciplined banks. At the same point it also works to articulate that the internal decision making processes of banks are key parts of the overall governance process. This is an important element in legitimating and reinforcing their roles as 'self-governing' bodies.[232]

At the same time, capital adequacy also rearticulates the role of the supervisor.

---

[231] Hooks, Linda M. (1994) *Capital, Asset Risk and Bank Failure*, Group of Thirty Occasional Paper no. 47, Washington, DC: Group of Thirty

[232] The term self-governing is not the same as self-regulatory. This distinction will be laid out more fully later in the chapter.

From an interest-based perspective it is noted that capital adequacy is a method of governance that "significantly shift[s] the administrative burden of ensuring that banks are run prudently from supervisory authorities to banks and their shareholders".[233] In doing so it at least partially replaces the more costly tools of supervision like detailed individual monitoring with oversight of self-governance.[234] However, in replacing those costly tools, the articulation of the role of a regulatory also shifts. The supervisor becomes an entity that achieves its mandate through the monitoring to ensure that banks are meeting preset standards than the more comprehensive form of supervision that it is implied occurred before.[235] Throughout the Accord there are multiple references to the supervisor in this context. For example, credit risk measurement explicitly states, "The alternative methodology, which is subject to the explicit approval of the bank's supervisor, would allow banks to use their internal rating systems for credit risk."[236] In the more sophisticated internal modeling structures, in particular, the primarily focus on the role of assessment of models and ensuring compliance.

This is not to argue that the national supervisor has no role in governance, they are central to the supervisory review process in Pillar II of Basel II, which focuses on oversight and the management of risks not included in the calculations of Pillar I. Throughout the discussion of the various micro-practices one can easily see that the increasing reliance on private sector elements in governance has not been traditional free

[233] Porter, Tony (2003), p. 62
[234] Ibid
[235] This shift does not imply that the regulator does not supervise individual banks. Within Pillar II of the Accord good practices of supervision are elaborated which include monitoring the overall financial health of the organization through combinations of periodic reporting requirements and the evaluation of external auditors, on site inspections, off site discussions and meetings.
[236] Basel Committee on Banking Supervision (2005), p. 15

market neoliberalism. Supervisors still maintain some key power and control, primarily the ability to examine, authorize and legitimize.

Finally, the Accords formalize capital adequacy as the primary legitimate form of governance for banks. Yet, this is also a construction, not necessarily an apolitical choice. The claim that capital adequacy is a superior form of governance is not uncontested. In a 2006 book, Barth, Caprio Jr. and Levine argue that capital adequacy standards actually reduce the economic performance of banks and the overall financial system.[237] After an extensive empirical study of the impact of banking regulations around the world, they argue that governments should actually be encouraging less active regulation and more market discipline. Their analysis highlights the tension between risk as economic necessity and risk as danger. This inherent tension between risk as required effective protection but being required for effective economic growth has created a discussion of the appropriate level of capital adequacy structures, which continues in the shift to and throughout the new Accord. In the final section, four of the key practices of capital adequacy laid out in the Accords are examined.

Performances and Identity in Risk-Based Capital Adequacy

From their inception, the Basel Accords have been inextricably discursively linked with risk and the practices/techniques of risk weighting. Just like capital adequacy in general, the idea that capital held in reserve could be determined through risk

[237] Barth, James R., Gerard Caprio Jr. and Ross Levine, *Rethinking Bank Regulation: Till Angels Govern,* Cambridge: Cambridge University Press, 2006

weighting assets was not universally accepted prior to the inception of capital adequacy regulations. For example, through the early 1980s the United States constructed capital adequacy rules around a fixed, or static, measurement system -- $5.50 for every $100 in assets – and only applied it on-balance sheet assets. It was not until 1986 that the technique of risk weighting was put into practice in the US even though other regulators, particularly Belgium, France and the United Kingdom, shifted to measuring capital through risk weighting before this.[238] As we turn to the practices articulated in the Accords it becomes clear how they formalize and solidify particular notions of risk management and measurement through this performance of risk weighting. The aim is to make the capital adequacy requirement as efficient as possible. Yet risk weighting also constructs or reflects ideas about various actors and entities at the same time. For example, financial actors and market activities are divided and ranked based on their perceived credit worthiness. In the process, certain choices are made more attractive to banks, while others are not. In this sense, the performance of risk weighting can also have an impact in disciplining the actual financial market, not just reflecting its structure in order to reduce the 'risk' to it.

Therefore, the importance of risk discourse extends beyond its power as a framing device – the idea that financial governance must address 'risk'. Under the search for risk management and measurement there are multiple activities and identities constituted. While there is not space to examine all of them here, four key practices and their related performances will be discussed below. The following sections will look at the use of

[238] Ibid

three different techniques for risk weighting: risk buckets, credit rating, and internal modeling, as well as some of the overarching performances of operational risk management. While these may initially seem like technical or mundane details of regulation, their important implications for identities and relations within the financial sector will be revealed.

Risk Buckets

Basel I formalized the notion that capital should be risk weighted asserting,

> The Committee considers that a weighted risk ratio in which capital is related to different categories of asset or off-balance-sheet exposure, weighted according to broad categories of relative riskiness, is the preferred method for assessing the capital adequacy of banks. This is not to say that other methods of capital measurement are not also useful, but they are considered by the Committee to be supplementary to the risk-weight approach.[239]

In this statement, Basel I clearly constructs credit risk most effectively measured using the technique of risk weighting. Moreover, it legitimates the use of 'broad categories of relative riskiness' otherwise known as risk buckets. Throughout Basel I there were 5 different risk buckets weighted at 0, 10, 20, 50, 100 percent respectively.[240] The first risk

[239] Basel Committee on Banking Supervision (1988), p. 7

[240] **0%** (a) Cash; (b) Claims on central governments and central banks denominated in national currency and funded in that currency; (c) Other claims on OECD central governments and central banks; (d) Claims collateralised by cash of OECD central-government securities3 or guaranteed by OECD central governments, government, and loans guaranteed by such entities - **20%** (a) Claims on multilateral development banks (IBRD, IADB, AsDB, AfDB, EIB) and claims guaranteed by, or collateralised by securities issued by such banks; (b) Claims on banks incorporated in the OECD and loans guaranteed by OECD incorporated banks; (c) Claims on banks incorporated in countries outside the OECD with a residual maturity of up to one year and loans with a residual maturity of up to one year guaranteed by banks incorporated in countries outside the OECD; (d) Claims on non-domestic OECD public-sector entities, excluding central government, and loans guaranteed4 by such entities; (e) Cash items in process of

bucket contained liabilities to OECD member state governments (and other foreign states when lending in specific circumstances). It was articulated as follows,

> Claims on central governments within the OECD will attract a zero weight (or a low weight if the national supervisory authority elects to incorporate interest rate risk); and claims on OECD non-central government public-sector entities will attract a low weight (see (iii) below). Claims on central governments and central banks outside the OECD will also attract a zero weight (or a low weight if the national supervisory authority elects to incorporate interest rate risk), provided such claims are denominated in the national currency and funded by liabilities in the same currency. This reflects the absence of risks relating to the availability and transfer of foreign exchange on such claims.[241]

On the other hand, all corporate exposures were placed in a different risk bucket and were given a risk weight of 100 percent with most other exposures falling in one of the middle buckets. A discursive analysis allows one to question these risk buckets, particularly as they are not apolitical or natural. Who and what is constructed implicitly in these categories? These buckets reflect a political and normative stance on what actors were considered good investments and which were not. For example, after the original Accord was put into place, some generalized questions were asked about the 100% risk weighting given to all corporate entities, as it is arguable some corporations are actually better 'risks' than some governmental bodies. Even if one rejects this comparison, not all corporate entities are the same. The constructed nature of the categories was made

---

collection - **50%** (a) Loans fully secured by mortgage on residential property that is or will be occupied by the borrower or that is rented - **100%** (a) Claims on the private sector; (b) Claims on banks incorporated outside the OECD with a residual maturity of over one year; (c) Claims on central governments outside the OECD (unless denominated in national currency - and funded in that currency - see above); (d) Claims on commercial companies owned by the public sector; (e) Premises, plant and equipment and other fixed assets; (f) Real estate and other investments (including non-consolidated investment participations in other companies); (g) Capital instruments issued by other banks (unless deducted from capital); (h) all other assets - **0, 10, 20 or 50%(at national discretion):** Claims on domestic public-sector entities, excluding central banks

[241] Basel Committee on Banking Supervision (1988), p. 10

apparent in the 1994 amendment to the Accord. One change in this document was in footnote 2 of Annex 2. It was altered to state,

> For the purpose of this exercise, the OECD group comprises countries which are full members of the OECD (or which have concluded special lending arrangements with the IMF associated with the Fund's General Arrangements to Borrow)**, but excludes any country within this group which has rescheduled its external sovereign debt in the previous five years.**[242]

This alteration to what qualified for the OECD group limited its membership to only include some OECD governments in the 0 percent risk weight it received. More specifically, it explicitly removed Mexico, South Korea and Turkey who had become OECD members in the early 1990s.[243] The limitation based on the five years without re-scheduling its external sovereign debt was not simply recognition of these entries but a clear normative statement on what an OECD government was perceived to be.

The impact of the risk buckets is not limited to the regulatory process. They can alter the economic practices of banks as well. The BIS acknowledged this impact when it argued that "the new system of risk asset weights [was] indeed likely to have a significant impact on banks' portfolio decisions".[244] First, this highlights a recognition that the decision to measure credit risk but investment risk in capital adequacy increased the costs of lending for banks. Some analysts also argue that this additional cost to lending partially drove banks toward greater securitization. In order to achieve economic growth banks now increased their movement into fee-based instruments and securities and away

[242] Basel Committee on Banking Supervision (1994) *Amendment to the Capital Accord of July 1988*, p. 1 emphasis in the original.
[243] Wood, Duncan (2005), p. 125
[244] Bank for International Settlements (1989), p. 93

from its traditional role in financial intermediation.[245] Interestingly enough, it is the role of banks in securities markets that is the next addition to the calculation of capital adequacy. The market risk amendment in 1996 was intended to officially address the risk that came from this practice of banks.[246]

Moreover, the original process of risk weighting clearly makes some investments more attractive in the context of capital reserves than others. Therefore, risk buckets, while providing greater precision than a preset weight for all forms of investment and lending, are not neutral. Like the labels for types of risk, these risk buckets were not independent observable categories that existed in markets waiting to be discovered by the BCBS. In fact, the committee acknowledged "that the risk buckets can be rather "broad-brush judgements" which are not intended as a substituted for calculating risk in market pricing.[247] Implied within the market pricing comment is the notion that what are perceived as the actual risks of specific lending is not necessarily perfectly mapped with these risk buckets. Rather the BCBS established these categories discursively.

Basel II introduced increasing complexity in risk measurement in an attempt to more precisely capture the risk of entities that was lost in the simpler risk buckets. Although forms of risk buckets (or more accurately risk categories) are used in the standardized approaches to credit risk and to market risk, these are more nuanced and utilize credit rating to determine risk weights within different groups rather then the five risk buckets that were the basis of Basel I. These methods arguably provide more

[245] Wood, Duncan (2005), p. 90
[246] The effectiveness of this amendment should not be overstated. As the current financial crisis highlights, banks have still been able to avoid capital adequacy standards on securitized assets by creating off-balance sheet vehicles.
[247] Basel Committee on Banking Supervision (1988), p. 8

precision for banks unwilling or unable to use internal models. The practice of credit rating in the Accord is the focus on the next section.

Official governance through Credit Rating

A second performance of risk management articulated in Basel II is credit rating. The ability of banks to use this technique at the basis of the risk calculations is at the center of the standardized approach to credit risk in Pillar I of the new Accord. The use of these ratings are deemed an important way to increase the sensitivity of the capital adequacy required which will allow for what is argued to be more precise measurements of risk. Credit ratings are essentially constructed as tools to differentiate the credit quality of an organization. For example, Standard and Poor's defines ratings as opinions on the general creditworthiness of an obligor, a particular debt security or other financial obligations.[248] The higher the rating received (up to AAA) the more sound and reliable (implying the less risky) the institution is assessed to be. These ratings are assessed by credit rating agencies, bodies constructed as having the required expertise, information and access to reduce an organization into a single number/symbol.

Credit rating is the most developed in the United States, however, the influence of these ratings can be seen in both the public and the private governance practices around banking. The first agencies emerged in the 19th century as the demand for 'private information provision' in US financial markets grew considerably between 1850 and

[248] Lastra, Rose Marie (2004)

World War I.[249] The governmental use of ratings is also not particularly new. Again it has been used in regulation in the United States for more the 70 years.[250] Basel II marks a shift in the acceptance of this technology in international regulation by explicitly including it in the standardized approach to measuring credit risk. Some of the justification for utilizing this technique is made in a study by the BCBS in 2000, which found that ratings were included in regulations of 11 out of 12 BCBS countries, the exception being Germany.[251]

With its inclusion into the Accord, this practice of credit rating is reinforced as a useful and accurate way to measure 'risk' with the additional state delegated power.[252] Turning to Basel II specifically, Figure 5b below highlights how the credit ratings work in two of the most commonly identified risk categories. Under Basel I, sovereign governments were risk weighted at 0 percent for OECD states and 100 percent for non-OECD central governments ("unless denominated in national currency - and funded in that currency" which receives a weight of 0 percent).[253] All corporate lending was given a single weight of 100 percent. Under Basel II, there is more variation within the weights.

---

[249] King, Michael R. and Timothy J. Sinclair (2003), p. 346

[250] Basel Committee on Banking Supervision (2000) *Credit Ratings and Complementary Sources of Credit Quality Information.* Basel Committee on Banking Supervision Working Paper No. 3. August. Basel: Bank for International Settlements.

[251] Basel Committee on Banking Supervision (2000)

[252] The applicably and accuracy of ratings is not without question. There are a number of concerns that have emerged over the years which bring this claim into question. Key among these is the argument that credit rating agencies may actually reinforce systemic instability because ratings tend to be pro-cyclical. The problems with credit ratings around mortgage-backed securities in the recent financial crisis are a further example that these assessments can inaccurate and sticky. (King, Michael R. and Timothy J. Sinclair (2003); International Monetary Fund) (1999). *International Capital Markets: Developments, Prospects, and Key Policy Issues.* Washington, DC: IMF.)

[253] Basel Committee on Banking Supervision (1988), p. 18

Figure 5b
Risk Weighting in the Standardized Approach to Credit Risk
(only sovereign and corporate rates)

	External Credit Assessment / Risk Weight					
Claims on sovereigns	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to B-**	**Below B-**	**Unrated**
	0%	20%	50%	100%	150%	100%
Claims on corporates	**AAA to AA-**	**A+ to A-**	**BBB+ to BB-**		**Below BB-**	**Unrated**
	20%	50%	100%		150%	100%[1]

Yet, within these categories the important role of credit rating in defining not just revealing risk can be seen. First, it is interesting that it is better in terms of capital adequacy to be an unrated organization than a poorly rated one. Second, although there is a shift in recognizing that not all corporate entities present the same credit risk, sovereign lending is still given a capital adequacy advantage. There is nothing inherently wrong with these structures but it is worthwhile to highlight the normative hierarchies that are constructed in the process. Ratings are also not neutral, technical measurements of risk. As Deuchars assets,

> Sovereign credit rating, for example, is a form of representing a country, often as a single figure, or say a rating such as Ba1, making comparison with other countries appear objective and straightforward. It is a way of mapping perceptions of risk as an on-going process and tends to obscure the ideological and contested nature of this form of representation. The in exactitude of risk mapping in this way also tends to be downplayed.[254]

For example, one of the concerns about the normative nature of risk assessment in credit rating within Basel II can be seen in the World Bank response to the Consultative Draft 3

[254] Deuchars, Robert (2004), pp. 68-9

in 2003. This international organization argues, "the current risk weights as largely defined on the basis of evidence from G10 countries which may offer very different levels of protection in emerging economies."[255] Since Basel II is explicitly intended to apply to all states eventually, this variation may prove problematic in the future.[256]

Furthermore, this seemly technical shift in the measurement of risk also has implications for identities. In particular, this technique of risk management reaffirms the identity of credit rating agencies as 'expert' in the calculation and measurement of default risks. In a number of previous studies, Sinclair has convincingly argued that credit rating agencies have achieved their authority in the market because of their ability to lay claim to the expert knowledge that the practice of credit rating provides.[257] This is because of the market and governmental recognition for their ability to accurately simplify complex economic actors into a single risk rating. This creates a source of power and authority of voice for the credit rating agencies, particularly the three main international bodies – Moody's Investor Service, Standard and Poor's and Fitch. It is worth noting that Basel II actually grants authority to the technique of credit rating, not the main rating agencies. Instead governments must approve acceptable external credit assessment institutions (ECAI), ensuring they satisfy six criteria: objectivity,

---

[255] World Bank (2003) Response Letter to BCBS on the Third Consultative Paper of the New Basel Capital Accord, July 24, 2003 <http://www.bis.org/bcbs/cp3/worlbank.pdf>

[256] Basel II states, "This document is being circulated to supervisory authorities worldwide with a view to encouraging them to consider adopting this revised Framework at such time as they believe is consistent with their broader supervisory priorities." (Basel Committee on Banking Supervision (2005), p. 1)

[257] Sinclair, Timothy J. (1994) "Passing Judgement: Credit Rating Processes as Regulatory Mechanisms of Governance in the Emerging World Order." *Review of International Political Economy*, Vol. 1, no. 1, Spring, pp. 133-159; Sinclair, Timothy J. (2003)"Global Monitor: Bond Rating Agencies." *New Political Economy*. Vol. 8, no.1, March, pp. 147-161; Sinclair, Timothy J. (2005) *The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness*, Ithaca, N.Y.: Cornell University Press

independence, international access/transparency, disclosure, adequate resources and credibility.[258] However, even though Basel explicitly does not identify which credit rating agencies should be used by national supervisors, the role of Standard and Poors, Moody's and other similar organization is increased in the aggregate.[259] In essence, through Basel II the power of these agencies to discipline financial market participants in search of a good rating is used to supplement governance while the ECAI's authority is reinforced by recognition from the state regulatory system. Although the inclusion in the governance process marks the increasing role of private governance in the regulatory system, it is in the context of a complex interplay of self-reinforcing public-private relationship.

Due to the additional power and legitimacy given to credit rating agencies, some may argue that this is simply another case of market capture. However, this situation is substantially more complex given that a role in formal regulation is not something that the major rating agencies have sought. In fact, the two major international credit rating agencies attempted to dissuade the BCBS from including their products in the measurement of risk for capital adequacy. In particular, both Moody's and Standard and Poor's have expressed a fear that banks and other organizations will begin ratings shopping and the potential role of governmental and other influence on the objectivity of ratings.[260]

---

258 Basel Committee on Banking Supervision (2005), p. 23-4

259 Interestingly the credit ratings in the Accord itself are listed in Standard and Poor's format. There is a footnote highlighting that this is not meant to encourage or preference this corporate structure but it is interesting.

260 Moody's Investor Services (2001) "Comment on the Second Consultative Package of the New Basel Capital Accord", May 30, 2001, <http://www.bis.org/bcbs/ca/mooinvser.pdf>; Standard and Poor's (2001) "Standard and Poor's Response to The New Basel Capital Accord", New York: Standard & Poor's

The Increasing Presence of Internal Modeling

The search for precision in the pursuit of both stability and economic efficiency has also legitimized the third form of risk measurement, the introduction of internal risk modeling. Internal modeling in the Accord actually emerges with the 1996 and 1998 amendments adding market risk, which laid out qualitative standards that allowed banks to base their capital requirements for market risk on the results of internal calculations.[261] More specifically, these models were to measure market risks arising from banks' open positions in foreign exchange, traded debt securities, equities, commodities and options. It also tentatively accepted the idea of using a bank's own internal risk model as an evaluation of specific risk.[262] In arguably the clearest statement on the rationale of accepting internal risk modeling for market risk, the BCBS states,

> The Committee notes that the use of proprietary in-house models to measure market risk for supervisory capital purposes represents a *significant innovation* in supervisory methods. Moreover, many internationally active banks are themselves in the process of gaining experience with the use of risk measurement and management techniques based on the value-at-risk approach. In order to gain additional information and comfort with the results produced by internal models, supervisory authorities reserve the right to require banks wishing to use internal models to perform testing exercises and to provide any other information necessary to check the validity of banks' models. All banks that wish to use models should therefore have the capability to evaluate a test portfolio.[263]

[261] Felsenfeld, Carl and Genci Bilali (2004) highlight that the principal goal of 1998 amendment was to confirm that a bank could use its own internal model to estimate both market risk and specific risk.
[262] Bank for International Settlements website (http://www.bis.org); Felsenfeld, Carl and Genci Bilali (2004)
[263] Basel Committee on Banking Supervision (1996), p. 6-7

There are three key elements of risk that are made visible. First, the committee draws on the idea of 'innovation' in supervision. It implicitly highlights how the power and performance of internal modeling marks a dramatic departure from the preset risk weights of Basel I. In this case, there is a reliance on modeling through a VaR approach, making the calculative process for risk significantly more complex than the building block type approach used previously. Moreover, the role of individual banks in calculating risk is increased in that they do not apply a preset measurement process but are able to develop and fine tune their own process. At the time these were relatively new approaches to the measurement of capital. In addition to the shift toward modeling, the Committee also expressed a desire for this approach to be developed and improved by the banking sector.[264] These two aspects combined provide evidence of the belief that banks possess sufficient expert knowledge to more accurately measure risk. The second element that is related to the use of modeling is the continued role for the supervisory body. Again this highlights that the inclusion of internal modeling is not a clear shift toward pure private governing techniques. Instead there is this complex interplay between public and private, where the regulator shifts to examining the process of risk measurement and management not necessarily the risks of the bank directly.

By Basel II, there is the explicit preference toward internal bank modeling of risk. At the advanced levels (the Internal Ratings-Based Approach [Advanced] for credit risk and the Advanced Measurement Approaches for operational risk) of Pillar I in the Accord, banks are now allowed in principle to use their own internally developed risk

[264] Bank for International Settlements website (http://www.bis.org); Felsenfeld, Carl and Genci Bilali (2004)

measurement models. This role is legitimized based on an argument that banks are better able to accurately capture their own risk exposure and adjust their capital adequacy reserve accordingly[265] - i.e. they possess more expert knowledge to build the model accurately for their organization. As with market risk, it is important to realize that the relevant supervisors must approve these models before they can be used but each model is developed and implemented within the bank itself. Unsurprisingly, the expansion of internal modeling into all three areas of risk-based capital adequacy calculation also expands on the 'self-governance' elements of capital adequacy. Now the role of banks in governing risk is not simply in their investment choices between externally risk weighted positions but to also set what those weights should be (in consultation with their national regulator).

With the inclusion of different measurement techniques the Accord recognizes and formalizes distinctions between individual banks. Large banks are constituted as sophisticated enough to undertake their own risk measurement, while other banks are still responsible for risk management but risk measurement is done through pre-made basic or standardized approaches. In fact, the Accord explicitly encourages large banks to adopt the Advanced Measurement Approach to operational risk in stating,

> Internationally active banks and banks with significant operational risk exposures (for example, specialised processing banks) are expected to use an approach that is more sophisticated than the Basic Indicator Approach and that is appropriate for the risk profile of the institution.[266]

[265] Power, Michael. (2003) "The Invention of Operational Risk." *CARR Discussion Paper Series* Centre for the Analysis of Risk and Regulation, LSE DP16; Power, Michael (2005) "The invention of operational risk" *Review of International Political Economy,* Vol. 12, no. 4, pp. 577-599

[266] Basel Committee on Banking Supervision (2005), p. 140

This is not to argue that the public element of banking regulation is unimportant. Supervision by public authorities is, at least in writing, maintained.[267] Even if a bank chooses to utilize an internal measurement model. it is important to remember that they can only do so under certain conditions and the model itself must be approved by the relevant government regulator. Furthermore, Pillar 2 of Basel II specifically deals with the issue of supervisory review of both a bank's internal assessment process and its capital adequacy, in addition to creating a set of standards to advance consistent treatment across jurisdictions. What cannot be known yet is if this evaluation leaves sufficient space to question the purpose, role and broad assumptions of these internal models or will end up focusing on whether the details of the models in use are effective and accurate measurement tools. Although there is a continued role for regulators and supervisors, the use of internal modeling shifts their identity and roles. In some ways, it must be more complicated as they are expected to assess the bank's ability to appropriately measure exposure to risks through the qualifying conditions necessary to use internal modeling. Compared to the standardized or basic approach, this will require more expertise from the regulator to adequately examine and assess the adequacy of the internal model.

As discussed earlier in the chapter, the idea of operational risk and its inclusion in the Accord marks an area where what is identified as a risk and how it can be measured is still undecided. Therefore, the inclusion of internal modeling was not a reflection of adapting to existing understandings of risk and technical decision making.

---

[267] According to the Basel Committee the supervisory system should contain a mixture of offsite and on-site inspection, periodic reporting, and discussions with senior management and the board of directors. [Basel Committee on Banking Supervision (July 2004), p. 4]

Unsurprisingly, it did not go uncontested. Much of the debate around internal modeling addresses concerns about its self-regulatory aspect using the frame of risk as an essential part of corporate financial and economic growth as its basis. Many of the complaints are, implicitly or explicitly based on the belief that in the competitive financial world, holding as little a capital reserve as possible is key to profit and even survival for banks. Therefore, the potential of internal risk assessment models to lower reserve requirements is the political core of the debates over a new Accord. It has been argued elsewhere that this hazard could be improved by cultivating self-interest among banks in ensuring there was a capital reserve appropriate for risk exposures.[268]

Others have expressed a more fundamental concern about the ability of quantitative modeling to actually measure risk. This can be seen in the Accord itself in that even in Pillar I (which is clearly the quantitative section) there has been a recognition by some in the field that these quantitative measures need to be augmented with judgment and experience in order to work prudently. However, even when arguments are made regarding the need to supplement financial science, it can be very difficult to ascertain whether this is simply sought to enhance the quality of the quantitative risk management measures. The connections made between modeling and regulation are particularly important if one believes "minimum supervisory requirements only make sense in a world where financial risk is *statistically deterministic*", in essence that it can be modeled as a

[268] Power, Michael (2003); Power, Michael (2005)

predictable phenomenon.[269] The current financial crisis has shown that the models built, based on previous experience, were ineffective in measuring the threat in the system.

Inclusion of internal modeling, in pursuit of more precise risk measurement, has lead to another increase in the private sector performance of public governance. The final category discussed in this chapter is the performance of operational risk.

Performing Operational Risk

This discussion of operational risk that started earlier in this chapter leads nicely into a final substantive section on performing regulation. Interestingly the reconstitution of some activities as risk, specifically operational risk that was controversial for the banking community, provides one of the most visible signs of the constitutive impact regulations can have. As Power notes in his earlier study of Basel II and operational risk, "the discursive character of regulation is most visible in instances of regulatory innovation".[270] This is very clear in the concept of 'operational risk' as its inclusion is very telling about the identification, measurement, and management that the discourse of risk seems to encourage.

First, operational 'risk' as part of the Accord clearly rearticulates activities within and beyond the individual bank because operational risks involve constructing internal management decisions and other unforeseen events as unexpected *losses*. This link rearticulates events from fraud to computer failure to employee mistake into calculative

[269] Izquierdo, A. Javier (2001) 'Reliability at risk: the supervision of financial models as a case study for reflexive economic sociology', *European Societies* Vol. 3, Iss. 1, pp. 69–90.
[270] Power, Michael (2003), p. 578

rationality by attempting to measure their impact and mitigate it. In essence, the framework for operational risk measurement and management highlights an intrinsic belief that losses due to failures in this area are not simply random but have some form of probability. As Bielski explains,

> If you believe loss is random, then it requires self-assessments from which you create indicators. You use these to help you steer your organization and figure out reserve amounts. If you believe even 'random seeming' events have probability, however strange those curves look, then you can use mathematical techniques to normalize them and this provides guidance on reserve amounts.[271]

Given the focus on modeling and datasets of loss distributions to assess even expected losses due to operational risk under Basel II the latter conception is predominant. For example, under the Advanced Measurement Approach, when evaluating business environment and internal control factors the

> choice of each factor needs to be justified as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas. Whenever possible, the factors should be translatable into quantitative measures that lend themselves to verification.[272]

This statement fits not only with the trends of calculation and rational foresight that are part of the discourse of risk writ large. It is also useful in highlighting a conditions of possibility from Chapter 4, the focus on calculability and measurement. In addition it makes another reference to the idea the banks possess the appropriate expert knowledge to identify and measure risk.

---

[271] Bielski, Lauren (2003) "Getting a framework", *ABA Banking Journal*, FEATURES: Special Section- Operational Risk Measurement, November, pp. 55

[272] Basel Committee on Banking Supervision (June 2004), p. 147

Furthermore, we saw earlier in this chapter that the constructed nature of this category was highlighted. There has been a consistent problem with defining what is included in the term operational risk. Over the course of the negotiations some types of risk – such as systemic, strategic and reputation risks – have been excluded from the Basel definition of operational risks, while other types of risk, such as legal risk and fraud, are included.[273] Yet, in the end, one could argue that operations risk is simply a catch-all for adverse outcomes.[274] Some of these are likely immeasurable (like a natural disaster or terrorist attack), others involve more than simple quantification (like systems failure, fraud). As an outcome of this quandary, it becomes clear that quantifying operations risk will actually require a combination of both objective and subjective tools even though current practice significantly preferences the latter.[275]

This relationship between objective and subjective elements creates an interesting dilemma for the management process for operational risk. As many of the activities now conceived of as operational risk are fundamental to doing business, regulations on this 'risk' cannot ever fully eliminate it. Instead, the common interest is to identify, measure, monitor and control such risks.[276] In many ways, operational risk appears to have substantial overlaps with activities, identities and practices that are usually governed from within the frame of corporate governance. Yet there are key differences in how one seeks

[273] Alexander, Carol (2003) Operational *Risk: Regulation, Analysis and Management,* Financial Times Prentice Hall (1st edition), p. xxii
[274] These can range from losses due simple human error to fraud, to simple stupidity, a technological change and even acts of God.
[275] Matz, Leonard (2005) "Measuring operations risk: are we taxiing down the wrong runways?", *Bank Accounting & Finance,* Vol. 18, no. 2, February, p. 3
[276] Nash, Ralph (2003) "The three pillars of operational risk" in Alexander, Carol (ed.) *Operational Risk: Regulation Analysis and Management*, Toronto: Prentice Hall Finance Times, pp. 3-13

to deal with individuals and activities in operational risk as opposed to corporate governance. The latter are included in the risk management systems that are reviewed but the former seeks to quantify losses that may occur from a whole host of activities.

Outside of the Basel Accord, the BCBS has created a corporate governance standard which addresses many of the same activities that are included under operational risk, including fraud and error.[277] However, the techniques in corporate governance are more qualitative and not substantially linked to exact measurement tools. The focus of these corporate governance documents largely does not address risk measurement and management, and definitely not in the specific way of the Basel Accords. Instead, the discursive frame of reference is on elements of largely qualitative governance processes – like conflict of interest and board oversight. These are covered under the supervisory review (Pillar II) of the Basel Accord, but are also tied to the process of quantification for the operational risk weight in capital adequacy.

A shift from the discourse of corporate governance to operational risk is more than simply a shift in language. It reframes the practices and processes with all other governance techniques. Failures in corporate governance become part of economic loss measurements, which provide the input into a quantitative measure of capital required to cover operational risk in the advanced method. The shift of these activities from a frame of corporate governance to one of operational risk has not been uncontested.[278] However,

[277] Basel Committee on Banking Supervision (2006) *Enhancing corporate governance for banking organizations*, Basel: Bank for International Settlements
[278] Both the articles by Richard J. Herring (2002) and Rose Maria Lastra (2004) focus on this dissent and its sources.

the overarching process is one that seeks to come up with a model and assign values to these different activities in order to capture a value for the potential loss they can pose.

Under a frame of operational risk, data collection becomes crucial to the measurement and mitigation of operational risk. It is at this point that "'dangers' become 'risks' capable of being located in the logic of managerial decisions making… and in a business/management model which supports routine data collection".[279] In looking at both credit and operational risk, the proper functioning of Basel II requires individualized data as institutions are expected to make their decisions based on their rigorous analysis of historical data. Joe Sabatini, Managing Director and Global Head of Operational Risk at J.P. Morgan Chase highlights this when he argues, "As soon as you introduce a risk-based approach, by definition you're going to be more granular and the data capture demands are going to be higher." Although in some cases this data has been collected in banks for years, it likely was not in one central location and may or may not lend itself to the kind of quantified analysis in Basel II easily.[280] Yet Basel II, as Syer argues, is explicit about all relevant data used for operational risk analyses (including interval data, relevant external data, scenario analysis and factors reflecting the business environment and internal control systems). He notes, however, that there seems to be a certain amount of faith (not totally justified in his mind) that some "unspecified combination of this data can be used to capture potentially severe 'tail' loss events."[281] This has lead to an increasing level of attention given in the last five years to the development of operational

[279] Power, Michael (2003), p. 9. Also see Power, Michael (2005) for a discussion of the same point.
[280] Milligan, Jack (2004) "Who will choose Basel II?" *ABA Banking Journal*, Capital Risk Management Section, November, p. 61
[281] Syer, David (2003) "Dealing with Basel II: operation risk - encouraging best practice", *Balance Sheet*, Vol. 11, no. 4, pp. 24-5

risk databases and modeling systems within large banks and by financial technology firms.

Moreover, operational risk does not simply require banks to quantify their activities into possible losses. The focus on operational risk also seems to change the discursive frame of reference from one of governance within the corporation, i.e. the performances of its different employees and directors, to one of risk management and mitigation. Power maintains that "categories such as 'operational risk' play this role in a regulatory visioning process, providing tentative maps for the reordering of practice and new languages and ideas for change agents at the organizational level". Turning to identities of individuals, the requirement that banks formally identify, measure and manage their operational risk encourages important identity shifts for some involved in the sector. As Power highlights, the questions 'What is operational risk?' cannot be separated from 'Who is reinventing themselves in the name of operational risk?'[282] For example, within banks, the role of the chief risk officer has become more prominent and the roles of lower risk managers have also been redefined as well.[283] Bielski argues that Basel II seems to encourage the use of a common risk language or vernacular, creating a system where all employees are encouraged to think about their relationship to risk and risk management.[284] On a basic level, it is linking the identity of employee with the identity of risk manager that was not necessarily an explicit connection previously.

---

[282] Power, Michael. (2003), p. 1
[283] Barfield, Richard (2004) "The nature of risk: Deep impact - Basel in the European Union" Balance Sheet, Vol. 12, no. 5, pp. 32-37
[284] Bielski, Lauren (2003)

External to banks, there is also likely to be an emerging group of consultants and advisors that are able to benefit from the shifts. For example, the inclusion of legal risk in understandings of operational risk has created a space for the remaking of legal advisory work in banks.[285] Financial IT firms, like Algorithmics, have created a market around the development and sale of risk management systems, not only for credit and market risk but now increasingly for operational risk as well.

Through this focus on the performance of operational risk management, one can actually see the full picture that shifting out of a rationalist, interest-based account can provide. The creation of 'operational risk' and the search for precision in measuring the potential losses due to it appear to be a simple expansion of the capital adequacy regime to better capture the objective risks that banks face and mitigate them. However, with the inclusion of these activities, an approach which looks through a discursive lens can see how this does not only capture the activities but also reconstitutes them as amenable to calculation—to measure and capture in quantitative form (at least at the aggregate level). Moreover, it reconstitutes the internal organization of banks, enhancing some actors' power and importance and reframing all employees as both risk managers and potential risks.

Conclusion

By assessing the Basel Accords through the performance of international capital adequacy regulation from the onset of the 1988 Accord, this chapter has intended to show

[285] Power, Michael (2003), p. 3

that there are more developments between Basel I and Basel II in how governance occurs than meet the eye. The regulatory practices that reflexively emerged within the performance of the Accord have altered practices and identity from the individual working within a bank to the supervisor. First, the identities and practices of the regulators, the banks and other market actors are rearticulated in different ways. National regulators are still important. In the process of capital adequacy as a risk management tool, these supervisors still ensure that banks maintain the appropriate level and type of capital. Yet, their position has become explicitly part of an increasingly formalized larger governance network that extends from the individual bank employee activities (now a part of operational risk management) through to the BCBS and throughout the public and private sector.

The private sector elements are substantially more prominent and diverse in Basel II, with important roles for credit rating and internal modeling. However, the choice of risk-based capital adequacy as a technique in Basel I marked the initial shift, placing the daily responsibility for risk management in the realm of the bank. These processes have not been pure neoliberalism but rather a hybrid from of public-private governance.

Furthermore, with the decision to use risk buckets Basel I also began a process that has continued to develop over the course of the Accords and their amendments. One can see a consistent trend that involves the quest for increasing precision in the identification and measurement of risk in the techniques of capital adequacy. Underneath this process the tension between the discourse of risk as a danger and that of risk as an economic necessity is visible. The former is what drives the creation of the Accord and its continued focus on comprehensiveness, like adding a measure for operational risk. However, the role of risk as an economic necessity for banks has led to the development of risk management techniques attempting to achieve increasingly precise calculations of the different types of risk. Particularly in Pillar I of the new Accord, there is an increasing instrumentalization of 'risk' into smaller units and more sophisticated tools used to capture it. In looking at the final version of Basel II, the complexity of governance around risk weighting is clear in the two of the key areas discussed – the inclusion of credit ratings and the use of internal modeling. Market Actors and banks themselves have been constructed as capable of possessing the expertise to provide that level of precision and accuracy.

This tension with both neo-liberalism and interest-based explanations is also visible in the discussion around the inclusion of operational risk. If, in fact, the new goal of economic governance is liberalization, then the inclusion of an entirely new category of bank activities seems counterintuitive. It also challenges the interest-based approach if one considers that if one considers that the industry did not want this category included.[286] It is shown how risk is really better conceived of as a myriad of discursive categories through which activities, events and identities are marshalled for governance. It highlights that the inclusion of operational risk has implications far beyond a rationalist study of interests in why it appeared.

[286] Wood, Duncan (2005)
From the industry response to Basel consultations, there was substantial variation in how to address operational risk if it was to be included in the new Accord. Industry response to the inclusion of operational risk varied between concern whether modeling was effective method (ex: UBS AG) to concerns about a lack of precision (ex: BNP Paribas). Wells Fargo's (2003) response the final consultation on Basel II argued that the Accord was entirely too prescriptive on risk management processes in general.

In this chapter, the discourse of risk has allowed us to see the inherent complexity in the Basel Accords and their recommended practices and performances of governance. It is clear that the discursive connection to risk as a danger to the system has been very dominant in encouraging very comprehensive and precise international governance. The following chapter will look at a case where the risk is still present but the notion of systemic risk is largely absent and the governance processes that have emerged in light of this condition.

Chapter 6 -
Collective Investment Schemes and the Private Sector Governance of Risk

The second example to be looked at in this dissertation is the international regulatory efforts for collective investment schemes (CIS). This category of financial instruments includes mutual funds, unit trusts, investment companies, and investment trusts among others. Part of the asset management industry, these schemes act as the "interface between investors, on the one hand, and financial markets and companies, on the other"[287] Unlike the first case, there has been little to no focused attention paid to this area by International Political Economy. One key exception is the work by Harmes, which looks at the growth in mutual funds and other institutional investors, like pension funds, and their ability to create and reinforce neoliberal economic production through the structural power of the capital they control.[288]

Similar to banking, international regulatory efforts around CIS are not particularly recent phenomena. The first attempts to address this financial instrument emerge in the 1970s and it has re-emerged in the international regulatory space since the early 1990s. The first attempts to address this financial instrument emerge in the 1970s and it has re-emerged in the international regulatory space since the early 1990s. In CIS governance, the discourse around risk as danger is still clearly present legitimizing governance but the subject at danger in this sector is constructed quite differently. In this case, the individual is the subject seen as 'at risk', with other potential subjects like the system, largely

[287] Franks, Julian and Colin Mayer (2001) Risks and Regulation in European Asset Management: Is there a Role for Capital Requirements? *Oxford Economic Research Associates,* January 2001, p. 1

[288] Harmes, Adam (2001) *Unseen Power: How Mutual Funds Threaten the Political and Economic Wealth of Nations*, Toronto: Stoddart Publishing Co.; Harmes, Adam (1998) "Institutional investors and the reproduction of neoliberalism, *Review of International Political Economy*, Vol. 5, no. 1, pp. 92-121

ignored. This is distinct from both the Basel Accords where the implied threat or danger is to the system via the banks is the dominant frame.[289] Moreover, we can see how this shift in the larger discursive frame rearticulates itself in a different set of legitimized micropractices, especially around disclosure and internal governance. To elaborate this second area of financial governance, we will first turn to a brief overview of Collective Investment Schemes and the international governance initiatives that have developed around them. Following these sections, we will examine the language of risk in the standards and codes before turning to the practices of risk management that are constructed around them in the final section.

What are Collective Investment Schemes (CIS)?

The International Organization of Securities Commissions (IOSCO) defines a CIS as "an open end collective investment scheme that issues redeemable units and invests primarily in transferable securities or money market instruments" excluding property/real estate mortgages and venture capital.[290] However, Collective Investment Schemes actually encompass a variety of market instruments, often more recognized by other names like mutual funds, unit trusts, UCITS funds, etc. The variation in CIS forms extends beyond its plethora of names. In general, there are two main varieties: open-end

[289] In the Basel Accords the overall subject at risk is left relatively unclear. However, the focus on 'systemic stability' as justification for risk management implies overall subject that is important in relation to risk as danger is the 'system'. Moreover, early BCBS documents do note that the overall goal is not to completely remove the possibility of bank failure but to discipline banks to significantly reduce the possibilities of failure and its implications on the sector more broadly.

[290] International Organization of Securities Commissions (IOSCO) *(1995) Principles for the Regulation of Collective Investment Schemes, Report on Investment Management*, July.

or closed-end funds. The latter developed first, at least a century prior to the open variant.[291] As a closed-end fund, these instruments issue a fixed number of shares. For the investor to access the value of the shares they must sell them on the market. An open-end fund, on the other hand, can continuously issue new shares as a way of creating new investment. The investor accesses the value of their shares by selling them back to the fund for their net asset value (NAV) rather than placing them on the market.[292]

Moreover, funds can also take multiple different legal forms. An OECD working paper in 2001 divides these different legal structures into three categories. The first is the corporate form, most common in the United States, where each fund is set up as a separate corporate entity with investors as shareholders. The second is the contractual form where investment management is contracted to invest the funds on behalf the investor. Trusts, which emerge from common law, are the third legal form.[293] In some states multiple legal forms are permitted, whereas in others there are restrictions to allow only one.[294]

With so much variation, one may question what unites CIS as a category of financial instruments. In general, all CIS funds have three related components. First, they involve pooling resources to achieve the size needed for adequate diversification and to maximize economies of scale (particularly reduced cost and efficient trading). It is also argued that pooled assets allow for the overall risk of investments to be spread more

---

[291] Markham, Jerry W. (2006) "Mutual Funds and Other Collective Investment Mediums —A Comparative Analysis of Their Regulation and Governance" Working Paper 1386, California: The Berkeley Electronic Press (bepress), p. 4

[292] Carmichael, Jeffrey and Michael Pomerleano (2002), p. 9

[293] Thompson, John K. and Sang-Mok Choi (2001) "Governance Systems for Collective Investment Schemes in OECD Countries" *OECD Financial Affairs Division Occasional Paper, No. 1*, Paris: Organization for Economic Co-Operation and Development, April, p. 4

[294] Ibid.

broadly than would be the case if each individual simply invested their own funds directly.[295] Second, these funds contain "professional portfolio management to execute a defined investment strategy."[296] Finally, these funds have a defined formal governance and/or legal structure which they operate under which includes among other things investor protection arrangements.

These instruments fill an important niche in financial markets. By pooling resources under the management of a single fund and manager, these schemes are articulated as a way for individual small investors to overcome some of the handicaps that come with their size and level of expertise. The aspects construed as disadvantages for this industry range from the inability to afford sufficient diversification or the execution of large trades and the lack of the needed investment skills.[297] One article in *Financial Planning* in 2004 went so far as to argue,

> Mutual funds are arguably the greatest packaged product ever developed in our industry. They make it possible for investors with virtually any size asset pool to participate in the capital markets and to enjoy the benefits of professional money management. There is no other product now available that is as simple and easy to access for small investors.[298]

In conceptualizing CIS this way, it serves to not only justify the presence of CIS in financial markets but portray them as important instruments in everyday financial life. However, one should exercise care in unequivocally praising the CIS industry. Investors are more exposed to losses than they would be in depositing money in a bank, and there

[295] Carmichael, Jeffrey and Michael Pomerleano (2002), p. 5
[296] Thompson, John K. and Sang-Mok Choi (2001), p. 9
[297] Ibid.
[298] Reinhart, Len (2004) "Righting the Ship: More regulation and safeguards will solve some- but not all-of the problems uncovered in the recent mutual fund scandals" *Financial Planning*, New York: Jan 1, 2004

are certainly multiple examples of questionable sales practices and management of some of these funds. Another more critical account appears in Harmes' study of these forms of institutional investors. While he acknowledges the benefits of these instruments in opening up financial markets to greater segments of society, at the same time he notes some of the problematic ways that they can serve to further control of the financial sector due to the enormous amount of capital they control.[299]

The CIS sector is an important part of the international financial markets, particularly in the United States where the industry is most developed. In 2004, there were more than 91 million Americans (representing a little less than half of the national households) and approximately $7.5 trillion US invested in collective investment schemes, in part because of the well-developed mutual fund industry.[300] When the first international governance efforts began in 1972 a significant number of states did not have much of a market for CIS.[301] Since then however, the fund industry has emerged more noticeably across the world.[302] Much of this growth has been even more recent as "the total assets held by the world's mutual funds in the fourth quarter of 2003 was $13.96 trillion, some $2.6 trillion more than four years earlier".[303] In Europe, the total net assets of mutual funds increased from 2,743,228 to 6,002,249 and the number of firms to 20,107

---

[299] Harmes, Adam (2001)
[300] Tafara, Ethiopis (2004) *Presentation at the Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004, p .3
[301] OECD (1972) *Standard Rules for the Operations of Institutions for Collective Investment in Securities*, Committee on Financial Markets, Paris: Author
[302] Khorana, Ajay, Henri Servaes and Peter Tufano (2005) "Explaining the Size of the Mutual Fund Industry Around the World" *Journal of Financial Economics*, Vol. 78, iss. 1, p. 145
[303] Tanzer, Greg (2004) "Challenges in the Regulation of Collective Investment Schemes" *Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004, p. 2

to 30,053 between 1998 and 2005.[304] This maps with the growth in assets held in funds, which now exceed the assets held in banks in many countries, over the last two decades.

While there have been dramatic increases in the presence of CIS in Europe and North America, this growth has not necessarily been universal. Even among the OECD states, where the financial markets should be the most sophisticated, in a number of states the industry did not show dynamic growth in the 1990s. Norway, Finland, New Zealand, Czech Republic, Mexico and Turkey, and more distinctly Korea and Japan, fit within this second group.[305] In the Asian states, the overall weak performance of equity markets combined with government control in the process of intermediation and a high savings rate in traditional instruments like bank deposits are part of the explanation for this lack of growth.[306] Between 1998 and 2005, the number of funds dropped in Korea from almost just under 13, 500 to just under 7, 300 and in Japan from just over 4,500 to 2, 640, although the total net assets increased slightly.[307] Moreover, the impacts of the Asian crisis that occurred in the late 1990s have weakened the industry. Thompson and Choi argue that in Korea the industry recovered from the first shock in 1997 with growth in mostly fixed income funds but there were further disturbances in late 1999 because of valuation and governance concerns.[308]

One final feature of the industry that is also worth addressing is the connection between CIS and the banking industry. In North America, we generally think of the collective investment industry (as part of the securities sector) as emerging in competition

[304] Investment Company Institute (2006) *2006 Investment Company Fact Book* -- See Table 44 and 45.
[305] Thompson, John K. and Sang-Mok Choi (2001), p. 7
[306] Thompson, John K. and Sang-Mok Choi (2001), p. 19
[307] Investment Company Institute (2006), Table 44 and 45.
[308] Thompson, John K. and Sang-Mok Choi (2001), p. 35

(and potentially antagonism) with the more traditional deposit-taking practices of banking. The competition between securities and banking more generally can be seen in the studies that find the growth of money market funds as adversely affecting the banking industry, in particular.[309] Given this relationship, the U.S. mutual fund industry grew out of securities markets and it is only in the last few decades that banks have moved to take a more active role in this area.[310] Yet outside of the U.S., the relationship between banking and collective investment is significantly more intertwined. In some of these markets, the primary promoters and distributors of these funds are banks.[311] The equivalent versions of mutual funds in France, public corporations known as SICAVs, are frequently managed by banks (although they are not part of the banking enterprise formally).[312] Therefore an explanation that focuses on the division between the two sectors is too simplistic at the international level.

There is one caveat that should be noted before continuing. Some studies will discuss CIS at the same time as other collective schemes like hedge funds or pension funds.[313] However, this chapter will not include an examination of the latter two fund types. The conscious choice to avoid a discussion of pension funds is based primarily on the fact that they present a range of additional issues beyond the scope of what can be covered adequately in a single chapter on collective investment schemes writ large. More

---

[309] For example see: Lam, Chun H., Rajat Deb and Tom Fomby (1989) "Deregulation and the Demand for Money Market Mutual Funds" *Journal of Macroeconomics*, Vol. 11, No. 2, Spring, pp. 297-308

[310] One study found that US bank sponsored funds accounted for only 21.5 percent of all money market fund assets by mid-1996. Bisignano, Joseph (1998) *Towards an Understanding of the Changing Structure of Financial Intermediation: An Evolutionary Theory of Institutional Survival*, Amsterdam: Société Universitaire Européenne de Recherches Financières

[311] Khorana et al. (2005), p.13-4

[312] Bisignano, Joseph (1998), pp. 56-7

[313] Carmichael, Jeffrey and Michael Pomerleano (2002), p. 9

importantly, pension funds are subject to an additional set of regulatory requirements outside of CIS. Therefore, they exist within a different regulatory assemblage then more generalized CIS funds. Variation in governance structure is also the reason that hedge funds have not been examined systematically. Hedge funds, or highly-leveraged institutions (HLIs) as they are sometimes called in the international governance literature, are a variant of a collective investment scheme. However, they operate and are regulated quite differently than open-end CIS. These funds have been essentially unregulated in their operations by many states and are limited to only 'sophisticated' investors who are able to invest large sums of money. Some additional detail will be presented later in the chapter as hedge funds are discussed briefly to highlight some key elements of international CIS governance. The following section will look at the international regulatory efforts for CIS.

International Governance for Collective Investment Schemes

Similar to the Basel Capital Accord, international regulatory and governance efforts in this field are not something new with the twenty-first century. The CIS industry has been the subject of international regulatory efforts dating back to efforts in the 1970s. Even a cursory look reveals the "considerable sharing of experience among countries and articulation of common standards" which were occurring since the mid-1970s.[314] Key earlier CIS governance efforts are the OECD Principles of 1972. The EC/EU UCITS

[314] Thompson, John K. and Sang-Mok Choi (2001), pp. 10

Directive followed these thirteen years later in 1985 and the IOSCO CIS Principles a decade after that in 1994/5.

The first well documented international regulatory initiative emerged from the OECD in 1972. However, this was not the first modern attempt at transnational standard creation. Since 1970 the Council of Europe had engaged in studies with the intent of creating standard rules for open-end investment funds and in October of 1971 it adopted a draft resolution. This resolution is approximately comparable to the OECD standards that are the focus here.[315] The standard that the OECD created includes articles on minimum requirements around information and investor protection, CIS investment practices, their management methods and general obligations, issues relating to advertising, sales activities and canvassing and "the application of these rules by supervisory authorities".[316] In essence, it is a recognized early attempt at developing harmonized rules for CIS.[317] In many ways, it is very similar to the modern standards promoted through IOSCO.

The next major transnational agreement for CIS was the "Undertakings for Collective Investment in Transferable Securities" (UCITS) directive created by the European Community in 1985. Like many of the EC standards from this time, the UCITS Directive aimed at harmonizing regulatory frameworks between the member states with the intention of encouraging greater regional market integration. In general, it focused on regulating open-ended collective investment vehicles which advertise and promote to the general public but not schemes that are authorized under other national regulatory tools

[315] OECD (1972), p. 14
[316] OECD (1972), p. 13
[317] OECD (1972), p. 10 – The report states that the committee "realizes that the rule are not perfect in every respect but feels that they could represent a major step forward."

and do not seek to be issued outside of those national borders. Since its inception, a number of updates to UCITS have been made, the last coming into effect in February 2004.

In the last fifteen years, the key international body active in CIS regulatory efforts has been the International Organization of Securities Commissions (IOSCO). Its work specifically on CIS governance emerged in 1994 when it published the *Report on Investment Management: Principles for the Regulation of Collective Investment Schemes*. Referred to here as the Principles, this standard covers a broad range of practices of the CIS industry.[318] In 1997, the committee published it *Principles for the Supervision of Operators of Collective Investment Schemes*.[319] This standard is intended to complement the more explicit 1994 regulations aimed at CIS operators themselves. These IOSCO principles covered many of the same issues as the OECD and the UCITS standards.[320] Thompson and Choi highlight a number of similarities between these three initiatives. Although there is variation in the strength in the rules because in some cases UCITS requires instead of recommends, all these regulatory texts reassert the CIS's obligation to

---

[318] IOSCO (1994) *Principles for the Regulation of Collective Investment Schemes and Explanatory Memorandum*

[319] IOSCO (1997) *Principles for the Supervision of Operators of Collective Investment Schemes, Report of the Technical Committee*, September 1997

[320] The report lays out the legal form and structure of this diverse sector before moving on to a second section on the rules relating to the appointment, qualifying requirements and independence of the fund's Custodian, Depository or Trustee. The third section lays out the core standards of conduct and minimum eligibility standards that the regulatory authority should approve prior to any CIS marketing itself to the general public. These include: honesty and fairness, capability, capital adequacy, diligence and effectiveness, compliance and ensuring that the operator does not exceed the powers that are conferred in the constituting documents of the scheme. Section 4 deals with the complex and tenuous questions around delegation and the roles and responsibilities of the operator in light of this. In the fifth section the focus is placed of the types and methods of supervision that the CIS should be subject to. The following five sections look at conflicts of interest and the general duties and obligations of the CIS, valuation and the purchasing and redemption of units, limitations on Investment and Borrowing, investor rights and issues of marketing and disclosure respectively.

act in the interests of the investors and the creation of a custodian to ensure that the CIS assets are properly held and separate from other funds (in the case of UCITS a more comprehensive body – a depository). Other similarities are the requirement to create and distribute the company's economic prospectus, the general content of this document, some basic limits to the fund's assets and their composition and the explicit legitimation of the regulator's role in licensing.[321] Finally, all three documents maintain a role for regulators based on the belief that the supervision of these bodies needs to be comprehensive enough to ensure compliance.[322]

In the last seven years, there has been a renewed interest in the governance of the industry at the international level. However, the discourses, techniques, and objectives of the international regulatory arena have not significantly changed since these three initiatives. The key focus on this chapter will be on IOSCO initiatives relating to CIS governance. In addition to the 1995 and 1997 Principles, the organization retained its interest in the governance of CIS at the international level in this new century. In the last decade IOSCO has published multiple papers and issuing reports on CIS topics as varied as unit pricing, conflicts of interest, anti-money laundering, fees and expenses and shareholder responsibilities. The work of IOSCO, along with an OECD White Paper from 2005, is the primary foundation for this chapter.

[321] In UCITS the applicable assets include: transferable securities, money market investments, deposits, derivatives and forwards; and units in other collective investment schemes and there are certain quantity restrictions on some. In the IOSCO principles there is reference to transferable securities not listed on a regulated market, transferable securities issued by the same issuer, derivative instruments, and other CIS. In the case of the OECD limits are set on certain types of assets.

[322] Thompson, John K. and Sang-Mok Choi (2001), pp. 11

Risk in International Regulation of CIS

The focus on risk is less visible in the international official documents of CIS compared to the Basel Accords. Although the risk language is omnipresent in this sector, international regulatory documents do not generally focus on risk management directly. At the international level, the 1995 and 1997 IOSCO standards only have a total of 23 references to risk combined. Some explanation can be found in IOSCO survey of national CIS regulatory structures in early 2000 concluded

> Risk management is generally the responsibility of the CIS Operator and is not subject to specific detailed regulatory requirements such as risk measurements or models in most jurisdictions. In some jurisdictions, prospectuses are required to contain disclosure relevant to detailed risk management requirements applicable, in addition to any risks inherent to investments of the CIS. [323]

In more recent documents there have been increasing references to risk. However, the regulations are different from the Basel Accords that make increasingly specific practices on the processes of risk measurement and management (particularly around capital reserves). In fact, the most prominent reference to risk in international CIS standards is in those promoting regulators adopt a risk-based regulatory strategy in assess the various CIS.[324]

[323] International Organization of Securities Commissions (May 2000) *Summary of Responses to the Questionnaire on Principles and Best Practice Standards on Infrastructure for Decision Making: A report to the Technical Committee*, p. 3

[324] International Organization of Securities Commissions (2002) *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods, Report of the Technical Committee*, October 2002 -- The report presents a framework for a "a common view of the risks that CIS operators may pose or face relevant to the achievement of regulatory objectives and of the relative importance of those risks".(p.2) It describes risk factors associated with managing and operating a CIS. The report divides the risks into two types, namely, inherent business risks and control risks. This framework, while clearly drawing out a very specific understanding of the different risk categories focuses more on highlighting for regulators what to take into account rather than how this should be done.

Instead the driving discourse in the broader discussion of CIS governance is in the language of investor protection. However, even within this larger frame the notion of risk is inherent. The dynamics of risk discourses and notions of responsibility in relation to investor protection are apparent in the first few pages of IOSCO's *Examination of Governance for Collective Investment Schemes: Final Report Part 1* in 2006. The report asserts:

> The major role of CIS Operators is primarily to execute investment strategies on behalf of well-informed investors while investors must be able to select the desired level of risks and potential rewards amid a reliable market environment.[325]
>
> The Core Principles and broad general principles of CIS Governance are, however, complementary. They share the ultimate goal of investor protection. The general goal of investor protection is not to protect investors from suffering any market driven loss, but rather to enable investors to understand the risks that pertain to investments in specific CIS.[326]

In these two key statements alone, the myriad of constituted objects, identities and performances centered on risk, CIS, and governance are visible. First, it is clear that market 'risks' are articulated as an inherent, and implicitly unavoidable, feature of investment. This construction is largely seen as common sense but within it is the discourse of risk as an economic necessity for CIS to work. As Soederberg reminds us, "the risk-driven form of profit seeking behaviour acts as a mainspring for the construction

[325] International Organization of Securities Commissions (IOSCO) (2006), p. 4 … Also quoted in International Organization of Securities Commissions (IOSCO) (2005), p. 5

[326] International Organization of Securities Commissions (IOSCO) (2006) *Examination of Governance for Collective Investment Schemes: Final Report Part I*, June 2006, p. 1 (Also quoted in International Organization of Securities Commissions (IOSCO) (2005) *Consultation Report: Examination of Governance for Collective Investment Schemes*, February 2005, p. 3) The 'Core Principles' refer to the 30 key principles of securities regulation laid out in International Organization of Securities Commissions (IOSCO) (2003) *Objectives and Principles of Securities Regulation*, May 2003

of financial instruments, such as mutual funds".[327] In the Core Principles, the articulation of risk is still the potential future event/situation, but the decline or reduction of these risks is not the goal of regulation. Instead, assuming risk is the necessary action to achieve the outcome of reward or profit.

Through this depiction of risk and the act of risk-taking, the individual/ investor and regulator for governance purposes is articulated in a distinctive way. As the regulatory goal is not to protect the investor from the market 'risk', it reinforces the individual as having agency around risk and the role of choice. These risks are framed as something scheme participants 'took' rather than something they are 'exposed to'.[328] This discursive construction in the international CIS governance legitimizes the placement of fault and repercussions for risk decision-making on the individual provided the structure of the internal governance is followed and corporate and market information are properly disclosed to the investor previously.

The placement of responsibility at the level of the individual investor does not mitigate all supervision however. As articulated above, the supervisor's role is primarily investor protection. However, this is not a sweeping category that protects investors from all potential harm. A IOSCO articulates,

> investor protection relates to, among other things, the prevention of misleading, manipulative and fraudulent practices. It is also related to

[327] Soederberg, Susanne (2003) "The promotion of 'Anglo-American' corporate governance in the South: who benefits from the new international standard?" *Third World Quarterly*, Vol. 24., no. 1, pp. 7-27

[328] The recent OECD White Paper also articulates this relationship. It states, "While the legal framework and regulatory regime are intended for the protection of investors, it is important to make absolutely clear to investors that the objective of the legal and regulatory system is not to prevent or minimise losses to investors where such losses occur through developments in capital markets. CIS are market-based investment vehicles and they are not subject to the same prudential controls and safeguards as banks and insurance companies. (OECD (2005), p. 142)

> the prevention of loss due to malfeasance or negligence on the part of those that organize and operate the CIS.[329]

The supervisor or regulator's role becomes more defined around internal corporate governance.

In addition, there is also a role for these actors given the final sentence on the broad principles of CIS governance above. It stated, "The general goal of investor protection is not to protect investors from suffering any market driven loss, but rather **to enable investors to understand the risks** that pertain to investments in specific CIS".[330] This goal, along with the regulator's interest in market integrity more generally, serves to legitimize the emphasis on disclosure and investor education as part of governance.

The regulatory efforts around internal governance and disclosure creates an interesting dichotomy in the discourses of risk and investor protection. It constructs a governance structure based on an individual that is constituted as both requiring protection from certain activities but also ultimately responsible for the consequences of 'fair' risk-taking and acting as the ultimate risk manager. At the same time as the investor is responsible, international governance initiatives also articulate the investor as a 'well-informed' subject that legitimates a series of practices to create an 'informed investor'. This chapter will focus on these initiatives around internal governance and disclosure and the mundane practices that constitute these processes later in the chapter.

---

[329] International Organization of Securities Commissions (IOSCO) (2006), p. 1
[330] International Organization of Securities Commissions (IOSCO) (2006), p. 1 (Emphasis added)

Performing Risk Governance for Collective Investment Schemes

In CIS governance the articulation of risk is performed through a variety of practices and identities. Although not universally implemented, all these constructions move beyond the realm of ideas; they are articulated and reinforced in practices and material constructions. In contrast to Basel II, not only are the practices of risk management at the level of the individual and CIS firm with the regulators providing arm's length risk supervision, but so is the risk measurement design process. Instead, the performances of governance in this situation focus on ensuring that the individual investor is exposed to what I refer to as "fair' risk. More specifically, the risks individual investors are expected to assume are the outcomes of their explicit informed investment decisions rather than a flaw in internal management structures or lack of understanding. This performance component is elaborated in the following sections by drawing out the micropractices and mundane aspects that legitimized in international governance.

Internal Corporate Governance

The internal control structures are set up to minimize two sets of possibilities that would exacerbate information asymmetries in favour of the CIS. The first are cases of fraud and other forms of outright abuse like misrepresentations. The second set of activities these structures seek to constrain is the potential conflicts of interest between the CIS managers and the interests of the investor.[331] The essence of the importance of internal management in relation to risk is captured best in the OECD White Paper. It asserts,

> Individual investors cannot make informed decisions unless the governance process functions satisfactorily. Consequently, it is incumbent upon public policy, the CIS industry and individual CIS to assure that robust governance structures are constructed and maintained to safeguard the interests of investors and maintain their confidence.[332]

If investors are not able to make informed decisions this mitigates the placement of responsibility for risk management on them. Moreover, the OECD also partially constructs this conception as important for the real economy. A few pages previously it asserted that this type of financial intermediation can only "best promote efficiency in the real economy if institutional investors and asset managers can be relied upon to deploy assets on behalf of investors".[333] In this case the fund operator decisions are also connected to economic necessity and efficiency at the systemic level. This is also alluded to in the phrase, 'maintain their confidence'. If investors have no confidence in a particular CIS, it will have trouble attracting and maintaining interested participants. Moreover, if the problems of internal governance are seen as endemic, then the industry as a whole will face similar problems. However, in most of the governmental documents the connection is made explicitly with investors' interests and protection rather than this larger economic point.

[331] IOSCO recognizes that there is inevitable overlap between the above two categories but maintains the distinction anyway.
[332] OECD (2005), p. 140
[333] OECD (2005) "White Paper on Governance of Collective Investment Schemes (CIS)" *Financial Market Trends*, No. 88, March 2005, p. 138

At the frontline of internal management practices is the investment fund manager. Although individual investors are responsible for selecting their overall level of risk exposure and management, the day-to-day performance of risk management is performed by the investment fund operator(s). Therefore, ensuring that the decisions of these actors are representative of their investors is a key element of the industry and its legitimacy. In both the governance and trade literature it is accepted that the fund operator is intended to be the representative of the individual investors and to manage the fund in the best interest of those investors.

It can be argued that these rules are even more important today because in the current financial system many CIS are now "increasingly capable of executing very refined investment strategies, (e.g. value, growth, technology etc) which require varying degrees of analysis, trading activity and discretion by the portfolio manager."[334] An effective governance structure should work to ensure that the investment manager is accountable to the investors in the fund. It is unsurprising given this construction that a variety of corporate governance style rules have been suggested to ensure that the organization fulfills its commitments, particularly given there is not a uniform legal structure of CIS. In the 1994 IOSCO *Principles*, these include: appointment, qualifying requirements and independence of the external oversight, core standards of conduct and minimum eligibility standards, rules on conflicts of interest and the general duties and obligations of the CIS, valuation and the purchasing and redemption of units, limitations on investment and borrowing, investor rights and issues of marketing and disclosure

[334] Thompson, John K. and Sang-Mok Choi (2001), p. 20

respectively. Section 4 of this document in particular deals with the complex and tenuous questions around delegation and the roles and responsibilities of the fund operator. It is interesting to compare the highly qualitative and interpretative character of these rules with the much more narrow, but technical calculation process in Pillar I internal modelling for operational risk under Basel II. In this, case discussions of risk are largely kept at arm's length with only minor references to risk in the process of CIS.

Looking more closely at the standards and norms of internal governance, the reason for the prominence of investor protection is because it becomes mapped with articulations of asymmetries in power and information that occur between the 'sophisticated' investment manager who controls the flow of information and the investor who is represented as small, dispersed and often unsophisticated.[335] For example, IOSCO constructs these market participants in the following way: "Most CIS investors are retail investors, many of whom are not financially sophisticated and could benefit from investor education."[336]

One counter-argument to this claim is that CIS funds are not the exclusive domain of small investors but are also populated with other institutional investors, like pension funds.[337] The regulatory bodies offer two responses to this accurate claim,. First, IOSCO governance initiatives articulate this distinction between individual or retail participants in CIS and these institutional bodies and it notes, "our work focuses on retail

[335] Thompson, John K. (2004) "OECD Corporate Governance Principles and Governance of Banks", APEC Finance and Development Program Workshop 2004, Shanghai National Accounting Institute, 18-19 May 2004

[336] International Organization of Securities Commissions (IOSCO) (2001) *Investor Education in the Effective Regulation of CIS and CIS Operators,* March 2001, p. 2

[337] Khorana et al. (2005), p.152

investors in CIS, although we recognize that institutions also invest in CIS".[338] In a second tack, the 2005 OECD White Paper highlighted this need for protection for even a sophisticated investor when it argued,

> Even the most sophisticated investors tend to concentrate their analytic efforts on the relative performance, risks and costs of CIS as well of the suitability of each CIS for the investor's objectives. Relatively little effort is ever expended on assessing the governance of CIS, except in cases where serious lapses in governance come to light.[339]

These elements construct the investor as an actor who is in need of 'protection', but not from the 'risk' in the market, from potential, thought largely undefined, risks of the scheme.

Although there are multiple areas of governance that can be addressed to this discussion, one of the earliest and primary frames of regulatory concerns of CIS stemming from the fund operator is conflict of interest. IOSCO explains that conflict of interest comes from the separation of the "ownership" from management, which

> gives rise to potential conflicts between the self interest of CIS operators and interests of investors in CIS. Such conflicts of interest, in the absence of proper control mechanisms, not only adversely affect the interests of investors but also have the potential to undermine investor confidence in CIS as an investment vehicle.[340]

These conflicts may be intentional or unintentional. For example, Harmes argues even though "mutual and pension fund *money* may have long-term investment horizons, but the *people* who manage these funds often don't, because they're evaluated and paid based

---

338 IOSCO (2005), p. 1
339 OECD (2005), p. 140
340 International Organization of Securities Commissions (IOSCO) (2000b) *Conflict of Interests of CIS Operators*, May 2000, p. 2

on their ability to perform strongly in the very short term."[341] In this case, the governance structure that requires disclosure and reporting to serve the interests of investors can create incentives for conflicts of interest. This disconnection creates a space for governance.

The 1994 *Principles* argue these potential conflicts should be properly monitored and addressed by national supervisor or regulators.

> The regulatory regime should recognise that an operator of a CIS may have interests that if exercised without restraint would conflict in a material way with the interests of investors. Regulatory authorities should respond to this *risk* by ensuring that a regime provides for the exercise of management responsibilities with full regard to the best interests of investors. Such a regime may be general in nature, relying on the concept of "fiduciary responsibility" as interpreted domestically. Equally, the establishment of detailed regulations designed to monitor potential conflicts of interests between operator and investors is recognised as an acceptable regulatory method.[342]

Interestingly, when compared with Basel II, these practices of regulation allow for more national discretion in the development of rules. However, here are some suggested regulatory strategies that can be used alone on in concert.[343] Moreover, most IOSCO jurisdictions require some review/oversight of CIS operator's activities by an independent person or body (a trustee, a company Board, an independent director or an independent auditor for example).[344] In some states, like the United States, the specific variants of

[341] Harmes, Adam (2001), p. 22 (emphasis in original)
[342] IOSCO (1994), p. 9
[343] IOSCO (1994), p. 10 – these options include (a) direct prohibition under the law; (b) a precise code of business conduct either established by the regulatory authority, or a code established by a practitioner's organisation, which is approved and enforced by the regulatory authority; (c) review and/or approval of certain transactions and activities by the regulatory authority; (d) surveillance of operators by the regulatory authority; (e) disclosure by the operator; (f) record keeping by the operator; (g) limitation of the activities of the operator; or (h) independent review by a third party.
[344] IOSCO (2000b), p. 12

conflict of interest and penalties are laid out explicitly in law, while others, like the European Union, use a more general clause(s) and the supervisory process to achieve it.[345] Therefore, the national supervisor does not directly address risk selection and measurement, it is responsible for oversight of the fund operator and its independent review body.

The other interesting aspect about the conflict on interest regulatory system promoted above is the connection to "detailed regulations". Although IOSCO stops short of proscribing the exact rules in a one-size-fits-all way, there is still a focus on precision. This is particularly interesting as conflict of interest is one of the few areas of CIS practices that have been explicitly articulated as a risk itself, as we can see in the quote on the previous page.

This relationship between the investor and the fund operator is inherent to the governance of the area. In some cases it has been extended into discussions of entitlement and rights. We can see the former in a 2004 statement by then SEC chairman William H. Donaldson in his testimony before the US Senate for a representation of this construction. He stated, "Mutual fund investors are entitled to honest and industrious fiduciaries who sensibly put their money to work for them in our capital markets. Investors deserve a brokerage and mutual fund industry built on fundamentally fair and ethical legal principles".[346] The OECD White Paper takes this farther when it discussed the 'rights of investors.' These were intended to capture the 'rights' that were granted in the laws and regulations of CIS and the rules of the CIS in its internal corporate

[345] Ibid
[346] Tafara, Ethiopis (2004), p. 4

governance.[347] These included the right to expect competent management from the CIS (including accurate valuation of assets and the maintenance of accurate records) and protection from fraud, negligence or conflict of interest., the right to be informed of key CIS features (including the investment policies, assets held and their value, unit or share redemption policies, the cost, fee and expense structure and the voting rights the CIS many have in other companies).[348] This articulates a relationship between the CIS and its investor in the language of 'rights' drawing connections to a much larger legal language and tradition. However, it does not necessarily undermine the construction of the abstract individual investor as small and unsophisticated or their responsibility for market based risk.

Disclosure, discipline and the informed investor

A key way to address the information asymmetries between the fund operator and the investor is to focus on disclosure. Therefore the second type of regulatory practices we will address in the practices of CIS governance has utilized the techniques of disclosure. In Principle 19 of IOSCO's primary document on all securities regulation, the *Objectives and Principles of Securities Regulation,* the call for disclosure in CIS is explicit. It states, "Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment

[347] OECD (2005), p. 146
[348] OECD (2005), p. 146-8

scheme for a particular investor and the value of the investor's interest in the scheme."[349] It is obvious that disclosure is not separate from the internal governance discussed in the last section. The OECD White Paper asserts that "sound internal governance and official supervision work best in transparent markets in which informed investors scrutinize and compare the performance and services of CIS, as well as other investment instruments".[350]

In a rationalist understanding of financial regulation, the purpose of disclosure is providing the appropriate information to assist in investor decision-making. Then Vice President of the Belgian Banking, Finance and Insurance Commission, Jean-Paul Servais echoed this argument in a 2004 speech where he argued that disclosure "is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme."[351] More specifically, disclosure in theory should provide investors with sufficient information to make a decision about a scheme's appropriateness for them in addition to providing this information in a format that is understandable to the investor and in a timely manner.[352] In some cases, these recommendations about disclosure are more specific. For example, an IOSCO report in 2003 addressed in detail

[349] International Organization of Securities Commissions (IOSCO) (2003) *Objectives and Principles of Securities Regulation*, May 2003

[350] OECD (2005), p. 152. However, the information available goes beyond the mandatory disclosure referred to in the White paper. It is clearly an important flow in the information being sent to the market, or more accurately investors in the market. Yet this is supplemented with an increasing amount of data provided by "a growing network of information-processing firms" which not only obtain data from the firms but also organize it in a manner that this consistent across firms allowing (if not outright providing) comparison between different CIS. In addition to these avenues, additional information may be provided by CIS themselves and/or by independent investment advisers.

[351] Servais, Jean-Paul (2004) "New Challenges in the Regulation of CIS: A European Regulator's Point of Vue." *Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004, p. 6

[352] Servais, Jean-Paul (2004), p. 6

the proper disclosure process for fees and expenses in the CIS.[353] Along with requirements to publish prospectus and simplified prospectus, there are also IOSCO best practices on disclosure in advertising and other material.[354]

In a general sense, increasing calls have been made for more information to be disclosed. This leads international bodies like IOSCO to argue,

> Accordingly, efficient disclosure requirements, accounting, valuation, reviewing and auditing standards should be in place in order to make sure that the risk-performance equation of the fund is adequately managed as the major role of CIS operators is primarily to execute investment strategies on behalf of well-informed investors while investors must be able to select the desired level of risks and potential rewards amid a reliable market environment.[355]

Again while the disclosures regarding risk exposure are only one part of a larger disclosure package, the reference of the need for individuals to be able to properly assess their risk levels is clear. Since the individual retains the responsibility for the risks in investment, the goal of regulation and governance shifts to the "development of an environment conducive to informed risk-taking".[356]

This process of disclosure involves substantial disclosure of management structures but also the risk strategies and exposures, both in kinds and in degree, which the CIS will assume. The OECD argues that at a minimum, disclosure should cover the basic risk breakdown that is assumed in the investment style and the nature of risk

---

[353] International Organization of Securities Commissions (IOSCO) (2004) *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, November 2004
[354] International Organization of Securities Commissions (IOSCO) (2004b) *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, May 2004
[355] IOSCO (2005), p. 5
[356] OECD (2005), p. 142

management techniques if derivatives or external guarantees are going to be used.[357] One assumes that as the funds' risk management becomes increasingly complex the disclosure should include an increasingly detailed disclosure of the risk and risk management techniques, provided to investors in an understandable language. In theory, without these provisions one cannot expect an investor's choice to map with their actual risk bearing preferences.

However, the practices of disclosure also have implications that are overlooked even when it is seen only through the rationalist information lens as a source of information. Returning to the pressures of fund managers, a potential problem emerges when increasingly frequent releases of information are required as they can enhance the pressures on managers to look for short-term results in order to boost their performance.[358] In this situation two key interests of the fund manager are in conflict and the choices selected may not actually serve to increase governance. This highlights the overlapping qualities in CIS governance, as it is assumed that strong internal governance rules and supervision will address and mitigate these concerns.

Moreover, CIS disclosure rules do acknowledge that it is not just a question of quantity of information but also quality and pitch. For example, IOSCO performance presentation standards also argue that information should be written for the level of the 'average investor'. In this case, average investor implies the level of the individual, the main type of investor in a CIS.[359] This objective is a recognition that focusing on the

[357] OECD (2005), p. 154
[358] Harmes, Adam (2001), p. 21
[359] International Organization of Securities Commissions (IOSCO) (2004b), p. 4

quantity of information and not necessarily quality, can severely diminish its usefulness. As Carmichael and Pomerleano note, "Excessive or complex information can be counterproductive: it not only confuses consumers but also may discourage them from using disclosure documents."[360] Therefore, the practice of disclosure can contradict its purpose. This leads to the key identity construction for risk in this sector, the notion of the 'informed investor'.

Although it is presented as a mundane practice, this focus on disclosure is part of a larger political project that reconstitutes the individual who invests in collective investment schemes and mutual funds. Earlier in the chapter, one can see the individual investor was conceived of as small (in terms of funds invested) and unsophisticated. However, disclosure and other related information techniques impact on this conception in ways not necessarily made visible by rationalist approaches. For a rationalist, providing access to information is a way of narrowing the power and knowledge advantage fund promoters and managers have over investors.[361]

A discursive and a more Gramscian analysis also captures these potential impacts. For example, Harmes links this process to Gill's concept of 'market civilization'.[362] He argues that CIS funds fit into this conceptualization because they are not 'passive' like the financial instruments of bank deposits or pension funds. Instead "investing in mutual funds requires a higher level of attention on the part of individuals."[363] It requires the

[360] Carmichael, Jeffrey and Michael Pomerleano (2002), pp. 62-3
[361] Thompson, John K. and Sang-Mok Choi (2001), p. 8
[362] Gill, Stephen (2003), p. 70 The disciplinary neoliberalism and new constitutionalism that are part of market civilization rework the language and structure of social relations in a more commercialized, marketized and commodified way.
[363] Harmes, Adam (1998), p. 113

individual to be consistently active in their financial management. This development presses individuals to become aware of the market in their day-to-day lives and must take on the attributes of a marketized life to a greater degree than in banking.[364]

Investor Education

This broader process of informing the investor also ties with an increasing reference to and call for investor education in national and international regulatory arenas. These efforts inherently support this attempt to reconstruct the investor with the intention of creating "a financially literate investor base".[365] There are multiple private sector efforts that are readily apparent from the ease and growing references to financial planning. More interesting is the increasing number of financial literacy programs, some of which aim at children like the one involving 'Henry the Hedgehog'.[366]

However, more importantly for this study is that similar ideas of investor education are present in governance initiatives at the international level. IOSCO has built a system where investor education is a part of the governance of CIS. There are allusions to investor education in multiple documents. However, a 2001 IOSCO report that explicitly addresses the merits of encouraging investor education and the implications of this for governance is the most informative. Arguing that investor education can be a

[364] Moving beyond Gramscian analysis to a more post-structural perspective, the important role of investor education initiatives in constructing the 'other': the informed investor is implicitly set against an abstract 'other' who is at best uniformed (and if one assumes there is an attached normative value to the becoming informed, they are also irrational and imprudent).
[365] OECD (2005), p. 152
[366] See Harmes (2001); Langley, Paul (2004) "(Re)politicizing global financial governance: what's 'new' about the 'New International Financial Architecture'?" *Global Networks, Vol.* 4, no. 1 pp. 69–87

important tool for regulators, it also has endorsed the use of some of these private programs and the internet to lessen the resources that national regulators would need to provide. However, it also notes that regulators coordinating with private investor education programs must be vigilant. For example, if the program focuses on "crafting tools to help investors assess risk, regulators must take care to avoid providing investors with specific investment advice".[367] Moreover, it must "remain independent of the market participants that they supervise. When regulators engage in investor education activities with market participants, care must be given to avoid even the appearance of endorsing the products or services of any market participants".[368]

Furthermore, investor education can have impacts on governance directly. IOSCO argues, "investor education assists in the effective regulation of CIS and CIS operators. It further agrees that investor education should complement, rather than substitute for, direct supervision and regulation of the operations of CIS and CIS operators."[369] It is interesting that investor education and other activities like it are not seen as substitutes for governmental supervision, but a complement to it. In relation to this IOSCO argues that the regulator can utilize investor education to provide the tools to assess the risks associated with their CIS investments. This discursive construction of the individual allows government and others to shift some of the burden of governance and management onto to the individual. This is explicit in the claims by IOSCO that informed investors are better able to act as watchdogs because "investor education also

[367] IOSCO (2001) *Investor Education in the Effective Regulation of CIS and CIS Operators,* March 2001, p. 4
[368] IOSCO (2001), p. 8
[369] IOSCO (2001), p. 2

allows investors to protect themselves against fraud and other abuses. Educated investors can better monitor certain activities of the CIS in which they invest (or in which they are considering an investment) and assist the regulator in spotting abuses."[370] Therefore, investor education works to 'teach' the investor with varying levels of sophistication about their risk in concert with internal governance rules and disclosure to provide the relevant information and protection.

CIS, Systemic Risk and Risk in Regulation

It is worthwhile to discuss briefly the role of systemic risk in CIS governance. Although systemic risk management is not an explicit goal of CIS governance,[371] reduction of systemic risk is one of the three objectives of the *Core Principles of Securities Regulation*.[372] Looking to the actions by those in the international financial community, we can gauge a recognition and examination of the potential links between CIS and systemic risk. IOSCO activities related to CIS governance are reported to and addressed by the Financial Stability Forum.[373] As a body set up specifically to deal with addressing sources of systemic risk in the international financial system, this is an indication that there are at least some concerns. However, within the CIS standards,

---

[370] IOSCO (2001), p. 4

[371] The 4 stated goals are investor protection, market integrity, integrity of operator, and global developments of CIS as an investment vehicle. (IOSCO (1997) *Principles for the Supervision of Operators of Collective Investment Schemes*, September 1997, p. 4-5)

[372] International Organization of Securities Commissions (IOSCO) (2003) *Objectives and Principles of Securities Regulation*, May 2003

[373] Financial Stability Forum (2004) "Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)" for the Financial Stability Forum Meeting on 8-9 September 2004

codes, and reports there is little other reference to risk in the systemic sense. This is in contrast to the clearly visible link between investor protection and individual risk.

In the academic and trade literature, whether CIS are systemic risks is contested. There are a number of academic arguments made as to why the CIS sector does not present a systemic risk. Franks and Mayer assert that because asset managers and CIS invest for other people, the fiduciary relationship is likely to mean they pose less concern than commercial and investment banks and brokers and dealers.[374] Others point to the difference between deposits and investments[375] or the lack of crises as evidence that existing governance mechanisms work well.[376] However, Karmel argues that these funds can contribute to market volatility. "Since open-end investment companies are required to be sufficiently liquid to be able to redeem shares on a daily basis, trading by mutual funds significantly contributes to the severity and speed of market declines."[377] However, what she finds particular problematic is that regulators have not really looked at this role in relation to systemic risk, instead being "trapped" in a paradigm of investor protection. Given the increasing size of the industry and its links with pension funds, banks and other financial actors, the potential that failures in this industry will spill over into the financial system as a whole are plausible. An example of these links is the connections between

[374] Franks, Julian and Colin Mayer (2001), p. 5
[375] Edwards, Franklin R. (1996) *The New Finance: Regulation and Financial Stability*, Washington, D.C.: The AEI Press -- Edwards, for example, argues that while open-fund CIS must buy back its shares, this is done at current market value, whether that is higher, lower or the same NAV as when they were purchased. Therefore in a case of problems the NAV price that they would be reimbursing is likely to be lower. In the case of banks, the deposit must be returned at the same value.
[376] Thompson, John K. and Sang-Mok Choi (2001), p. 5
[377] Karmel, Roberta S. (2004-5), p. 927

mutual funds and pension funds. Harmes argues that by the early 1990s, pension funds were increasingly delegating asset management to mutual funds.[378]

There may be a temptation to explain the difference between banking and CIS and their discursive links to systemic risk because they are part of the securities market. However, this argument that CIS have not been discursively linked with systemic risk because it is a securities instrument is weakened when one considers the discussion of hedge funds. Hedge funds have been the area of CIS that has been most connected with the discourse of systemic risk. For confirmation we can look to the words of the regulators. In a speech in September 2006, Timothy F. Geithner, Governor of the New York Federal Reserve, stated that the growth in hedge funds "will force us to consider how to adapt the design and scope of the supervisory framework to achieve the protection against systemic risk that is so important to economic growth and stability".[379] Moreover, at the G7/G8 finance ministers meeting in February 2007 Germany's finance minister, Peer Steinbruck, drew attention again to his concerns about the lack of transparency of these funds and their potential with regard to systemic risk.[380] The centrality of concern with potential systemic risks is apparent. Discursively, the relationship between hedge funds and systemic risk goes back to the very public 'almost failure' of the hedge fund Long-Term Capital Management (LTCM) and its bailout by a consortium of global banks in September 1998. However, the lack of international standards for hedge funds until

[378] Harmes, Adam (1998)

[379] Mufson, Steven (2006) "Hedge Fund's Collapse Met With a Shrug: Amaranth's Loss in Natural Gas Gamble Not Seen as Affecting Broader Market" *The Washington Post*, Financial Section, September 20, 2006, D01

[380] Munchau, Wolfgang (2007) "The Germans have the right idea on hedge funds" *Financial Times*, London Edition 1, Comment, February 12, 2007, p. 19

very recently also reminds us that construction as a systemic risk is not a simple answer to the why or how of international financial regulation.[381] IOSCO highlights how regulatory concerns are driven by systemic risk and not investor protection arguing,

> HLIs do not generally raise significant investor protection concerns as their direct investors should be capable of protecting their own interests. However, the activities of some HLIs may raise issues in the area of systemic risk and market stability.[382]

Conclusion

This chapter has sought to provide a background into the international governance of collective investment schemes and their links with the discourses of risk. In the process it has highlighted another combination of the two discourses of risk that were discussed in chapter 4. In this case, these funds and companies have not been as consistently connected to systemic risk. However, an examination into the regulatory initiatives does, provide an important insight into explaining the identities and roles that are articulated in the performance of governance and regulation. As we can still see today, there is a discursive frame in this industry which places responsibility for market risk on the individual investor. Given this, actual risk management becomes less a concern for regulation. It instead becomes about ensuring the most transparent and fair market for the investor to make their choice in. This leads to the key discourse - investor

---

[381] IOSCO should be releasing a set of high-level principles on the regulation of hedge funds in June of 2009.

[382] International Organization of Securities Commissions (IOSCO) (1999) *Hedge Funds and Other Highly Leveraged Institutions*, November 1999, p. ii -- This lack of earlier movement is related, in part, to the construction of the hedge fund investors as 'sophisticated'.

protection - articulating the investor as a subject needing protection from certain market activities. The most apparent of these is protection from fraud and other sources of misconduct. The other key way this occurs is through disclosure as investors must be able to effectively choose their levels of risk. However, in order to maintain that investors can bear responsibility, the system also requires the re-articulation of the investor into an informed and able to assess their risk options. Therefore, disclosure does more than simply provide neutral information; it also creates a situation where investors must be 'educated' to interpret it. We see this idea of 'education' performed in the work of IOSCO on investor education and also the public and private programs and practices which aim to construct the 'well-informed investor' that international regulation articulates. The complex and technical aspects of how to properly assess and manage risk do not appear in the regulatory text the same way we see Basel II because they have been downloaded onto the individual. Turning to the final case of reinsurance, a third articulation of risk and financial regulation can be seen.

Chapter 7: Reinsurance
A Risk Management Technique and/or Systemic Risk?

To conclude the discussion about risk and the international governance of finance, this chapter will look at the reinsurance industry and its regulatory structures. The reinsurance sector is a highly global market.[383] In 2004, there were 150 active reinsurance providers with premiums of around $170 billion US worldwide.[384] However, regulation of the sector has been nationally based and has varied substantially between these different jurisdictions historically. The fact that there has been an emerging focus on harmonizing the international regulatory framework in recent years makes it an appealing case for analysis.

Interestingly, like collective investment schemes, there has been little to no attention paid to reinsurance by International Political Economy scholars. In fact, there are only a few places where explicit work on insurance has been done. One key sphere is inspired by Virginia Haufler's work on the insurance sector, which looks at the concept of political risk in the context of insurance.[385] This work also highlights the private authority role that reinsurance can exercise in international financial markets and the global economy more generally. A second work is Singer's recent book on international financial regulation more generally, which contains a chapter focused explicitly on insurance.[386] This work argues that the impact of global competitiveness between states

[383] While impressive, one should remember that this globalization is not complete as Japanese markets are still largely closed to foreign firms (Singer, David Andrew (2007), p. 101)
[384] Group of Thirty (2006)
[385] Haufler, Virginia (1997)
[386] Singer, David Andrew (2007), pp. 96-113

and fragmentation in regulators explains the lack of international reinsurance standards. One cannot deny that reinsurance regulation is more fragmented and varied internationally than banking. Yet, one also can not deny an increasing emphasis on global regulatory harmonization from bodies like the Financial Stability Forum, the OECD and the International Association of Insurance Supervisors (IAIS). These standards, codes and reports do seek to create a world within their structure. The final potential area of reinsurance analysis is the brief references found in global governance studies mentioning the work of the International Association of Insurance Supervisors (IAIS) in the context of the larger international regime of financial regulation. These studies tend to examine its potential as a form of soft law or knowledge creation.[387]

This chapter will argue that international reinsurance regulation is marked by a complex construction as both a type of risk management (and potential source of governance) and as a financial industry that can pose risks. Due to its role in distributing risk, reinsurance has been largely constructed as a tool of risk management, not as a source of risk itself, in the financial industry. Even where the reinsurance industry is seen to pose risks (dangers/threats) which should be addressed through governance, constructed notions of the sophistication and expert knowledge of insurers have influenced these practices. These two intertwined identities of reinsurance explain, at least in part, why there can be such diversity in regulatory structures and so few highly

[387] For example, Porter (2005) briefly discusses the IAIS in this context, along with the Basel Committee, IOSCO, the Financial Stability Forum, the Group of Twenty (G20) and others, particularly the work of these organizations combine to create a global regime in financial regulation.

precise international regulatory efforts in spite of the historical highly globalized nature of the reinsurance market.

However, in recent years there has been increasing questions about the sector as a source of systemic risk. The regulatory debate that emerges around the implications of this attempted reconstruction of the industry manifests in discussions of practices of disclosure and transparency. Again the legitimacy of these roles and practices is related to the articulation of both insurers and reinsurers as sophisticated financial organizations. Mimicking the structure of the last two chapters, the following two sections will provide a general background on the reinsurance market and international regulatory efforts in the field. However, this chapter will shift in structure slightly for the substantive discussion, focusing on each of the three constructions above and their related practices in turn: reinsurance as a market for 'pure risk' and a tool of risk management, risks in the process of reinsurance and their governance and finally reinsurance as a potential source of systemic risk.

What is reinsurance?

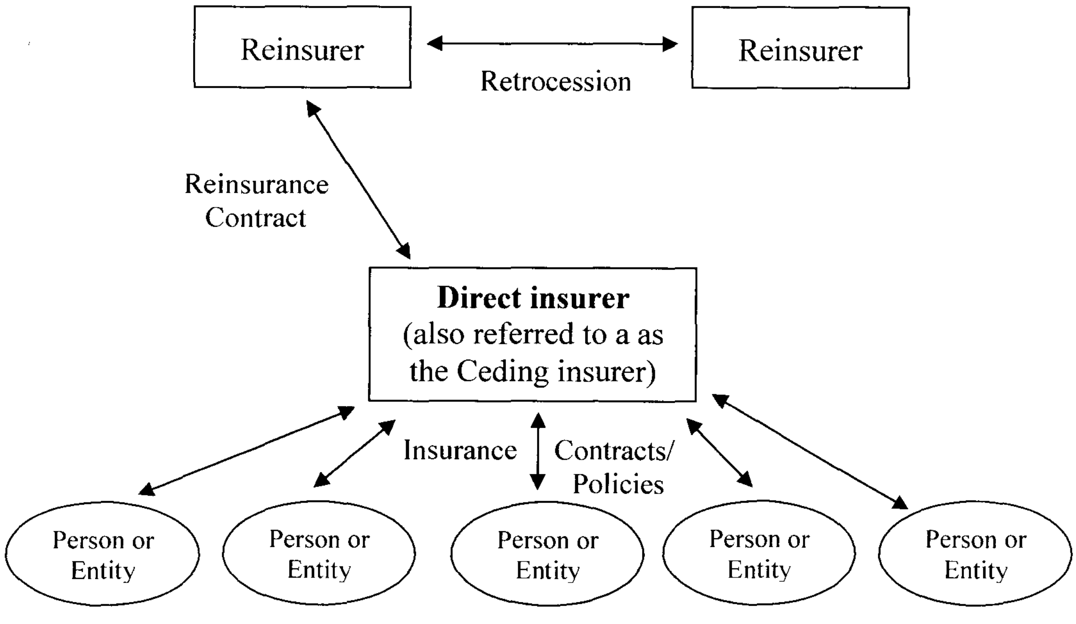
Reinsurance is essentially 'insurance for insurance contracts and companies', a contract in which risk is transferred. The quantity of risk transferred (or ceded) is referred to as the cession and therefore the primary insurance company can be referred to as the ceding insurer or cedant. More specifically, the reinsurance sector is composed of countless bilateral insurance contracts "in which a reinsurer agrees to indemnify a ceding insurer based upon the cedant's own loss experience".[388] In other words, the reinsurance contract involves the transfer of a stipulated amount of liability from their policies to the reinsurer from the insurer for an agreed upon price. In the event of a claim, the reinsurer provides reimbursement to the ceding insurer for claims payments covered by the reinsurance agreement. However, reimbursement from the reinsurer to the original insurance company does not alter the underlying insurance policies or their obligations, as the ceding insurer is still obliged to pay policyholder claims regardless of its reinsurer's performance or financial state.[389] When a reinsurer seeks to insure its own contract with the primary insurer, it can purchase reinsurance on that contract/policy from another reinsurer. This reinsurance contract is known as a retrocession. See Figure 7a below for a representation of these links.

Reinsurance contracts are tailored to the needs of the primary insurer and its premiums are priced according to the expected losses of the reinsurer plus an extra charge to compensate the reinsurer for underwriting the risk.[390] Due to this tailoring, contracts can take numerous different forms. However, the most common and conventional types of reinsurance arrangements are 'treaty' and 'facultative' reinsurance contracts, which in turn are either 'proportional' or 'excess of loss' in class. Treaty contracts are designed to cover multiple risks of a specific type possibly over a certain period of time.[391] Typically,

[388] Grace, Martin F., Robert W. Klein and Richard D. Phillips (2001) "Regulating onshore special purpose reinsurance vehicles" *Journal of Insurance Regulation*, vol. 19, iss. 4, Summer, pp. 551-591
[389] McIsaac, Donald A. and David F. Babbel (1995) *The World Bank Primer on Reinsurance*, Washington, D.C.: World Bank Financial Sector Development Department
[390] Grace et al. (2001)
[391] Moreover, there are two forms of treaty contracts, obligatory and non-obligatory. In the former the primary insurer can choose what is ceded (based on prior agreements); in the latter this option is unavailable.

the multiple risks are an entire category of risk or line of business and may only extend up to a certain limit. In contrast, facultative contracts address a single risk. In this case, the reinsurer retains the ability to accept or reject any individual risk from the primary insurer.

Figure 7a: Insurance, Reinsurance and Retrocession



Based on McIsaac, Donald A. and David F. Babbel (1995) *The World Bank Primer on Reinsurance*, Washington, D.C.: World Bank Financial Sector Development Department, p. 1

Both of these contract types can be proportional or 'excess of loss' in nature. In the former, the reinsurer is responsible for losses in a stated proportion to the premium it receives. "For example, if the primary insurer cedes 60 percent of its liability to a reinsurer, it pays an amount equal to 60percent of the original premium for the privilege".[392] In contrast, 'excess of loss' contracts have an 'attachment point' or minimum claim level. If the claim does not exceed that level then the reinsurer pays nothing. However, if the claim exceeds this amount the reinsurer is responsible to reimburse a percentage (or the entirety) of the claim amount that is over this point depending on the terms of the contract.[393] Furthermore, unlike proportional agreements, the premium is not connected to the loss so it is negotiated separately. Currently, many catastrophe reinsurance programs are excess-of-loss based, so the primary insurer is responsible for all covered losses up to a particular limit and the reinsurance company agrees to pay part or all of the losses above that point up to a pre-determined limit.[394]

Reinsurance is not a new financial practice. The first reinsurance contract was signed in the 1370 when an underwriter reinsured part of the sea journey from Genoa to Sluys.[395] However, professional reinsurers did not emerge until over 450 years later. The first company, the Cologne Reinsurance Company, was formed in 1846 in response to ruinous fire in Hamburg four years prior. Not long after, similar institutions emerged on the European continent, including the two largest reinsurance companies currently: Swiss Re (in 1863) and Munich Re (in 1880).[396] However, the practice of reinsurance was slower to develop in the United States and the United Kingdom. In the case of the latter,

[392] CNA Re "Reinsurance Basics" www.business.uiuc.edu
[393] For example, if an 'excess of loss' contract is signed with an attachment point of $500,000 and the claim is for $450,000 then the reinsurer pays nothing. If the claim is $1.6 million then the reinsurer is responsible for up to $1.1 million. These forms of contract are written on per risk, per occurrence or on an aggregate or stop-loss basis.
[394] Grace et al. (2001)
[395] Edelman, Colin, Andrew Burns, David Craig and Akash Nawbatt (2005) *The Law of Reinsurance*, Oxford: Oxford University Press, pp. 3-4
[396] Edelman et al. (2005), pp. 3-4; Group of 30 (2006) *Reinsurance and International Financial Markets*, p. 10

the legal restrictions imposed in 1764 and the unique structure of the Lloyd's market partly explain this.[397] However, the lifting of the prohibition on reinsurance in 1864 allowed the firm entrenchment of London as the center of the marine reinsurance market by the mid 1900s. The early 20th century, particularly the major earthquakes in San Francisco in 1906 and Tokyo in 1923, marked a growing consensus of the stabilizing role that this industry can have in cases of extreme losses. These events displayed the resilience of the industry, as there were very few reinsurer insolvencies (excluding any voluntary market exits).[398] However, in the United States, the financial instrument of reinsurance really began to develop only after World War II.[399]

The reinsurance industry today is very centralized with 90 percent of the industry located in eight centers: Bermuda, France, Germany, Ireland, Japan, Switzerland, the United Kingdom and the United States.[400] This trend toward centralization extends to the reinsurance actors as well. Although there are over a hundred active firms, most are relatively small and following a wave of mergers in the late 1990s the ten largest reinsurers account for approximately sixty percent of the market (compared to only forty percent in the early 1990s).[401] A report by Swiss Re asserts that this concentration is even more focused. It maintains that the top five reinsurers actually controlled 57 percent of

[397] Ibid. Lloyds began as a co-insurance market where large risks were spread between a numbers of its syndicates backed by well-to-do local merchants. Furthermore, Lloyds was initially primarily active in insuring marine risks. The fact that the core of the marine reinsurance market developed in this location is not surprising.
[398] Group of Thirty (2006), p. 10
[399] United Nations (1980) *Transnational Reinsurance Operations: A Technical Paper* New York: United Nations Centre on Transnational Corporations
[400] International Association of Insurance Supervisors (IAIS) (2007) *Discussion Paper on the Mutual Recognition of Reinsurance Supervision*, October 2007, p. 4
[401] Group of Thirty (2006), p. 1

market share in 2001.[402] Moreover, the industry is primarily active in the non-life insurance business lines that compose 80 percent of premiums ceded by insurers with the remainder ceded in life insurance lines.[403]

Recently the industry has gone through a number of 'hard years', although general consensus seems to indicate that it has emerged from them quite well. In the early part of this century the performance of major reinsurance groups deteriorated in the context of a number of adverse factors and developments. These include: the effect of the soft market conditions in the late 1990s on operating performance; the reserve shortfalls that many reinsurers needed to top-up and the effect of this on their bottom line; credit risk losses due to large unexpected corporate failures, lower investment returns following the fall in equity markets and volatility of bond markets; the impact of the terrorist attacks of September 11, 2001; the costs of natural disasters like the multiple hurricanes which have hit in the southeast United States and the resulting rating agency downgrades from all these developments.[404] This emerging situation had reflexively affected the discursive construction of the industry in governance arenas. Therefore, we are in discussion at a moment where the connections between reinsurance and discourses of risk are slightly in flux. Given this context, the study can now turn to examine the efforts in international reinsurance regulation.

---

[402] Baur, Patricia and Rudolf Enz (2003) "Reinsurance – a systemic risk?" *Swiss Re sigma No. 5/2003*, Zurich: Swiss Re, p. 4 <http://www.swissre.com/sigma>, p. 12
[403] Group of Thirty (2006)
[404] Reactions (2005) "10 CEOs, 10 questions" *Reactions*, Vol. 25, iss. 9, September, pp. 44-52

International Reinsurance Regulation

The recently developed international governance assemblage around reinsurance stands in sharp contrast to the highly focused Basel discussions in the banking industry. The harmonization of standards and the push toward mutual recognition, also less developed than those initiatives in the CIS sector, have only gained focus in the last five years. The key actor in the international governance of reinsurance is the International Association of Insurance Supervisors (IAIS). The IAIS was created in 1994 with a mandate of developing international principles, guidelines for supervision and improving the insurance and reinsurance supervision through mutual assistance and cooperation.[405] However, the recentness of the shift to internationally coordinated governance can be seen in the 1999 comment of Hanley Clark, then Chairman of the IAIS Executive Committee. In a *National Underwriter* article he stated,

> insurance supervisors are years and possibly decades away from developing and implementing an international regulatory standard for the reinsurance industry, according to regulators and reinsurers. In fact the key supervisory body for insurance, the 87 member International Association of Insurance Supervisors, has not yet decided if it even supports international reinsurance regulation.[406]

It was three years later the major harmonized standards for reinsurance began to emerge. Moreover, they were explicitly driven by concerns with risk.

---

[405] The IAIS membership is largely composed of national insurance regulators. However, since 1999, the association has permitted non-voting observer members, including re/insurance companies and brokers, law firms and accounting firms. Currently the association has insurance regulators and supervisors of some 180 jurisdictions and over 100 observers. For more information on structure of the IAIS see their website <http://www.iaisweb.org>

[406] Maurice, Alex (1999) "Int'l Re Regulation Still Could be Decades Away" *National Underwriter*, August 30, 1999, pp. S-24 & S-28

By the late 1990s, the global reach and diversification in the sector had lead to an increasing tendency to question whether the reinsurance industry was a systemic risk and a potential source of system-wide instability. Unlike banking, where the systemic danger or risk is articulated clearly and used in concert with consumer protection to justify regulation, or CIS, where it is largely left unexamined, in reinsurance the discourse of risk as systemic danger is in a period of problematization.

In reinsurance, there have been three key governance bodies directly active in this discussion: the Financial Stability Forum[407], the IAIS and the G30. The FSF has asserted a concern about the reinsurance industry since not long after its inception in the late 1990s and it a key actor in this discourse.[408] However, the G30 has also devoted resources and attention to the global role of reinsurance in recent years.[409] Responding to the challenge to its stability that the industry faced following the "terrorist attack of September 11, 2001, falling stock markets in 2001 and 2002, and concerns about the robustness of the credit derivatives market", an informal discussion between reinsurance executives, financial stability experts, and G30 members was formed. Eventually this evolved into the creation of a working group addressing the impacts of the global reinsurance industry. In order to avoid overlap, this group also discussed the efforts

[407] Following the Asian financial crisis, governments of the top seven economies in the global system created the Financial Stability Forum (FSF) which facilitates the regular meeting of financial services regulators to head off market or regulatory developments that could pose a threat the global financial architecture, or so-called 'systemic risks'. (Vaughan, Terri (2002) "NAIC and IAIS: Bringing global insurance regulation closer to home" *Journal of Insurance Regulation*, vol. 21, iss. 1, Fall, pp. 85-87)

[408] Financial Stability Forum (2000) *Report of the Working Group on Offshore Centres*, 5 April 2000, p. 15 < http://www.fsforum.org/publications/OFC_Report_-_5_April_2000a.pdf>

[409] The Group of Thirty, formally called The Consultative Group on International Economic and Monetary Affairs, Inc. was founded in 1978 as a non-profit, non-political organization to explore issues of business practice and public policy. It issues suggestions to improve the functioning of the international financial system.

through the Financial Stability Forum, the IMF, the Joint Forum and the BIS in relation to the sector. In their recent comprehensive study, one of the questions that they sought to specifically answer was whether reinsurance substantially added to systemic risk in the international financial system that will be discussed later.

In 2000, the FSF called for an explicit examination of the reinsurance industry to assess its potential to be a systemic risk. It argued that an:

> examination of the reinsurance industry in OFCs [offshore financial centres] as well as elsewhere yielded little evidence to suggest a significant threat to systemic financial stability. While one or more large reinsurance company failures could have a significant, adverse impact on the primary insurance sector, due to the extended time in which insurance claims are typically paid out, it is unlikely to lead to the kind of liquidity crisis that can follow from an equivalent large bank failure. Further, the capital and reserves of the industry appear large relative to all but extremely low probability, extremely high damage, natural catastrophes. Nevertheless, there are some features of the reinsurance industry that raise potential prudential-type problems. The market has become increasingly concentrated, and there has been a significant increase in the number of firms domiciled in OFCs.[410]

Due to this remaining concern, the FSF issued a recommendation in this report encouraging the IAIS "to develop best practices for reinsurance and its supervision".[411] In response the IAIS created a Reinsurance Committee to assess the security of reinsurers and begin to develop a standard of best practice for evaluating these actors. In 2002 the output of this work was released as the *IAIS Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers* in January and the *Principles on Minimum Requirements for Supervision of Reinsurers* in October.

[410] Financial Stability Forum (2000) *Report of the Working Group on Offshore Centres*, 5 April 2000, p. 15 < http://www.fsforum.org/publications/OFC_Report_-_5_April_2000a.pdf>
[411] I Financial Stability Forum (2000), p. 4

In 2002 the IAIS highlighted the variety of national reinsurance regulation that existed arguing,

> Currently, reinsurers in some jurisdictions are fully or partly directly supervised; other jurisdictions rely on rating agencies in assessing the security of a reinsurer. Some supervisors maintain a register of those reinsurers authorised to underwrite reinsurance in their jurisdiction, while others evaluate reinsurers writing business in their jurisdiction. Some jurisdictions require reinsurers to post collateral, covering the likely liabilities (or liabilities plus a margin). In most jurisdictions, a reinsurer who also acts as a primary insurer is subject to direct supervision.[412]

Development of an integrated regulatory structure has been slow, however a more current IAIS discussion paper notes that although significant variations still exist, "recently a convergence has occurred regarding reinsurance regulation and supervision among key jurisdictions."[413]

The Principles serve as the key coordinating standard of the IAIS's work on reinsurance and the convergence that has occurred. Within the document the IAIS legitimizes the creation of internationally harmonized regulation in the following clauses.

> Internationally recognised principles for the supervision of reinsurers are needed because of the global nature of the business and the expectation that the business will continue to expand, for example into new regions. They are also needed to ensure that new entrants in the reinsurance markets or existing entities that expand their business rapidly offer acceptable security.[414]
>
> Recognising that there will always be some differences in the supervisory regimes, this principles paper identifies minimum requirements for supervision of reinsurers. These requirements should be supplemented by effective systems for exchanging information. It is

[412] International Association of Insurance Supervisors (IAIS) (2002) *Principles on Minimum Requirements for Supervision of Reinsurers*, Principles no. 6, October 2002, p. 4

[413] International Association of Insurance Supervisors (IAIS) (2007) *Discussion Paper on the Mutual Recognition of Reinsurance Supervision*, October 2007, p. 4

[414] International Association of Insurance Supervisors (IAIS) (2002), p. 4, point 4

> assumed that the move towards global principles will be an evolutionary process.[415]

In this justification two key elements are visible. First, the highly globalized nature of reinsurance markets and the responsibility to ensure security is clear. Second, the aim of reinsurance harmonization is to create *minimum* requirements for national supervision not extensive, highly detailed and prescriptive regulations for reinsurance directly.

The 2002 *Principles on Minimum Requirements for the Supervision of Reinsurers* aim to identify the minimum requirements and elements of a supervisory framework for the governance of reinsurers. It separates activities and practices into two categories, those that should be the same as primary insurers and those that should be adapted to fit the unique characteristics of the reinsurance market for insurance supervisors. These minimum requirements look specifically at the areas of technical provisions, capital requirements, investments and liquidity, corporate governance and the exchange of information among supervisors. They also elaborate discussion on legal forms, licensing, financial group relations, sanctions and methods of supervision.[416] This regulatory framework was developed more comprehensively in the *Standard on Supervision of Reinsurers* in October 2003.[417] In this document, the supervisory requirements were elaborated on to explicitly "include financial strength, supervisory review and disclosure requirements."[418] These standards have clear connections to the three pillars in Basel II.

---

[415] International Association of Insurance Supervisors (IAIS) (2002), p. 4, point 6
[416] International Association of Insurance Supervisors (IAIS) (2002) *Principles on Minimum Requirements for Supervision of Reinsurers*, Principles no. 6, October 2002
[417] International Association of Insurance Supervisors (IAIS) (2003b) *Standard on Supervision of Reinsurers*, Supervisory Standard no. 8, October 2003
[418] International Association of Insurance Supervisors (IAIS) (2003b), p. 3

However, unlike the banking regulation there is no explicit detail on how to calculate financial soundness.

Since the beginning of the century, the IAIS has continued to develop principles, standards and guidance papers explicitly aimed at reinsurance.[419] More specifically, the organization has also released:

- Supervisory standard on the evaluation of the reinsurance cover of primary insurers & the security of their reinsurers -- Supervisory Standard No. 7 (January 2002)
- Standard on supervision of reinsurers – Supervisory Standard No. 8 (October 2003)
- Standard on disclosures concerning technical performance and risks for non-life insurers and reinsurers – Supervisory Standard No. 9 (October 2004)
- Standard on disclosures concerning investment risks and performance for insurers and reinsurers - Supervisory Standard No. 11 (October 2005)
- Guidance Paper, no. 11 -- Risk transfer, disclosure and analysis of finite reinsurance (October 2006)
- Guidance paper No 3.5 on the mutual recognition of reinsurance supervision (October 2008)

The discussions of risk in international reinsurance governance in this chapter are largely drawn from this work of the IAIS.

Risk in International Reinsurance Regulation

As with the other two cases, reinsurance has clear links with understandings of risk and the techniques, practices and performance of risk management elaborated in its international standards. Yet there are key differences with the banking and CIS industries. Unlike both securities and banking, which are channels for the flow of capital from savers

[419] This list does not include standards which include references to reinsurance, focusing on regulatory documents which are more explicitly centered on this sector.

to borrowers, insurance serves as an explicit risk management practice for individuals, organizations and the financial industry. Reinsurance is one aspect of this larger process. This chapter will argue that risk emerges in three distinct ways in the international regulatory codes and standards: as potential systemic risk, as an object managed through reinsurance, as a variety of specific threats or dangers that occur in the practice of reinsurance which should be governed. Each of these constructions and the practices, and identities legitimated in them will be discussed in turn in the rest of the chapter.

Reinsurance and the market for risk

In the simple description of reinsurance earlier in the chapter it is clear that risk is an economic necessity in this sector. Not only is the measurement of risk in relation to premiums the primary source of profit and growth for reinsurers; it is the foundation of its very existence. Reinsurance intends to augment the fundamental objective of insurance, i.e. to spread risk so that no single entity bears a financial burden that is beyond its payment ability.[420] Therefore, without 'risks' there would be no sector. Singer conceptualizes insurance as "markets for *pure risk*. A consumer purchases an insurance contract as a means of ceding risk to another entity not as an instrument for earning a return on excess capital."[421] The source of profit for those who accept the transferred

[420] Nutter, Franklin W. (2002) "Testimony before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the House Committee on Financial Services" Insurance Regulation and Competition for the 21st Century < http://financialservices.house.gov/media/pdf/061102fn.pdf>, p. 2
[421] Singer, David Andrew (2007), p. 99

risks comes from premiums charged. These premiums are increasingly seen to as based on the perception of accurately calculated risk scenarios.

This construction of the reinsurance industry has meant that the industry's position within the broader discourse of risk in financial services is as a source of risk management and mitigation, rather than being seen as a potential source of risk itself. The IAIS reinforces these constructions in the *Principles on Minimum Requirements for Supervision of Reinsurers* (Principle no. 6) stating,

> Reinsurers contribute to the stability of insurance markets. They can improve the risk profile and the financial soundness of primary insurers by diversifying and limiting territorial accumulations of exposure, and consequently creating underwriting capacity. However, to have this stabilising effect these entities must be able and willing to meet their obligations as they fall due.[422]

In this statement, many of the key elements of reinsurance as a source of risk management are articulated. The industry is beneficial for improving the financial situation or 'soundness' of the primary insurer. In the process, it is constructed as a key aspect of growth in the insurance market (through increased underwriting capacity). The 2007 *Discussion Paper on Mutual Recognition* makes this connection to economic benefit more explicit stating,

> Reinsurance is one of the most important risk mitigation tools for insurers. Through risk diversification and more efficient use of capital, the transfer of risk to reinsurers can provide significant economic benefits for primary insurers and their policyholders.[423]

---

[422] International Association of Insurance Supervisors (IAIS) (2002) *Principles on Minimum Requirements for Supervision of Reinsurers*, Principles no. 6, October 2002
[423] International Association of Insurance Supervisors (IAIS) (2007), p. 4

The financial stability and economic benefit reasons alluded to in regulation are reinforced by a World Bank Policy Research Paper by McIsaac and Babbel.[424] This work reflects a similar construction of the benefits of reinsurance in risk management. It argues the primary insurer benefits from the use of reinsurance to stabilizing earnings through stabilizing losses, create greater underwriting capacity, and potentially reduce in the insurer's risk-based capital reserve requirement.[425] Reinsurance inherently stabilized the potential losses of a primary insurer, as some of the liability for the losses transfers to the reinsurer. Therefore, although reinsurance is an industry within the financial sector, it has also been articulated into a risk management tool for the greater insurance sector.[426]

Furthermore, in these constructions of reinsurance as a source of risk management one can see a variety of identities and practices. First, the global nature of reinsurance is

[424] McIsaac, Donald A. and David F. Babbel (1995)

[425] A fourth role is that reinsurance can provide an avenue for companies to withdraw from specific areas of the insurance sector, in certain instances. If a primary insurer seeks to exit an insurance line along with stopping the issue of new policies, it also can transfer all of the liability of the policies currently in effect to a reinsurer. This role is not as directly linked to explicit risk management activities of the insurance organization.

[426] In this sense, the industry is in itself a tool of diversification and risk transfer. The other key way that the insurance industry accomplishes this is through multiple tools for securitization through a number of significant catastrophe (CAT) financial instruments, like CAT bonds, CAT options, etc. Emerging in 1992, the first place that these instruments were traded was on the Chicago Board of Trade (CBOT) but now there are multiple special exchanges which trade catastrophe risk. (See: Tynes, Johannes Skylstad (2000) "Catastrophic Risk Securitization" *Journal of Insurance Regulation*, Vol. 19, no. 1, Fall, pp. 3-27). The emergence and development of securitization is based on the growing acceptance of alternative risk transfer (ART) and financial reinsurance techniques in the financial services sector. Securitization is on method of ART that can be utilized to transfer risk to reinsurers and other counterparties. According to the IAIS, "securitizations commonly utilise either a 'protected cell' or a 'Special Purpose Vehicle' to effectuate the transfer of insurance risk from the ceding company" (*Supervisory Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers*, Supervisory standard no. 7). A Special Purpose Vehicle (SPV) is a corporation formed specifically to allow investors to purchase a stream of return in exchange for assuming an explicitly and specifically defined risk of loss of principle. These tools can be a used with the aid of reinsurers. However, they can also be a way to minimize the reinsurance industry by transferring risk directly to the market through the creation of captives and other SPVs. (See: Grace et al. (2001); Doherty, Neil and Kent Smetters (2005) "Moral Hazard in Reinsurance Markets" *The Journal of Risk and Insurance*, Vol. 72, no. 3, p. 377; Trace, John (2004) Current Trends in Reinsurance" *Risk Management*, vol. 51, iss. 8, August, p. 48)

recognized in the phrase, "limiting territorial accumulations of exposure". Yet this is more than an acknowledgement of fact. It also involves a clear normative claim that proper use of the globalized reinsurance market for diversification is beneficial to the insurance industry. Again, the 2007 Discussion Paper on Mutual Recognition makes this explicit arguing, "It is therefore a logical aim for risk based (re-)insurance supervisors to remove unnecessary barriers which could hinder a cross-border global diversification of reinsured risks."[427]

The second construction alluded to is in the phrase, "must be able and willing to meet their obligations as they fall due". If individual reinsurers do not fulfill their end of the contract, the risk management contribution of reinsurance is lost. This possibility provides the base legitimizing governance of reinsurers to minimize the potential that they will be unwilling or unable to meet their obligations. Through this theme in the regulatory literature, a space is created to consider the governance of reinsurance.

Risk in the Process of Reinsurance

Reinsurance serves an important role as a risk management technique for the sector. Yet, there is also a theme within policy literature about the need to ensure reinsurers are willing to and capable of meeting their obligations. Therefore, a space is created to consider the language of risk in the governance of reinsurance.

This second type of reference to risk draws out particular dangers/threats that occur in the process of providing reinsurance. For example, in the 2002 Principles argued,

[427] International Association of Insurance Supervisors (IAIS) (2007), p. 4

> The higher a company's sensitivity to risk, the greater the need for it to have strong risk management practices and capital to shore up its financial strength. Significant risks faced by reinsurers include **underwriting** (including cumulations and geographical diversification), **retrocession**, **investments** (liquidity and currency matching), **taxation**, and, for reinsurers in a group, **group risk**. In addition, like primary insurers, reinsurers are exposed to a variety of operational risks the sources of which could be employees (e.g., human error and internal fraud), technology (e.g., technological failure and deteriorating systems), customer relationship (e.g., contractual disputes), and external (e.g., external fraud).[428]

Yet, these risks are again dealt with differently than banking, where strong capital adequacy rules developed. Reinsurance rules addressing these risks directly are less well developed and more principle based. This is likely in part a result of lack of state initiative for harmonization, but it also is tied to the identity constructions or insurers and reinsurers. The IAIS maintains that "it is the responsibility of the ceding insurer to evaluate the security of proposed reinsurers and the duty of that ceding insurer's supervisor to ensure that the evaluation is adequate."[429] This reflects the underlying belief in this sector that insurance contracts "are written on 'the 'paper' of primary insurers" since their legal obligations in the original insurance contract are not altered by the failure of their reinsurers.[430] Therefore, it is in the best interest of the primary insurer to choose the best reinsurance possible. Since the primary insurer is knowledgeable and regulated, they should be able to assess the appropriateness of a potential reinsurer. This relationship constructs a governance system where reinsurers can potentially be governed effectively through market discipline while keeping this tool for risk management

[428] International Association of Insurance Supervisors (IAIS) (2002), p. 6
[429] International Association of Insurance Supervisors (IAIS) (2003b) *Standard on supervision of reinsurers*, Supervisory Standard No. 8, October 2003, p. 3
[430] Grace et al. (2001)

flexible. Here the justification for market discipline builds upon and reinforces the identity of insurers as sophisticated market participants which serves to limit the potential 'risks' of reinsurance to the individual or the system.

Intertwined with this argument in the limitation of the dangers of risk to the two main insurance actors of the contract is the belief that the reinsurance industry is composed of dealings between buyers and sellers that are both knowledgeable and sophisticated.[431] Given this connection, it is not particularly surprising that there is great variation in regulatory structures among states and that reinsurance is lightly regulated in some jurisdictions. Even in one of the most directly governed states, the United States, prior to 1985 there was little direct regulation of reinsurance.[432] In some arguments, the governance of reinsurance should occur through the regulation of primary insurers rather than directly targeting the reinsurer. This is based on a certain underlying logic that regulation of the responsibilities of the primary insurer could affect their appetite for and approach to both the reinsurance and individual reinsurers. There is a similar strategy used in counterparty risk management regulations that address the 'risks' of hedge funds through regulating banks.

Moreover, this approach can also be linked with a the assertion by the IAIS that, "Conduct-of-business rules do not apply, since the policyholders of reinsurers are not consumers and do not require the same protection."[433] This is justified because the policyholders are not consumers and therefore are not seen to require the same level of

[431] Weiss, Mary A. (1993) "The economics of reinsurance regulation" *Journal of Insurance Regulation*, vol. 11, iss. 4, Summer, pp. 448-
[432] Ibid.
[433] International Association of Insurance Supervisors (IAIS) (2002) *Principles on Minimum Requirements for Supervision of Reinsurers*, Principles no. 6, October 2002, p. 5

protection.[434] The choice of the term 'policy holder' and its separation from 'consumer' is interesting in that it obscures the commercial nature of the relationship in the reinsurance process. The only way to be a 'policy holder' is to purchase a policy even in reinsurance. Therefore, this separation serves an analytical purpose that is inherently contradictory. In the *Standards* that follow one year later, this contradiction becomes more clear. The references refer to 'sophisticated' customers. In this case there is a recognition that this is a commercial process. However, the qualifier 'sophisticated' becomes a way to legitimize disclosure and minimize the level of direct regulation. It also separates those policy holders in the reinsurance sector from those in the traditional insurance sector.

One must take care though as this discussion does not imply complete neoliberalism in regulation. For example, the IAIS maintains that reinsurers should keep a certain level of capital reserves arguing,

> since reinsurers' operating results are potentially more volatile than those of primary insurers, they must hold capital reflecting the risks inherent in this type of business and sufficient to be able to withstand extreme but plausible loss scenarios.[435]

Moreover, these actors should be subject to governmental oversight of their technical provisions, investments and liquidity, corporate governance.

[434] International Association of Insurance Supervisors (IAIS) (2002), p. 5, point 9
[435] International Association of Insurance Supervisors (IAIS) (2002), p. 6 emphasis in the original document

Performances of Risk in Reinsurance

As with the other two cases, risk is not simply an idea that frames regulatory discussion, risk measurement and management are performed in the industry. In this chapter the focus will be on three key performances and their implications for power relationships and identity – information and the use of modelling, the role of the actuary and the role of disclosure.

Information and Modeling

In the constructed role as a source of risk management, there are a variety of reinsurer practices that serve as performances of governance in the financial services sector. In her 1997 book, Haufler asserts that reinsurance can play a governing role over insurers because reinsurers create formal and informal rules in their daily market practices. These rules can constrain the actions of insurers through their impact on the decision of a reinsurer to accept a proposed risk transfer.[436] As an attractive and important tool for risk management[437], reinsurance companies have the potential to leverage this position into disciplinary power, requiring insurers to adopt particular forms of risk management and risk selection in order to qualify for reinsurance. We need to take care however, not to overstate the intentional aspect of this role; there are clear aspects of coordination, discipline, and therefore informal governance by reinsurers as

[436] Haufler, Virginia (1997), chapter 1
[437] This importance is also clear in reviewing the trade literature. For example an article by John Trace (2004) in the trade magazine *Risk Management* states, "Reinsurance has as important a role to play in risk management as ever, and it would behove risk managers – especially those responsible for large and complex risks – to have a solid understanding of the reinsurance marketplace". p. 48

well. This governance role can also be inferred from the *Standards for supervision of reinsurers*, which calls on regulators to ensure that reinsurers

> have an in depth knowledge of the underwriting policy and the claims handling procedure of cedants and should be informed about any material changes. This may be obtained by collecting appropriate information from cedants on a regular basis in agreed formats and quality. The contract terms between the reinsurer and cedant also often provide that the reinsurer has the right and ability to conduct claims audits of the cedants.[438]

Within this we can see a key way that this disciplinary governance is occurring is through reinsurers -- the demand for better quality information as a component in the pricing process. An 2005 article in *Global Reinsurance* highlighted that, "companies unable to produce this data in sufficient detail are already suffering a pricing disadvantage, and we see this tendency increasing."[439], which adds a commercial dimension to this exercise of power.

This information is necessary as the reinsurance industry has increasingly used quantitative and modeling techniques, particularly in determining reinsurance premiums and exposures. Similar to other financial services industries, the development of the computer and software technologies inherently links to the increasing use of this type of modeling. As discussed in Chapter 4 the turn to modeling is related to a belief that it provides greater ability to accurately measure risk, and therefore price the risk transfer contract that is at the heart of insurance. As risk taking is an economic necessity for reinsurance companies, a quest for better risk management to optimize the gains and minimize the losses from those risks has occurred.

---

[438] International Association of Insurance Supervisors (IAIS) (2003b), p. 5

[439] Murray, Mike (2005) "The New Regulatory Landscape" *Global Reinsurance*, February 1, 2005

One key area where modeling has formed a central part of the discussion of risk in the reinsurance industry is catastrophe risk. Christian Milton (responsible for purchasing reinsurance for AIG) highlights this when he asserts that excess-of-loss catastrophe reinsurance is "basically a model book, so whatever the [catastrophe] model says is basically pretty much what we, in fact, get".[440] The modeling aims to assess risk by looking at the probabilistic theory and actuarial estimates underlying catastrophe risk assessments, which are complex and difficult subject matter.[441] This trend plays a part in the clamour by reinsurers for more information, including better historical loss data, aggregate accumulations and better information on terrorism exposures. In the process, this rearticulates the market as one where more and better data are required.[442]

It is also interesting that this trend toward modeling of risk has been mirrored as primary insurance companies also now seek to model the impact of different reinsurance structures and layers for their business. This process creates an element of reflexivity as each group responds to developments in the modeling techniques and technology. It also indicates that both sides of the contract as seeking a greater level of precision in risk, requiring more detailed data and actuarial estimates which are inserted into increasingly sophisticated modeling to get a more exact measure of risk exposure and price accordingly. Some have seen this dual emergence of modeling as a more complementary process. For example, some, like Nicholas Michaelides, chief reinsurance officer with Ace Overseas General in 2004, argue these models are a way for insurers and reinsurers

---

[440] Ibid.
[441] Tynes, Johannes Skylstad (2000) "Catastrophic Risk Securitization" *Journal of Insurance Regulation*, Vol. 19, no. 1, Fall, p. 23
[442] Reactions (2004) "Reaching the peak", *Reactions*, March 2004, p. 1

to mitigate risks in concert.[443] However, it can also highlight an overreliance on modeling.

It is also important to remember that even if more statistical methods and risk models allow reinsurers to learn the relevant information and minimize adverse selection. The possibility of adverse selection remains a possibility.[444] There is an inherent underlying normative tendency and arbitrariness that occurs in the process of model building. Before the model can be used, companies have to identify risks and more importantly assign them values. A KPMG study alleged that the insurance sector does not necessarily have a precise understanding of the risks that are inherent to the business processes – operational risk – focusing more on market risk. The study also found that insurers are finding risks difficult to quantify."[445] Even in the area of catastrophe risk where modeling has made significant inroads, again there is recognition that modeling is not foolproof. There has been an increased emphasis in recalibrating these models following their failure to predict the four hurricanes that landed in Florida in the fall of 2005. "Reinsurers note the old models were undervaluing losses by up to 20-25%. That could be both because of the limitations of the old models as well as the data being input into the models".[446] There was recognition of the important impact that can occur if the 'proper values' of risks are not used. Recalibrated CAT models have become more

[443] BestWire (2004a) "Insurers take a closer look at their need for Reinsurance", *BestWire*, June 9, 2004
[444] Adverse selection can occur in the reinsurance process because the insurer inherently has more information about the risks that they are seeking to cede. In some cases, this can be exploited in favour of the primary insurer. (Cutler, David M. and Richard J. Zeckhauser (1997) "reinsurance for Catastrophes and Cataclysms" *National Bureau of Economic Research Working Paper 5913*, Cambridge, MA: National Bureau of Economic Research)
[445] Kielmas, Maria (2005) "Reinventing Risk Management" *Global Reinsurance*, March 1, 2005.
[446] Gambill, David (2006) "Reinsurance Outlook 2006: Hunger for Premium" *Canadian Underwriter*, July 2005

complex as they have grown to include phenomena like storm surge and demand surge.[447] How one determines what the proper value, although likely well thought out and developed, are still based on assumptions that are subjective. Therefore, although this is a search for precise risk measurement at its core, there are still many assumptions about how the world works and implicitly how it should be. Moreover, this marks another space where the constructed nature of risks can be seen. While events like hurricanes and others do exist, their conceptualization as catastrophic risk and the level of this risk is inherently one of perception and identification can act as a source of some governance for the sector.

From the regulatory standards, the IAIS's *Standard on Supervision* has legitimized the use of modeling in reinsurance modeling to understand their risk profile.

> Reinsurers should use models for internal management purposes to analyse their risk profile. Some risks faced by reinsurers are similar to those of primary insurers. Whereas a primary insurer faces the credit risk that its reinsurers may not fulfil their obligations, for example, a reinsurer faces the same risk with its retrocessionaires. Both face underwriting risk, although particular aspects of underwriting risk - such as the risk of cumulations, can be - but does not necessarily have to be – more acute for a reinsurer. Similarly, as noted above, both face investment risks, the significance of which can differ depending on the global reach and lines of business underwritten.[448]

It also argues models may be useful in the calculation of technical provisions but tempers overreliance on their results asserting that reinsurers

[447] Ibid.
[448] International Association of Insurance Supervisors (IAIS) (2003b) *Standard on Supervision of Reinsurers*, Supervisory Standard no. 8, October 2003, p. 7

> use a variety of quantitative techniques to estimate the ultimate cost of claims as reliably as possible. These techniques, however, must be supplemented by professional and managerial judgment, using in-house or outside information as well as input from experts in both risk and claims assessment. Reinsurers should check data and other relevant information received from cedants and reinsurance brokers against historical data. They should be able to explain if a claim provision is not at least as high as the amount reported by the cedant or broker. Because of the issues mentioned above, there must be close cooperation at least between the reinsurer's underwriters, actuaries, claims managers and accountants.[449]

However, although qualitative elements, like the insurer's underwriting philosophy, strategy and personnel, remain important, there is "a tremendous emphasis" on both quantitative and actuarial elements.[450]

The increased use of modeling and the search for more information also fit with a larger trend toward more significantly more formalized relationships. Historical reinsurance markets were largely informal. It was seen as "a 'gentleman's agreement' done in the utmost good faith"[451] where "agreements were seldom committed to writing and there was rarely any dispute for the reinsurer when a direct writer presented a legitimate claim for payment".[452] Even when documented, agreements were traditionally more informal and less comprehensive and detailed than other areas of the financial sector although this had already began to shift toward more detail and specificity. The Group of Thirty (G30) study in 2006 noted that there has been an increasing trend toward

[449] International Association of Insurance Supervisors (IAIS) (2003b) *Standard on Supervision of Reinsurers*, Supervisory Standard no. 8, October 2003, p. 5
[450] Ha, Michael (2004) "Carriers See More Stable Reinsurance Marketplace" *National Underwriter*, vol. 018, no. 6, February 16, 2004, pp. 14-15
[451] McIsaac et al. (1995) – 'utmost good faith' is a term that used to denote a high level of trust between the actors in the involved in the contractual process.
[452] Ibid.

contracts that are better articulated.[453] This also fits with the international standards which asserted, "the contract terms between the reinsurer and cedant also often provide that the reinsurer has the right and ability to conduct claims audits of the cedants."[454]

The Role of the Actuary

Therefore, both in its role as a source of governance, one can see an increasing tendency by reinsurers toward precision in identifying the risks of others and their own risk measurement practices. The main actor responsible for identifying these 'risks', their value and how to appropriately model and categorize them is the actuary. With the shift to more quantitative approaches in the industry, the role and potential power of the actuary has come more to the forefront.

The IAIS defines an actuary as 'a professional trained in evaluating the financial implications of contingent events. Actuaries require an understanding of the stochastic nature of insurance, the risks inherent in assets and the use of statistical models" including a comprehensive understanding of not only stochastic modeling but also the use of discounted cash flows, the role of derivatives and "an understanding of volatility and adverse deviation".[455] In general terms, the actuary's role "is estimating a company's liability for outstanding claims and establishing the solvency position of the insurer."

[453] Group of Thirty (2006), p. 23-4 This trend of more articulation in contracts is particularly advanced in the area of life insurance.
[454] International Association of Insurance Supervisors (IAIS) (2003b), p. 5
[455] International Association of Insurance Supervisors (2003) *Guidance paper on the use of actuaries as part of a supervisory model*, October

Fundamental to this is a full understanding of the probabilities that are behind insurance risk.[456]

Inextricably linked with determining the reserve ratios held by reinsurance companies, the role of the actuary has come under question. For some

> the actuary has been lauded as the saviour of the insurance and reinsurance industry for introducing a much greater level of discipline into the reserving process, while in equal measure [it] has been lambasted as the root cause of the deluge of reserve strengthening announcements which continue to plague the markets.[457]

In the early part of this century, many of the major reinsurance companies had to devote resources to building up their reserves in order to ensure beliefs about their solvency. This is at least in part explained by the miscalculation of the cost of some earlier contracts, particularly related to asbestos, which were substantially greater than expected. These concerns are also attributed to the lower stock market and other factors.

In the view of some in the industry, however, the actuary is to blame for this situation. A Standard and Poor's report *Insurance Actuaries: A Crisis in Credibility* released in November of 2003 asserted, "Actuaries are signing off on reserves that turn out to be wildly inaccurate. It's an abysmal track record".[458] In essence actuaries were either not assessing 'risk' correctly, were flawed in their estimation of the amount of capital necessary to compensate for risk failures or both. Ben Zehnwirth expands on this point from the perspective of individual actuaries. He "is adamant that the finger of blame should be pointed at the practices employed in estimating reserves. The standard

[456] Global Reinsurance (2004) "Accounting for Actuaries" *Global Reinsurance*, February 1, 2004
[457] Allen, Nigel (2005) "Dividing Responsibilities" *Global Reinsurance*, July 15, 2005
[458] Standard and Poor's (2003) *Insurance Actuaries: A Crisis in Credibility*, November

paradigm for loss reserving and pricing long tail liabilities is fundamentally flawed" because of the failure to adequately recognise the impact of inflation, specifically the 'superimposed' or 'social' inflation that sit above economic inflation, and past volatility.[459]

However, others point out that actuaries and actuarial measures do not act in seclusion and some in the industry highlight that reserving involves at least three parties – actuaries, management and the claims department.[460] Others also point out the importance of the underwriter in ensuring the actuary is fully informed of any rate changes that are made. In some cases this simply does not occur.[461]

More importantly, as Sir Derek Morris, author of the Morris Review of the Actuarial Profession in the UK explains, it is important to recognize that "Actuarial expertise must not be confused with an ability always to forecast the future accurately".[462] Actuarial science is actually more of an art and there may be greater expectations than is possible. "That the terminology surrounding the actuarial statement is dotted with words and phrases such as 'adequate', 'reasonableness standard', best estimate', 'opinion' reflects the fact that any attempt to ascertain a future liability based on current information is inherently uncertain."[463] However, the Morris Report found that actuarial advice has been taken at face value. In essence, it found that actuarial advice is often

[459] Allen, Nigel (2006) "Getting a grip" *Global Reinsurance*, April 1, 2006
[460] Ibid.
[461] Ibid.
[462] Morris, Sir Derek (2005) *Morris Review of the Actuarial Profession: Final Report,* March; London: Crown Copyright <http://www.morrisreview.org.uk>; Allen, Nigel (2005) "Dividing Responsibilities" *Global Reinsurance*, July 15, 2005
[463] Allen, Nigel (2005) "Dividing Responsibilities" *Global Reinsurance*, July 15, 2005

thought of as a 'black box' where the methodology and calculations behind its output and input assumptions are seen as quite opaque[464]

The increasing use of ,and reliance on, quantitative modelling will likely only increase the importance of the actuary in decisions that can have far ranging effects. In essence, this actor has seen a shift in role highlighting an increasing emphasis on ensuring precise risk management. They will become more important in many aspects of management through their role in managing risk but many also see increasing responsibility for risk failures settle on them. Moreover, as this occurs, actuaries themselves can become important spaces where governance of the reinsurer occurs.

Already, actuaries have undertaken the increasingly difficult task in serving two masters, their employer and the regulator.[465] The US Task Force on Actuarial Credibility, for example, argued that the actuary continues to play an essential role in protecting policyholders and stabilizing the insurance industry more broadly. This is an important, and heavy, burden to carry.[466]

Government Oversight and Disclosure

Finally, within international standards there is a clear role for supervision, with standards encouraging government oversight of reinsurers and their operations. The

[464] Morris, Sir Derek (2005); Allen, Nigel (2005). By face value and black box it is implied that little to no attempt was made to scrutinize the methods employed to produce this advice. It is also important to caveat this finding with the proviso that some companies may take a more active approach to assessing the methods and assumptions of their actuary.

[465] Ibid.

[466] Task Force on Actuarial Credibility (2005) "Report to the Board of Directors", May 15, 2005, United States: Casualty Actuarial Society, pp. 1-43, <http://casualtyactuaries.com/about/reports/tfacrpt.pdf>, Last Access: 8 July 2008

IAIS's *Principles on Minimum Requirements for Supervision of Reinsurers* contains two broad principles regarding governmental oversight. Therefore, reinsurance should not be viewed as completely self-regulatory, like credit rating agencies and hedge funds. Government oversight is seen as part of the overarching governance process.

However, within reinsurance regulatory standards, there is also a clear space created for market discipline, reflecting the IAIS belief that 'market discipline is an adjunct to supervision'. The construction of the reinsurance industry containing professional and informed 'customers' mean that increased disclosure should improve market discipline.[467] In order to exercise this discipline effectively, "market participants need relevant information on the technical performance and risks"[468] These practices reinforces the notions that insurers are sophisticated enough to monitor their acceptable risk.

An effective level of transparency and accuracy of information is necessary for both government oversight and market discipline to work. Transparency, in that it provides greater information, is useful in allowing regulators, investors and other market actors to make decisions that are more informed. However, the accuracy and precision of this information is also key, as more information is not useful if it is incorrect. In essence it is necessary to be more transparent and more precise in the disclosures for the market to properly use the information provided in it own risk management processes to informally govern reinsurers, i.e. to provide effective market discipline.

---

[467] International Association of Insurance Supervisors (IAIS) (2003b) *Standard on Supervision of Reinsurers*, Supervisory Standard no. 8, October 2003

[468] International Association of Insurance Supervisors (IAIS) (2004) *Standard on Disclosure Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers*, Supervisory Standard no. 9, October 2004

The Return of Systemic Risk?

The reinsurance regulation that emerged in the wake of concerns about systemic risk clearly creates a discursive picture of the reinsurance industry. However, concerns about reinsurance as a source of systemic risk did not fade away. In the academic and trade literature, there is consistent construction about the systemic risk that reinsurance may pose. First, there are a number of arguments explaining why the insurance sector in general appears to be a weaker source of systemic risk than other areas of the financial services sector. First, the liquidity that exists in this system results from the prior creation of wealth by policyholders and "consequently, the failure of an insurance company has a potential impact on its policyholders, whereas the insolvency of a bank has a potential impact on a large number of individuals, not just on its own clients".[469] In addition, it is argued that the insurance industry is less susceptible to 'runs' than banking because only a portion of the policyholder's claim relates to short term liquidity needs and policy withdrawal is necessarily more gradual since it is less easy and more costly than in banking due to the nature of insurance contracts.[470] Finally, the industry is conceptualized as separated from other financial institutions in the market, when contrasted with banking and securities. The exceptions to this are relationships with reinsurance and equity investments.[471]

469 Bebear, Claude (2002) "Remarks on the Development of Global Regulation for Financial Services Industries and its Impact on Insurance" *The Geneva Papers on Risk and Insurance*, vol. 27, no. 1, January, pp. 46-65
470 Ibid.
471 Ibid.

However, there are also clear arguments presented for the potential systemic risk of the industry. Ericson, Doyle and Barry (2003) point out that one reason reinsurance could pose a risk to the entire system is through the impacts of 'passing the trash'. In these cases, one of the partners in the contract – the primary insurer or the reinsurer – blatantly deceives the other about the actual risk exposure. The basic idea is to cede the risk onto other parties while retaining as much of the premium as possible. We can use a very apt quote they took from one of their interviews with a financial analyst regarding this process to illustrate how it could be seen as negative. The analyst said, "The problem is everyone thinks they have ceded the risk, and it's not clear where the thing ends, it's just a bowl of spaghetti."[472] There is some echo here of the types of problematic transfer of risk that are at the heart of the credit crisis of 2007-8. Moreover, when one looks at the reasons that insurance companies may use reinsurance, there are some easy similarities that can be drawn to the originate-to-distribute model that is at the center of the subprime crisis, particularly its use to increase underwriting capacity.

Turning to international governmental bodies, the G30 undertook an extensive study concluding that reinsurance is different from banks because it is not reliant on 'first-come, first-served demand liabilities' making them less vulnerable to crises of confidence, runs, and need for quick liquidation of assets for purpose of payment. In coming to their conclusion, the G30 study group generated what they considered a worst-case scenario stress test. Through this they highlighted the modest effect that the large scale failure of a major reinsurer would have on banks, primary insurers and capital

[472] Ericson et al. (2003), p. 124

markets. There again, however, were caveats that left open the possibility of reinsurance as a systemic risk. Specifically, they argue that if the securitization of risks by reinsurers becomes more prominent, this may change. Therefore, the study argues that the industry must 'identify, measure and manage the risks' involved in securitization and most importantly

> develop robust risk-based capital models that analyze the basis risk arising from the fact that securitization is unlikely to transfer exactly the same risks to the capital markets as the (re)insurer has written, and to determine the capital necessary to support this remaining basis risk. Such models must precisely describe the nature of the cash flows to be acquired by investors and need to be understood and accepted by regulators and rating agencies.[473]

It is interesting to see as it is the most clear call from the policy or regulatory side for reinsurers to actively undertake extensive modelling. In addition to this discussion, the study group also focuses on the impact that the lack of transparency can have on the system. It argues that this leaves both market actors and regulators "unclear about the risks the industry is taking and the risk management methods and models it uses".[474] Due to this situation, they advocated the improvement of transparency in the sector.

More explicitly, in September of 2002, the FSF expressed concern with transparency in the reinsurance industry. Recognizing the industry had 'performed well' through the recent shocks, they still asserted that the opaqueness of the reinsurance market and its public disclosures make difficult any assessment of the potential impact on the insurance sector, and financial stability more broadly, if problems were to develop in the reinsurance industry. The forum called for national and international efforts to

[473] Group of 30 (2006), p. 6
[474] Ibid.

produce data and enhance reporting on the market. In addition to this, it urged reinsurance companies to not only increase the frequency but also improve the quantitative and qualitative content of their public disclosures.[475]

In response the IAIS established Task Force Re[476] in 2002/03, a cross-sectoral public-private reinsurance task force to "improve the transparency of the global reinsurance market and risk-oriented disclosures of individual reinsurers".[477] As Knut Hohlfeld, secretary general of the International Association of Insurance Supervisors (IAIS) from its creation until the end of 2002, "Our members have realised that there is a need for reinsurance regulation and this enhanced disclosure was in part triggered by the credit risk transfer market where there is not enough knowledge or data on the activities of reinsurers".[478] To encourage this, there is mention of disclosure in all of the reinsurance documents on some level. In addition, the IAIS has created a formal reinsurers' information database, in an attempt to "produce global reinsurance market statistics, analysis and commentary that can be used by regulators and financial stability authorities, market participants and the general public."[479] At this point, the 'Reinsurers Database' is intended to provide: the contact details for active reinsurers, confirmation of

---

[475] Financial Stability Forum (2002) "Financial Stability Forum reviews vulnerabilities and efforts to strengthen the international financial system" Press Release Ref no: 17/2002E, 4 September 2002 < http://www.fsforum.org/press/PR_Toronto02.pdf>

[476] Task Force Re is short for *Task Force on Enhancing Transparency and Disclosure in the Reinsurance Sector.* It was succeeded by a Steering Group on Transparency in the Reinsurance Sector in March 2004. The Steering Group's membership is senior representatives of the regulatory authorities of the jurisdictions in which reporting reinsurance companies are incorporated but its meetings are open to industry representatives unless otherwise stated.

[477] International Association of Insurance Supervisors (2004b) *Task Force Re: Enhancing Transparency and Disclosure in the Reinsurance Sector,* a report presented to the Financial Stability Forum, March 2004, p. 3

[478] Reinsurance (2003) "London Focus - Regulation - Strengthening supervision" *Reinsurance*, 23 June 2003

[479] Bowe, Amanda (2004) "Regulation: European News" *Global Reinsurance*, February 1, 2004

the supervisory status of reinsurers (i.e. whether they are supervised, and by whom), brief details of the overall financial status of the company, and any additional information that the supervisor of the reinsurance company deems relevant.[480]

Yet, this database has not alleviated all concerns. On April, 24 2004 Roger W. Ferguson, Jr., Chairman of the Financial Stability Forum, still highlighted the concern that exists regarding the lack of transparency of the global reinsurance sector in his statement at the International Monetary and Financial Committee Meeting.[481] Since this time, the IAIS has published explicit guidelines in its *Standard on Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers* (October 2005).[482] Its purpose is "to enhance market transparency and the facilitate performance for insurers and reinsurers."[483] However, in doing standards, it constructs mundane business practices around disclosure. Along with a focus on ensuring that appropriate and sufficient qualitative information is released on areas that include investment objective, policies and management; performance measurement and asset-liability matching, it is also recommended that the company disclose sufficient information, including quantifiable data regarding its exposure to currency, interest rate, credit, liquidity and concentration risk. Interestingly some of these qualitative disclosures include whether or

---

480 International Association of Insurance Supervisors (IAIS) (2005b) *Principles and Terms of Use of Databases for Contributors*, October 2005 <http://www.iaisnet.org> The information on this database is collected and assessed by the appropriate national regulator and the IAIS does not control this for content.

481 Ferguson, jr., Roger W. (2004) "Statement" *International Monetary and Financial Committee, Ninth Meeting April 24, 2004*, Washington, D.C. <http://imf.org/External/spring/2004/imfc/statem/eng/ fsf.pdf> Last access: 6 May 2007

482 International Association of Insurance Supervisors (IAIS) (2005) *Standard on Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers*, Supervisory Standard no. 11, October 2005

483 IAIS (2005) Supervisory Standard no. 11

not stress and/or sensitivity tests on investment risk exposures are used – including the process, types of assumptions used and how the result are integrated into the risk management practices. Another example looks at the firm-wide risk management model, its types of parameters used, how they are calibrated, the model's performance over time and its testing and validation methodologies (if these models are used by the company).[484]

Conclusion

This chapter has argued the discourse of risk has provided a terrain of possible actions that are essential to fully understanding international reinsurance governance efforts. Historically, reinsurance has been, and currently remains, linked to risk in its roles as a risk management tool. This is due to the character of the industry in the redistribution of liability. In this role, the increasing use of risk modeling has marked interesting developments in the relationships between insurers and reinsurers.

However, since the late 1990s there have also been a number of questions raised about whether reinsurance is a systemic risk. This has resulted in a process of problematization where conflict does occur over details and principles of regulation and governance. The attempts of the IAIS to respond to these questions and concerns has lead to the development of international regulatory regime in insurance. This collection of standards has reaffirmed the role of reinsurance in risk management.

[484] There has been some concern raised about the potential economic effects of disclosure. Rolf Nebel argues that provisions should not provide competitors with undue insight into trade secrets, enabling some to take unfair advantage. He also doubts whether such voluminous disclosures do meaningfully enhance transparency or is this going to be a case of information overload. See Nebel, Rolf (2004) "Regulations as a Source of Systemic Risk: The Need for Economic Impact Analysis" *Geneva Papers on Risk and Insurance*, vol. 29, no. 2, 01.04, pp. 273-283

In this role of risk manager, there are a variety of practices of risk that are undertaken. First, their position potentially allows them to exert some disciplinary power over the insurance sector. Evidence indicates that the connections between the two sectors of the industry have led to the increasing use of modelling and other complex calculative techniques of risk measurement. This is also tied to the internal governance of reinsurers, where the actuary is increasingly central to risk measurement and management, and therefore governance, decisions. However, it has also attempted to address potential risks within the process of reinsurance.

Moreover, concerns about systemic risk has not disappeared. While a study and report by Sigma, the research branch of Swiss Re, has also attempted to assess the potential of reinsurance to be a systemic risk, its study found 'hardly any' evidence of this connection.[485] However, the authors of this report assert that this focus on systemic risk will enhance the transparency of reinsurers, particularly with regard to the risks assumed and risk management methods. This is clearly what has been seen in the current discussions for internationally governing reinsurance. The potential for it to be a risk rather than a risk manager has led to increasing efforts to encourage transparency and disclosure. This quest for transparency is also seen as an essential part of effective market discipline, increasing the precision with which market actors make their decisions, which then govern reinsurers through larger market forces. The important power given to market discipline in this case is also tied to the constitution of all the actors in the reinsurance sector (i.e. insurance and reinsurance companies) as 'sophisticated' actors. In

[485] Baur, Patricia and Rudolf Enz (2003), p. 4

the case of Basel II, market discipline is the third pillar, which is by far the least developed.

This chapter has shown that the tendency to seek precision in assessment and management of 'risk' has led the reinsurance industry to increasingly accept, develop and employ the use of different forms of risk modelling and statistical and mathematical assessments. This has increased the importance of the role of the actuary in the process of reinsurance, resulting in potentially more power but also more perceived responsibility for these actors.

Chapter 8
Criticizing and Repoliticizing the Practices of International Financial Governance

This chapter will look explicitly at the secondary discussion introduced in the first chapter of this dissertation: that the discourse of risk is a key part of the tendency to depoliticize the governance process in finance. In this chapter, some of the normative conclusions about the way that finance is currently structured are brought out more. First, the chapter will elaborate on the continued importance of experts in financial governance. The findings in the previous chapter highlight that in all three areas, experts are becoming more integrated into the governance structure. A variety of professions and agencies constituted as possessing expert knowledge have become more central to the regulatory process. This is particularly the case for those actors with a knowledge that can contribute to mathematical risk modelling – credit rating agencies, actuaries, etc. Moreover, in all three cases the international governance structures created require regulators to access an adequate level of expertise so it can authoritatively assess the risk management, and financial soundness, of banks, CIS and reinsurance companies. However, this involvement in turn, raises questions about voice and legitimacy.

Risk and the Art of Depoliticization

This dissertation has endeavoured throughout to highlight that risk is not natural or neutral, even though the discourses around it tend to ascribe it those traits. Despite being bound in neutral and objective language, the genealogy of finance in De Goede and the more extensive coverage of the discourse of risk in Deuchars have highlighted its highly political, gendered development in the financial services sector.[486] Therefore, the link between risk as a discourse and calculability is not without wider-reaching political implications.

The very word 'risk' as it has come to be used in finance is inherently depoliticizing, yet the act of labelling something a risk or a risk management practice has political implications. We can challenge this assumption of neutrality or naturalness of risk by entering the financial governance domain through a focus on the *discourse* of risk. Through this discursive approach to risk one not only sees but also questions and critiques the techniques and practices of risk management that are seen as 'objective', 'neutral' or 'technical'. Looking back to the banking sector, its highly technical character generally obscures its political and contested elements. In many ways, policy in this area is 'low politics'.[487] This can change with an overt, large-scale failure which forces the issue onto the political agenda, as happened with the credit crisis of 2007-8. However, even in crises, politicization may not be the consequence that emerges, and the role of politics may continue to be underestimated.[488] Even in periods where there has been a fair amount of coverage of problems with financial regulation in the mainstream media,

---

[486] De Goede, Marieke (2004). Due to this, she explicitly calls for the repolitization of risk in the financial arena arguing that the normative basis of risk management is hidden and unquestioned politically.

[487] Moran, Michael (2002) "Politics, Banks, and Financial Market Governance in the Euro-Zone", in Kenneth Dyson, ed., *European States and the Euro. Europeanization, Variation, and Convergence.* Oxford: Oxford University Press, pp. 257–77; Busch, Andreas (2004) "National Filters: Europeanisation, Institutions, and Discourse in the Case of Banking Regulation" *West European Politics*, Vol.27, no.2, March, pp.310–333

[488] Busch, Andreas (2001). "Managing Innovation: Regulating the Banking Sector in a Rapidly Changing Environment" in Mark Bovens *et al.* eds. *Success and Failure in Public Governance: A Comparative Analysis.* Cheltenham: Edward Elgar, pp. 311–25

this still does not translate into widespread participation in these issues outside of the business world. Moreover, this is reflected in the discussion around the Basel II Accord, when one looks at the various levels of official documentation, summaries, backgrounds, and speeches etc. An element that has been noticeably missing from both the discussion of national regulators and the banking industry is a discussion of the effect that these changes may have on people outside the industry.

Across all the cases analyzed, risk is treated more often as a noun – a real thing that needs to managed. However, in problematizing that assumption, this dissertation has shown multiple cases where the 'risk' in question was constructed. One can think of the ever-evolving list of risks in the Basel Accord for one example. Although we must acknowledge that the financial system has changed over the years, many of these risks are not new. One key area where the shifting of activities and events under a discourse of risk could be clearly seen was in the case of operational risk under Basel II. Banks have always faced the potential for unexpected losses simply by being in operation, just like all financial services actors. Yet, operational risk has been only recently considered a necessary aspect of regulation through capital adequacy. Moreover, many of these activities are captured under corporate governance. By discursively reconstituting these activities and individuals as a risk, multiple different shifts in practice occurred. First, operational risk measurement techniques needed to be developed. In addition to this, Basel II has also marked a shift in the internal makeup of banks as they have continued to implement changes to meet the deadline for Basel II as discussed in Chapter 5.

A second clear example of the construction of risk is found in the discussion of 'systemic risk'. When discussions turn to risks beyond the individual or the firm, they are often tied to the phrase "systemic risk". However, this term does not inherently focus on the societal systems; rather the predicate analysis and guided reading showed that the term was either left unclear or was specifically linked to risk posed to the financial system. Even links to the 'real' economy are often obscured by the technical character of discussions of governance. Therefore, the focus on 'risk' and risk management allows governance to concentrate on the techniques of management and to limit the discussion about the broader societal implications. Yet the last year has clearly shown that systemic financial crises have significantly more comprehensive economic effects than just within the financial system.

Moreover, in a number of spaces in the dissertation, it becomes apparent that the language of risk management and calculation has depoliticized or neutralized some important social impacts of governance options selected. In banking, the process of designing risk buckets for risk weighting means that categories of actors are created and assigned varying degrees of creditworthiness. The risk bucket that an actor is placed into, based on geography, structure or other variables, can have very real material effects on their ability to access credit. This categorization is presented as an impartial assessment of the actor and based on highly developed tools for measurement. However, at the base these are created identities for actors. Particularly with credit rating, the foundation of risk buckets in the Basel II standardized approach, it has been shown that agencies have erroneously rated organizations in a variety of situations highlighting the constructive and subjective nature of these categories.

Beyond Basel, there are also clear political implications of risk in the CIS industry. Given the increasing use of mutual funds and other forms of CIS, many individuals who would receive some protection through the more traditional intermediaries like banks are left bearing more of the responsibility for 'risk' and potential negative outcomes. Going back to the early 1980s small investors have increasingly made use of CIS to take advantage of the market. At the same time however, it has been less well acknowledged or recognized that "many of the risks in the intermediation process have been transferred to investors".[489] The governance standards make no attempt at drawing out this political implication, particularly for society as a whole.

Yet risk can serve as a call to action as well. The continual re-articulation of reinsurance as a potential systemic risk created the space for international reinsurance regulation to emerge. Prior to a link drawn in a regulatory report on different issue (off-shore financial centers) there was little indication if any that reinsurance required international harmonized regulation. In some states, there were still questions about whether it needed regulation and supervision at all. However, the construction of market participants as sophisticated tied to this discussion abstracts from the important social role that insurance plays in today's society.

[489] Thompson, John K. and Sang-Mok Choi (2001), p. 6

On a general level risk serves as a way to depoliticize financial governance, creating an informal barrier between it and larger discussions about the purposes of finance and the economy in relation to society. It is interesting when compared to the rarity of words like danger, hazard and threat in the regulatory literature overall. The implications of the discourses of risk are not only depoliticizing, however, they have also affected the identities and roles of those who can claim 'expert' knowledge.

Governance, Risk Management and Expert Knowledge

The cases in this dissertation have shown that expert knowledge remains central to the processes of governance. This increasingly occurs through the discourse of risk and the employment of different risk rationalities, where expert knowledge revolves around the calculative and probabilistic techniques that identify, measure, and manage risks. For Deuchars, the increasing sophistication of mathematics has subsumed statistical knowledge into one part of the ways and means of interpreting and representing different aspects of reality,[490] as when experts use statistically manipulated data to make knowledge claims that are seen as reliable.

Looking to the Basel Accord, in particular, this is readily apparent. Pillar 1 and the eight separate methods for calculating different aspects of credit, market or operational risk that it lays out are inherently connected to these types of expert knowledge.[491] One

[490] Deuchars, Robert (2004)
[491] It is realized and acknowledged that not all expert knowledge is about the connection to quantitative techniques only.

feels they need a crash course in financial mathematics to understand the models which are laid out in its pages.

It has been argued that this role of expertise also works to influence the nature of public regulation. This study has also shown that the implications of 'expert knowledge' are not limited to only rational actor interactions between governmental actors and those in the private sector. In some cases, expert status is granted even when the category of actor tries to minimize their claims to knowledge. This can be in the reaction of credit rating agencies and Basel II and actuaries in the reinsurance industry. As has been shown, the nature and content of what is accepted as 'expert' knowledge is historically contingent, emerging from specific developments in understandings of knowledge in general and the discursive domain they circulate in.

Looking at reinsurance in more depth, one can see the role that actuarial science has on the functioning and governance of the industry. This impact, however, is much more central and integral than simply the interests of actuaries as a group. Actuarial science is important for legitimizing some practices of insurance and distinguishing them from gambling. While the profession of actuaries has been questioned and critiqued in recent years, this has mostly focused on reconstituting the profession and its practices to make them more accurate. There has been very little questioning of the appropriateness of the role of actuarial science in the performance of insurance.

The same questions about accuracy also appear around credit rating agencies. There have been a number of times that they have been shown to miss the mark in risk measurement. Green argues that part of the reason that these bodies have not been 'dethroned' is because of the epistemological belief that risk can be calculated if one has the right math and information. In essence the modern financial world is built around these different risk expertise systems.[492]

It must be acknowledged that in all the cases discussed, some expert identities and roles have been contested. Again, the case of actuaries provides a good entry point. In this case, a variety of events have illuminated the subjectivity of the knowledge which underpins their role in governance. Yet from looking at the case of reinsurance, it seems that it is not the expert who becomes less salient but rather an attempt to make the techniques utilized or the information within them more precise, accurate and robust. While one might imagine that this may lead to a decline in the role of the expert knowledge in governance, instead it marks a moment where the technologies or practices of the expert in question are rearticulated. In the case of actuarial science more fault seems to have been laid on the frames of different models rather than a deeper and more fundamental question about the use of models and whether they can measure risk. It is not a problem of actuaries as a form of expert knowledge, but rather a complaint to make actuarial tools better.

All of these arguments around expert knowledge run counter to the risk society assertion that the reflexivity around risk in the current age works to create a decline in the salience of experts through their pluralization. Beck notes experts and expert knowledge are essential in modernity's attempt to manage of risk and the political problems that emerge from this position. However, in *Risk Society,* he also argues the post modernity

[492] Green, Stephen (2000), p. 86

has lead to an increasing reflexive scepticism of expert opinion and a declining trust in professionals and expert institutions as perceived risks increase and solutions fail.[493] In this dissertation, different individuals and groups through their connections to notions of 'expert' knowledge are seen to have increasing central and institutionalized roles in the governance arena. This is especially so for those who are seen as having mastery over some element of the governance framework, such as the processes of risk management.

An interesting element of this analysis of the political impact this can have on governance is the effect of this complex relationship between risk, experts and governance on 'lay individuals' or 'non-experts'. As Martinez notes, "Expert authority can offer insightful solutions to policy problems, but it can also be an exclusionary device that serves to shut out those without appropriate 'credentials' or those whose technical judgments are deemed to be too 'political' and not technical enough".[494] Therefore, questions emerge about the appropriate role for expert knowledge, particularly in relation to democratic governance. In light of this and the discussion of depoliticization, we turn to 'the people' and their options for voice in financial services.

The Possibility of Voice

The discourse of risk and its links with mathematical knowledge have the effect of depoliticizing finance by placing the "way in which finance calculates and classifies risk

[493] Beck, Ulrich (1992), pp. 61
[494] Martinez, Leonardo (2001) *Private Expertise and Global Economic Governance: The Case of International Accounting Standards (1972-2001)*, Masters of Philosophy, University of Oxford, p. 2

beyond public comprehension and debate".[495] There are a number of different, yet related, ways that constructing financial services in the frame of risk removes it from public debate. In most of western history, one can see the myriad of ways discourse, particularly scientific discourse, has been a tool of social closure and "mystification".[496]

Looking at the cases studied here, we can see this play out. The quantitative approach that Basel II has taken in parts of Pillar I especially, has clearly set a demarcating line between those who can understand the model and then imagine what future impact and outcomes will be and those who get lost within the jargon and mathematics. I am not attempting to argue that there is no place in regulation for expert knowledge, in fact it can serve an important role. However, all knowledge is political and subjective, without a broad enough inclusion of multiple voices this aspect can be lost. Modeling is one way to measure risk, however, it is not only way to manage risk. For example, micro-financial practices clearly work to manage the risk of default without extensive modeling, instead utilizing community pressure.

Yet there have been multiple points in each chapter which have highlighted industry concerns with a reliance on modeling. On a very general level, one can look at complaints about VaR models. Kevin Dowd highlights the necessity of recognizing that any estimates which come from stochastic modeling "are extremely prone to 'model risk' and the assumptions about them made by key personnel."[497] In addition to this inherent

[495] De Goede, Marieke (2004), De Goede, Marieke (2000), p. 200
[496] Mythen, Gabe (2004), p. 167
[497] Kielmas, Maria (2005). Kevin Dowd is a professor of financial risk management at Nottingham University Business School It should be noted the Professor Dowd does not have problems with stochastic modeling process in general. The industry article which this quote comes from also notes that he is a great believer in this process.

feature, the regulatory models developed tend to use Value-at Risk (VaR) as a standard measure. However, similar to stochastic modelling, Dowd believes VaR methodological shortcomings are not understood well enough in the industry.[498] Therefore, the fact that all three industries showed a acceptance of modeling for regulatory purposes is interesting.

The calls for greater disclosure and transparency in reinsurance and CIS are an attempt to demystify finance, but these are primarily directed at other market participants and regulators. The case of collective investment schemes, due to the location of responsibility on the individual, is an area where governance has made explicit efforts to demystify at least certain parts of each scheme. For example, in most states with a developed financial market, the operators or brokers are required to provide the investor with a prospectus that lays out in an 'accessible' manner the relevant information before purchase and a possibly at different points throughout the tenure of ownership. Moreover, in this sector there has been international attention also placed on investor education. In the IOSCO document on investor education it actually states,

> investor education may enhance investors' understanding of the role of the regulator, provide investors with the tools to protect themselves against fraud (and other abuses) and to assess the risks associated with particular investments, assist the regulator in the enforcement of the securities laws concerning offerings and sales of securities, and maximize the regulator's limited resources.[499]

This argument serves as a way that the process of risk management can be demystified. However, it is also important to realize that these efforts at demystification are not

---

[498] Ibid. As stated previously, the VaR is the amount of capital required to ensure that the company is not technically insolvent over a certain time period with a chosen degree of certainty, typically 99.5%.
[499] IOSCO (2001), p. 1

politically neutral either. It is in the CIS industry's interest to create informed investors in that it provides the basis for its own market. Moreover, it is important to remember that this disclosure is not aimed at encouraging more debate about the purposes of CIS industry for society more broadly, but to create an entirely different actor, that of 'informed investor' who is responsible for managing their own risk.

This point holds to some extent for reinsurance as well. In this case, disclosure is creating a small space to reassess the purpose and functioning of reinsurance, in particular the efforts to allow regulators to better assess the actual role and functions of the industry. However, the other side of disclosure is to allow for greater market discipline on reinsurers, disciplining their practices to market desires, which are not necessarily perfectly matched with societal needs.

The neutral language of risk expertise when attached to an international regulatory project, can also serve to minimize voice. The use of quantitative models and their ostensibly reliable numerical data for regulation encourages a division of labour around differences in types of expert knowledge. To quote Deuchars, use of these types of knowledge,

> constructs a type of governance, based on the acceptance of the superiority or a kind of knowledge that derives from mathematical methods and numerical manipulation and that is presented in such a way that skill is required for its meaningful interpretation, a skill that most people have not been taught.[500]

[500] Deuchars, Robert (2004), p. 77. Deuchars presents this development as something different (possibly deeper) than the rise of technocracy. For him, technocracy seems to inherently possess a level of antagonism in the relationship between recognized experts and those who are not based on the privileged position of the former, which does not exist in this instance. I am less convinced that the rise of a privileged position of 'experts' requires the antagonistic recognition or contestation is inherent to all forms of technocracy.

These enhanced roles for experts are in part problematic because governance around risk does not necessarily have to be confined to risk minimization through techniques of measurement and management. Often it includes other objectives, implicitly or explicitly, like equity, fairness, flexibility, or resilience that requires input from interest groups and those affected as well.[501] If experts dominate governance processes then their biases and those of the bodies of knowledge they are associated with can produce outcomes that citizens more generally might not have supported, had they been able to participate. The search for technically strong governance can lead to excessive reliance on experts and technocracy. Again the concern is not the inclusion or use of expert knowledge, but the lack of questioning or recognition of its contested construction. It is the potential triumph of technocracy that is worrisome.[502]

Models are no more value neutral than other forms of risk management. In the end, all models start with a base assumption, acknowledged or otherwise, about how society should function. In 'objective' mathematical and technical risk models all decisions require implicit or explicit intellectual commitments to a social model.[503] As Boyne puts it, "there is no single purely mathematical route to the essence of risk. In even the simplest cases, rationality and culture will mutually inform each other." As global finance is a key mechanism in regulating other areas of the economy and therefore

---

[501] Renn, Ortwin (1992) "Concepts of Risk: A Classification" in Krimsky, Sheldon and Dominic Golding (eds.) *Social Theories of Risk*, Westport: Praeger, p. 60

[502] It is important to remember that government is an important part of risk management not simply these perceived to be unaccountable experts. For example, Moss (2002) argues that government's ultimate role is as the risk manager for society through its development of law and other policies.

[503] Wynne, Brian (1992) "Risk and Social Learning: Reification to Engagement" in Krimsky, Sheldon and Dominic Golding (eds.) *Social Theories of Risk*, Westport: Praeger, pp. 275-300

society in general this is highly problematic.[504] Moreover, even after these supposedly objective sophisticated techniques of risk management are deployed, there are still roles for "interpreting, debating and communicating that information".[505] Looking at the catastrophic risk modelling that occurs in reinsurance there are inherent assumptions not only about how nature will work[506] but also implicit social assumptions.

Not only have modern conceptions of risk management reinforced the positions of certain 'experts' in governing society, but also at the same time served to minimize voice of those who make claims based on other forms of knowledge or purpose. This lack of civil society involvement is not universal through the international financial sector, suggesting that technocratic exclusion is not inherent to finance and that this exclusion can be reversed by political action. Looking at finance more broadly, one can see that this lack of engagement by civil society is clearly not the case in the work of the International Monetary Fund. A recent book by Best can be used to highlight how space is created for civil society actors through a need for the legitimacy that they can provide to IMF decisions.[507] Even the IMF, however, is relatively unreceptive to civil society.[508]However, if we shift to look at financial service activities, it becomes apparent that the legitimacy which they are interested in 'cultivating' does not come from engagement with civil society, but rather from claims that expert knowledge and status confer. If legitimacy is sought from civil society, it is the acceptance of the business

---

[504] Boyne, Roy (2003) *Risk*, Philadelphia: Open University Press, p. 6
[505] Best, Jacqueline (2006), p. 17
[506] We know from the documented mistakes that this is difficult in and of itself.
[507] Best, Jacqueline (2005). *The Limits of Transparency: Ambiguity and the History of International Finance*. Ithaca, NY: Cornell University Press
[508] This feature is particularly apparent when compared to its sister organizations, the World Bank Group

community that is the primary goal. One can see this in the highly technical discussions that occur around discussion and consultation papers in all three cases. The discussion is not related to the purpose of financial regulation, which has already largely tied to system stability through proper risk management tools, but in the details of achieving these goals.

Where are the people?

In addition to the absence of identities such as "citizen" or "people" in financial governance discourses and the exclusionary effects of technical expertise that have been discussed so far, it is also important to consider further the production in financial discourses of new identities that displace those others that have been associated with democracy or societal interests more broadly.

This identity of people as market actors is especially evident in the focus on investor identities and attempts to transform the identities of unsophisticated market participants to sophisticated ones. This is accompanied by a variety of different disciplinary practices, which encourage this shift. These can work through education by making investors that are expected to be responsible for losses. This offloads governance functions onto the individual. It is consistent with Foucault's concept of governmentality, in which the techniques of control shift from prohibiting certain activities to encouraging those who are governed to actively regulate their own conduct to bring it into alignment with the goals of the system of governance.

The key individuals who are present in international financial governance are the experts. However, the idea of the self-regulating individual also fits well in the current production of expert identities, integrating them into a social sub-hierarchy constituted by knowledge. Professionals, such as underwriters or actuaries, are also expected to engage in self-discipline, and technologies for ensuring that this occurs are produced, such as professional licensing and codes. As Deuchars argues, "it is through the micro-practices of expert discourse, of 'economics', of training in the bureaucracy and the academy, of elite education in schools, and so on" among many of those individuals who populate financial firms and supervisor's offices, which encourages a similar world-view.[509] These performances act as micro-practices in the similar way to how Foucault conceived of them in the training of armies. These practices create 'non-individualized individuals'.[510]

This again shows the importance of examining the performance of international governance as it stretches from the individual all the way through international organization. This opens up a way of thinking about governance outside of the inter-state focus or the excessively sharp public-private divide that marks many analyses.

Conclusions

This chapter has attempted to draw out some of the more normative implications that are created or reinforced by the discursive frame of the governance arena. It highlighted how discourses of risk have a tendency to abstract, to depoliticize, and to

[509] Deuchars, Robert (2004); p. 112
[510] Foucault, Michel (1979) *Discipline and Punish*, New York: Random House

obscure important political implications of the techniques, practices, and identities associated with these discourses. Moreover, it shows how they can serve to mystify the governance process in a way that minimizes potential openings for those who are not involved in its governance but who suffer its negative effects. In a previous paper, I referred to this as an instance of disclosure closure.[511] The connections between risk and expert knowledge further enhance this by empowering expert voices and de-legitimating those not speaking from this same space. For the most part, there was little reference in the cases to anyone outside the financial or supervisory bodies. The exception to this was the attempt to rearticulate the identity of the investor from 'unsophisticated' to 'sophisticated'.

[511] McKeen-Edwards, Heather and Ian Roberge (2007) "Striving for Legitimacy: Financial Services Sector Policymaking in the EU after Lamfalussy", *Current Politics and Economics of Europe,* Vol. 18, iss. 2, Special Issue

CHAPTER 9
Governance, the Discourse of Risk and International Financial Services

From the three studies discussed in this dissertation, it is clear that the international governance arena for financial services is a complex and messy space. In spite of this challenge, this chapter will draw out some of the broader themes that emerge about international financial governance from the study. The remainder of the chapter will be divided into four additional sections. These will return to the four main arguments of the dissertation. A final section will assess the potential of this type of approach for understanding international financial services governance.

Revisiting Risk and discursive power

The main argument made in this dissertation is that looking at international financial governance through a lens of discourse provides interesting and important insights. In doing so, it has looked at how activities, events, and individuals are made subjects capable for regulation. First, the previous chapters have shown how two related discourses of risk can help us to understand the particular governance arrangements that emerge or are maintained. All three industries show clear links with the language of risk. The related second argument was that the discourses of risk serve not only to constitute practices, events and identities but also link to different techniques that underlie the multiple performances of governing. By focusing this way, one is reminded that governance is more aptly conceived of as different intersections of power/knowledge and that governance is not just the negotiating of a major accord but actually occurs through multiple overlapping and repeating performances.

However, it is too simple to argue that risk impacts the international financial governance process. This statement minimizes the importance, and more importantly the nuance, of discourses in the sector. A key nuance is that the governance processes are influenced by a complex relationship between the two different discourses – 'risk as necessary for economic growth' and 'risk as danger'. In each case, risk as a danger seems a key reference and source of legitimacy for governance initiatives. This discourse is highly developed in the banking sector and significantly less developed in reinsurance and CIS. Mapping with this development, banking has by far the most active and precise international governance.

Yet, in the capitalist system as it is currently structured, risk taking is necessary for prosperity and growth. Therefore, a tension is created: risk as a danger should be addressed but good risk-taking should be allowed, even encouraged. Risk becomes something that should be managed rather than obliterated, if that were even possible. In the quest for risk management, there is a visible trend to developing and using increasingly complex and sophisticated sets of practices for the governance of risk. As Best so succinctly puts it, risk as a way of articulating the world invites "a particular set of institutional practices designed to develop ever more complex methods of risk measurement and management".[512] Looking at the three cases, this development can be seen. This feature is particularly evident in both the reinsurance and Basel examples.

[512] Best, Jacqueline (2006), p. 13

However, there are hints of a similar process that is occurring internal to management firms in the CIS sector.

Risk and the (unattainable) Quest for Precise Measure and Management

In the first case of capital adequacy and banking, the complex and highly specific practices of risk management have actually been increasingly built directly into the Basel Accords. What began with a relatively low of level of complexity through the application of a set of risk weights to one particular identified type of risk since the early 1990s has been marked with increasingly complex notions of what a 'risk' is and the applicable techniques for risk management through capital adequacy. A key sign of this was the inclusion of an additional risk measure - market risk – and the possibility of internally modelling it in the 1996 amendment to the Accord. With Basel II, highly complex risk measurement (and in some cases quantification) processes have been written directly into the Accord and there are now three types of risks that must be accounted for in the calculation of the capital adequacy ratio. However, this emerged related to clear connection between risk and danger to the system and then has become more precise in attempts to allow banks to still grow economically. Yet, it is not simply controlling for danger. Risk-taking by banks is a still an economic necessity for the functioning of the economic system and therefore, precise risk measurement and management becomes increasingly the focus of regulatory practices.

In reinsurance governance, it is again clear that risk also matters. In particular, this sector marks an interesting dynamic between being a technique to address 'risk as danger' but at the same time being increasingly questioned as to whether it creates 'risk as danger' itself. In terms of precision in risk and risk management, one can see it in both the increasingly complex models and other techniques used to calculate risk in order to ensure the reinsurer remains economically sound. Moreover, the concern that reinsurance may pose a 'systemic risk' has led to the collection of precise information on risk factors to determine if this is a true representation. Even if it is only a risk management technique, we can see some of the ways the reinsurance companies govern themselves and potentially the insurance companies they have contracts with. The potential connection between risk as danger to the system and the reinsurance industry has encouraged more focus on transparency.

Finally, when looking at the international governance efforts of CIS, a different connection between governance, risk and precision emerges. Similar to reinsurance, the use of collective investment can be seen as a technique of risk management because of the diversification it provides the investor. However, unlike reinsurance there has been less interest in the potential 'risks' it poses to the industry, with the potential exception of hedge funds. This is at least in part because the subject constructed to be 'at risk' is the individual and not the system. This allows the responsibility for risk management and the costs of losses to be placed on the individual. Yet, questions emerge in this construction about market risk. Given this placement of responsibility, it is understandable why the international governance that does exist largely only focuses on investor protection from conflict of interest and fraud, as well as disclosure. The process of risk management is discursively placed in the realm of the CIS manager and the individual. However, increasing complexity in risk management can be seen in the multiple allusions to the increasingly sophisticated investments of the schemes themselves, the important role that CIS managers play in implementing the schemes and the increasingly precise forms of disclosure that need to be provided to investors due to the risk.

The importance of the search for precision in risk management is a key element of each sector assessed. However, one must question whether this search for precision is at least partially, an unattainable goal. The genealogy of risk discourses are inherently linked with notions of calculability. However, the case of Basel is a useful example of the reflexive and constructed nature of risk. Once it is determined that credit risk is the major concern, it is defined and measurement tools are created in Basel I. However, this almost immediately proves to be inaccurate, both in the lack of sophistication of the available risk buckets and the activities included for coverage. This has evolved into a feedback loop where each attempt to increase the precision of the regulatory instruments has led to identification of another "risk" or aspect of a previously defined risk that is either misidentified or 'ineffectively' managed, which leads to the development of another more precise governance tool. If this loop continues, governance is caught in a process of searching for an unattainable pursuit of perfect identification, measurement and management. Yet governance also has a place for ambiguity and adaptability.[513]

[513] Best, Jacqueline (2006)

Risk and the Variation in International Governance Initiatives

Looking at the international financial system currently, one is right to ask: if there are commonalities in the quest for precision in risk then why is there so much variation in international governance across these sector? Again through the lens of discourse we can examine and understand these variations. The language of 'risk' brings with it a collection of techniques, practices (along with their attached moral and political values) which filter into the performance of finance and financial services governance, reconstituting it in the process, but in distinctive ways. In all of the cases, it is clear that there is variation in how these sectors are governed. Even in the above section, one can see that they have varied relationships with the discourse of risk and the governance structures that are built around them.

In the case of banking it has been shown that there is a long history of its link to the discourse of 'risk as danger' in addition to its connections to notions of risk that portray it as necessary for the functioning of the economic market. These long links particularly to the discourse of systemic risk has made it particularly open to international public governance. The strength of the Basel Accords is a testament to the strong role that public forms of governance can build upon this discursive frame. Yet, the technique of capital adequacy is also seen as an inhibitor to growth, which puts it in conflict with the 'risk as economic necessity' discourse. This conflict emerges in the general concern about trying to achieve the right levels of capital – enough to ensure stability and safety but no more than that in order to achieve the maximum growth attainable under these constraints. Looking closely at the shifts in the international regulation of capital adequacy, this theme is reflected. The inclusion of credit ratings to achieve more sensitive risk weightings and the inclusion of internal modelling are seen as a way to provide greater precision in risk measurement for the calculation of the risk-weighted capital that must be maintained in order to allow for maximum 'safe' growth. Therefore, in the case of banking, risk as danger is the primary discursive frame but the other discourse of risk is also important and attempts are made to accommodate it with the broader frame of capital adequacy.

Shifting to look at the area of collective investment schemes one can see that the relationship between these discourses of risk is reversed from banking. In this case, it is acknowledged the risk is a danger. However, as these are securities instruments rather than banking deposits or insurance premiums, this risk is constructed as something that is borne by the individual or group who entrusts their funds for management. Given this, risk management techniques are not nearly as common, and instead the investor is responsible for inherent market risks in their decisions. Responsibility for risk measurement and management is inherently in the private sphere (with the scheme itself about investment portfolio decisions and with individual investors regarding the risk-return ratio they want). Risk remains seen largely as an essential feature of the economic system and the market more specifically. However, in order to keep the responsibility for loss with the investor there is a need to ensure that the system is transparent and fair. This is why the international regulation and governance practices that have emerged have dealt with issues of investor protection much more explicitly. The role of the public is clearly in facilitating the 'proper' functioning of the market. In fact, there is a great deal of importance placed on the internal governance mechanisms of CIS.

> the supervisor relies increasingly on the internal governance and risk management procedures of the supervised entity and on market discipline and less on direct controls on the supervised entity. The governance system of all financial institutions is expected *i)* to monitor management on behalf of shareholders and stakeholders such as depositors and *ii)* to ensure that all supervisory, regulatory and risk management requirements are met. Official financial supervision is concerned mainly with assessing the adequacy of governance systems and taking remedial actions when shortcomings are found.[514]

Therefore, in this case public actors have little role in 'hands on' governing of these schemes and their investment choices. Instead it is necessary to create the structure in which these relationships occur and get out of the way. Private sector actors have the more dominant role in governing the riskiness of the CIS industry. However, hedge funds, and their closer discursive connection to risk as danger may prove to challenge this in the next few years.

Finally, in the case of reinsurance there is yet a different understanding of the assemblage for governance. Reinsurance is interesting in this respect because the regulatory realm is currently in a state of flux. Previously, the discourse of risk as danger had been contained within the private side of the sector, like in the securities field more broadly, until the attempts to connect with the sub-stream about systemic risk began to open up its visibility to the public realm for the purposes of governing. This case highlights that the construction of risk discourses is an inherently political process. Actors involved in the definition of risk and responsibility are actively engaged in a

[514] OECD (2005), p. 140

contest to gain the symbolic power this act bestows.[515] In the case of reinsurance there is currently an attempt to reconstitute the sector in important ways for its governance.

Risk, Governance, and Power

Across all the cases, there is a variety of forms of power that are constantly employed. However, in each case we see clear and important elements of disciplinary and governmental power, where the structure that is created serves to control the actions of individuals and firms rather than direct coercion by the state. By looking through discourse, we are able to see power beyond the instrumental or structural conceptions. As such, one can see that governance is actually comprised of unique compositions of different exercises of power and the implications for this for self-discipline, surveillance and constraint-based governance.

In the cases of the Basel Accords and CIS governance one can see the intention that state-based power be exercised because in both these areas the primary form of international governance is a regulation meant to be implemented into national laws, implemented by national regulators and subject to official supervision.[516] It is also clear that the state maintains a role in supervising all of these cases, so shifts in governance processes in recent years are not simply total deregulation and shifts to market discipline.

---

[515] Garsten, Christina and Anna Hasselström (2003)

[516] The term state-based is used here in order to mark the distinction between this form of disciplinary power based on earlier Foucauldian conceptions and the disciplinary power that can be exercised from multiple points to encourage particular forms of self-government. In the case the former disciplinary power was the power exercised by the bureaucracies – in this case the state supervisors - of the sovereign to govern.

Yet the type of supervision and its intent are varied. In the case of Basel the regulator is constructed as a prudential body, whereas in CIS governance, the supervisor is constructed as a body which is intended to ensure transparency and integrity in the market. One can also see a less formal version of this in the reinsurance case in that state regulators are intended to compel disclosure, at least to the public actors and in some cases to the market, from individual reinsurers. Even in the current environment of the neoliberal state, public actors continue to play a supervisory role over the market in many areas.[517]

Moreover, in the process of governance each of these fields is marked with the increasing integration of a system of surveillance outside of the state – more often referred to as market discipline. The assumption is that 'the market' and market discipline provide the best form of oversight and punish those who do not self-discipline. More accurately, the surveillance is not provided by the market but by actors continuously performing different acts of surveillance and reporting. The 'market' is then understood to discipline through overall effects of the aggregation of many different transactions. There are numerous questions and concerns that one can discuss in regards to the whether market discipline can actually occur, including an appropriate scepticism about whether individual actions can be moved up to the aggregate in a way that would have any united impact.

In addition to these more known forms of power, there are also a multitude of instances where disciplinary and governmental power are present. With these forms of

[517] Langley, Paul (2006)

power, the governance and surveillance that are necessary to create and discipline the actions and identities of an individual have been internalized. In essence, the actor is responsible for governing his or her own actions but in a way that is consistent with broader imperatives of power. In the case of banking this is most clear with the introduction of operational risks and the implications that it has for the identities of those within the banking organizations. In the case of collective investment scheme governance, this process is clear in two areas. First, it can be seen in the promotion of internal corporate governance mechanism as the first line of risk measurement. Moreover, this self-disciplinary power spreads beyond the CIS actors, as we see in the arguably increasingly successful efforts to create a society of 'informed investors'. In this case, the power in question shifts to become more governmental rather than disciplinary.

In this discussion, it is again apparent that there are similarities but also interesting differences in the governance process. It is important to remember what is emerging in governing finance are a number of distinct assemblages of governance which each displays variations in the relationship between public and private actors and the exercise of disciplinary and governmental power. However, in looking at where there is divergence in the cases, as well as their commonalities, it is clear to see that these regulatory decisions do not simply constrain action. They work productively in creating new or rearticulated governing roles. Yet, who these actors are and the identity that they end up constructing with will vary across sectors. For example, in CIS the placement of responsibility for risk with the individual has led the governance regime to attempt to rearticulate her/him from an identity of unsophisticated and small to informed investor.

In the case of banking, the role of credit rating agencies has been re-articulated in a way that affirms their status as exercising the expert technique of credit rating in the calculation of bank capital adequacy. Moreover, in Basel II, it has been argued that the supervisor's identity is actually reconstituted as well. It is shifted to that of 'risk manager' who is responsible for overseeing that the models in Pillar 1 and systems in Pillar 2 are put into effect by banks.[518]

Finally, these discussions of power and identity bring to the center of the analysis the normative issues and decisions that are submerged under technical discussions of risk. Chapter 8 marks an attempt to critically analyze the different governance arrangements by destabilizing the notion of 'risk' as a natural and real phenomenon and the notion of 'expert knowledge' as 'neutral' and 'truth,' highlighting that they are both contestable and a form of power. By doing this, the depoliticization that occurs through a discussion of risk and expert knowledge is apparent. Moreover, if what this depoliticized process produces is not value-neutral then questions of voice and participation become even more apparent.

Discourse, Rational Choice and Neo-liberal Ideology Revisited

Throughout this work, I have endeavoured to make the case for the need to consider the implications of discourse in the international governance of the financial services sector. In doing so, I have been at the same time making a case against two other approaches to studying this field. – rational choice based explanations and the capitalist

[518] Power, Michael (2005),

class and neo-liberal ideology explanations. Both of these admittedly broad categories of approaches offer a distinct avenue to analyze and understand international financial regulation. However, both are constrained by different elements in their ability to offer a full understanding of these arenas.

In the case of rational choice, it is clear that this narrow conception of self-interested actors cannot explain the breadth of elements of the governance projects that have been shown here. The constraints of focusing on 'rational' actors in a process of trying to achieve predetermined preferences around utility-maximization would not capture the re-articulation of identities that we have seen among some of the actors. Moreover, in these approaches, the limitations around the conceptions of knowledge and power are problematic. In this type of approach, knowledge matters largely as ideas that are used as tools in achieving the goals of the actor or that are able to alter the preference of the actor toward the outcome that they are seeking and the cost-benefit analysis around this. A similar argument can be made about power, which is generally conceptualized as a tool used by states or other actors to achieve their goals. It is clear throughout the dissertation that knowledge and power in this study are much more fully understood than in a rational choice approach.

In relation to this point, each case also highlighted the important roles that both public and private actors play. Each of the cases were shown to be much more nuanced and multi-levelled than sometimes recognized in the International Political Economy literature. It definitely pushes the discussion of private and public roles in governance further than studies that explain private involvement through capital or interest-based terms. Moreover, it takes both these categories out of the traditionally separate, and in some cases conflictual, relationship that they are sometimes conceptualized as having. The governance process is not so much about public and private but what techniques are articulated in ways that make them acceptable and amenable to governance. An example, is the concerns with the technique of credit rating[519] if the function is performed by a public body instead of a private one? Clearly some of the points made in the text highlight areas where future direct research is needed. However, the opening would not be seen without beginning with discourse and risk.

Looking at more neo-Gramscian approaches, the difference between this analysis and what they provide are much smaller. Neo-Gramscian approaches are useful in that they provide an avenue for questioning and critique. However, they have a more limited understanding of power in comparison to the discursive approach used here. Instead of power being instrumentalized by a particular group, it flows through the process. Moreover, by moving away from a focus on the capitalist class one is able to see some of the variation that can be found in terms of the governance projects. Even in comparing banking and collective investment schemes one can see that these fields have distinct and different relationships to neo-liberal governance.

Conclusions

This chapter has attempted to summarize some of the key findings about the three different areas of international governance of the financial services sector. It has pointed

[519] Including its potentially pro-cyclical nature (King, Michael R. and Timothy J. Sinclair, 2003)

out a number of areas where there are key similarities. Specifically, each case has an identifiable connection with both the discourses of risk and an important connection to expert knowledge. Moreover, it is clear in each example that state, disciplinary and governmental power are present. However, it is also argued that studying this sector has highlighted the importance of making claims that are more specific rather than the tendency sometimes seen to talk about finance writ large. In looking at each case, the actual interaction between the two discourses around risk resulted in three distinct frames for governance. In banking, it was heavily weighted toward the systemic risk discourse but the elements of risk as economic necessity were important in explaining why the amendments and renegotiation have consistently aimed at achieving the more precise measure of risk-weighted capital. In the CIS, the relationship was weighted the other way to such an extent that the regulatory structure was geared toward creating a sound and transparent base from which market participants could make their decisions about how to invest. The exception to this could be the recent developments relating to hedge funds. Finally, in the case of reinsurance the discourse of risk as danger has been largely missing. Instead, one can see that the place of reinsurance as a risk management technique is still firmly in place. Yet, even through these differences, certain commonalities that fit with the constitute of risk as calculable are visible: a search for precision in identification, measurement and management. This has led to commonalities in the use of quantitative modelling, disclosure and 'expert' knowledge in governance. At the same point, it highlights the truly public-private relationship that is inherent to the performance of governance in the current era, even when the standards and codes are intergovernmental.

The main purpose of this dissertation has been to show how looking at discourse can provide a useful avenue to understanding international financial regulation more fully. More specifically it has focused on the relationships between two particular discourses of risk and how their interaction can be seen underpinning the international governance domains that emerged in each of the cases studied. In the process, however, the approach was also able to show how these matter more than simply as ideas but are instead connected to different techniques, practices and identities in governing. However, beyond simply describing the governance processes in each of the three cases, this study has also endeavoured to offer critiques of these governance processes, highlighting that although the knowledge underpinning them may seem natural or politically neutral it is not. In doing so, it has sought to begin to open up a space for questioning and critique on a more fundamental level. As Beck argues, "In world risk society the politics and subpolitics of risk definition become extremely important...This highlights the new *power game* of risk and its meta-norms."[520] In further opening up this space, it is hoped that more will engage in these politics.

[520] Beck, Ulrich (1999), p. 4

Appendix A
Research Methods and Documentation

The analysis for this project occurred through multiple related and overlapping methods.

1. An examination of the academic literature on international development and regulation for each case.

2. An extensive review of the trade literature on each case from 1985 (or earliest available date). This process involved a general analysis guided by the questions in the "guided question" section. Trade literature reviewed listed below.
   - **Basel – Specific Trade Publications:** *The Banker, ABA Banking Journal, Business Line, Balance Sheet, European Banker, Asian Banker Journal, Journal of Banking and Finance, Bank Accounting & Finance*
   - **CIS - Specific Trade Publications:** *Fundamentals (Investment Company Institute),* Articles also found in: *Business Week, Financial Planning, Journal of Banking and Finance*
   - **Reinsurance - Specific Trade Publications:** *Global Reinsurance, Reactions, Reinsurance, Datamonitor*
   - **General Financial Publications** - *Economist, The Wall Street Journal, New York Times, Financial Times, International Financial Law Review*

3. An assessment of primary material was done using two methods – the guided questions also used above and modified predicate analysis. A list of all primary documents reviewed is provided in following a brief discussion of the each method. Emphasis was placed on assessing actors that were international character or responding to this international rather than any specific national regulatory space.

   1. Assessment based on guided questions

Questions for Guided Question Analysis:

1. What subjects/objects are "at risk"?
2. Which subjects/objects are creating risks?
    a. Is this a outcome of agency and choice, 'natural phenomenon', or something else?
3. Is the 'risk' constructed as a negative or positive object/event?
4. What techniques are legitimized as methods to 'identify' this risk or risky situations?
    a. Is there an attempt to tightly specify or 'measure' these risks?
    b. If so, what elements are quantitative? Which are qualitative?
5. Who (individual, organization, society, etc) is framed as having responsibility for dealing with these risks or risky situations?
    a. Is this implicit or explicit?
6. What techniques are used (or promoted) to address this risk or risky situations?
    a. Is this focused on prevention, mitigation and/or 'how to deal with problems after the fact'?
    b. Are these techniques only encouraged/promoted or are they also required?
7. What subjects (groups, individuals, professions, organizations, etc) are explicitly identified in the document?
    a. What role(s) do they each have?
    b. How much agency are they ascribed?

2. Identification and analysis through Predication

Predication or Predicate analysis is a form of discourse analysis that focuses on identifying patterns in language, where attention is paid to identifying the adjectives, adverbs, and verbs that predicate particular subjects and objects ('things'). These elements serve to construct subjects in particular ways and imbue actors with different political identities, choices, and actions. These processes work to legitimate or prohibit certain actions, as well as construct activities and events as natural or unavoidable. In

International Relations, Jennifer Milliken and Roxanne Lynn Doty have been prominent in their use of this form of analysis.[521] Milliken, in particular sees predicate analysis as useful for establishing the presence of discourses and examining how they overlap.[522] Doty argued that this form of analysis of discursive structures was useful to examine and understand how identities and actions were constructed with language in United States foreign policy. She argues,

> to state that the United States 'has stood for fair play, for aid to the weak, for liberty, and freedom' establishes the United States as a particular kind of subject with these qualities. Attributes attached to subjects are important for constructing identities for those subjects and for telling us what subjects can do.[523]

For Doty, predication is combined with two other methods to create a 'grid of intelligibility': presupposition (examining what is presupposed underneath particular statements and claims) and subject positioning (examining the direct links drawn between different subjects or subjects and objects). In this analysis, the information provided through the guided questions examines these two elements. However, I decided to use predication/predicate analysis in addition to these questions as it captures slightly different information.

The assessed documents were reviewed and all instances where the word risk appeared, its relationship with the various subjects, objects, verbs, adverbs and adjectives

---

521 See Milliken, Jennifer (1999) "The study of discourse in international relations: A critique of research and methods" *European Journal of International Relations*, Vol. 5, no. 2, pp. 225-254 OR Milliken, Jennifer (2001)"Discourse Study: Bringing Rigor to Critical Theory" in Fierke, Karin M. and Knud Erik Jorgensen (eds.) *Constructing International Relations: The next generation*, London: M.E. Sharpe, pp. 136-159

522 Milliken, Jennifer (1999), pp. 231-34

523 Doty, Roxanne (1993) "Foreign policy as social construction: A post-positivist analysis of US counterinsurgency policy in the Philippines", International Studies Quarterly, Vol. 37, no. 3, pp. 308

was recorded.[524] Once the document analysis was complete, they were assessed to determine trends and generalities in the construction for each case. The key concern with this kind of analysis, or any more formalized method of discourse analysis, is that in the process of coding and categorizing the meaning and context of the text is lost. Even Doty has acknowledged this reality in a presentation at a 2003 conference.[525] In combining the primary method of the more fluid and flexible analysis of guided questions with this method, the intent is to draw out the strengths and mitigate the potential weaknesses of each method.

<u>Acronyms</u>

ABA	American Bankers Association
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
EAMA	European Association for Asset Management
ECB	European Central Bank
EFAMA	European Fund and Asset Management Association
EU	European Union
FBE	European Banking Federation
FSA (UK)	Financial Services Authority – United Kingdom
FSF	Financial Stability Forum
G30	Group of 30
IAIS	International Association of Insurance Supervisors
IAA	International Actuarial Association
IOSCO	International Association of Securities Commissions
Moody's	Moody's Investors Services
OECD	Organization for Economic Development and Cooperation

[524] For a list of the documents assessed, please see Appendix A.
[525] Doty, Roxanne Lynn (2003) "Response to James Richter and Jutta Weldes, Critiques of Imperial Encounters" *Identity Matters and How Conference*, Mershon Center, Ohio State University, May 30-31, 2003 < https://kb.osu.edu/dspace/bitstream/1811/31957/6/Doty%20Response.pdf>

Key Governance Documents Assessed

All documents listed were analyzed using the guide questions.
Marked documents (*) were also assessed using the method of predication.

BASEL CAPITAL ADEQUACY ACCORD

Intergovernmental Standards and Documents

	Organization	Document / Principle / Standard	Pub. Date
*	BCBS	Amendment of the Basel Capital Accord	November 1991
*	BCBS	Amendment to the Capital Accord of July 1988	July 1994
	BCBS	An Explanatory Note on the Basel II IRB Risk Weight Functions	July 2005
	BCBS	Compliance and the compliance function in banks	April 2005
	BCBS	Consultative Document – Enhancing Corporate Governance for Banking Organizations	July 2005
	BCBS	Consultative Document - Overview of The New Basel Capital Accord	April 2003
	BCBS	Consultative Document - Overview of The New Basel Capital Accord	January 2001
	BCBS	Consultative Document - The Application of Basel II to Trading Activities and the Treatment of Double Default Effects	April 2005
	BCBS	Consultative Document - The compliance function in banks	October 2003
*	BCBS	Consultative Document - The New Basel Capital Accord	April 2003
*	BCBS	Consultative Document - The New Basel Capital Accord	January 2001
	BCBS	Core Principles for Effective Supervision	October 2006
	BCBS	Core Principles of Effective Banking Regulation	1997
*	BCBS	Enhancing Corporate Governance for Banking Organizations	February 2006
	BCBS	Enhancing Corporate Governance for Banking Organizations	September 1999
	BCBS	Guidance on Paragraph 468 of the Framework Document	July 2005

	BCBS	High-level principles for the cross-border implementation of the New Accord	August 2003
	BCBS	Implementation of Basel II – Practical Considerations	July 2004
*	BCBS	International Convergence of Capital Measurement and Capital Standards - A revised Framework	July 1988
*	BCBS	International Convergence of Capital Measurement and Capital Standards - A revised Framework	April 1998
*	BCBS	International Convergence of Capital Measurement and Capital Standards - A revised Framework	June 2004
*	BCBS	International Convergence of Capital Measurement and Capital Standards - A revised Framework	November 2005
	BCBS	Modifications to the capital treatment for expected and unexpected credit losses in the New Basel Accord	30 January 2004
*	. BCBS	Operational Risk Management	September 1998
	BCBS	Principles for the home/host recognition of AMA operational risk capital	January 2004
	BCBS	Principles for the Management and Supervision of Interest Rate Risk	July 2004
	BCBS	Promoting Financial Stability (Activity Report)	March 1999
	BCBS	Report for the G7 Summit on the activities of the Basel Committee	June 2006
	BCBS	Report No 15 - Report on International Developments in Banking Supervision	September 2006
*	BCBS	Sound Practices for the Management and Supervision of Operational Risk	July 2002
*	BCBS	Sound Practices for the Management and supervision of operational risk	February 2003
	BCBS	Studies on the Validation of Internal Rating Systems- Revised version (Working Paper No. 14)	May 2005
	BCBS	Supervisory Risk Assessment and Early Warning Systems (Working Paper no. 4)	December 2000
*	BCBS	The New Basel Capital Accord - an explanatory note	January 2001
	BCBS	The Treatment of the Credit Risk Associated with Certain Off-Balance Sheet Items	July 1994
	BCBS	Update on the work of the New Basel Capital Accord	September 2001
	BCBS	Update on work of the Accord Implementation Group - Basel Committee Newsletter No.4	January 2005

*	BCBS	Working Paper on the Treatment of Operational Risk	January 2001
	BIS	Fifty-fifth Annual Report, 1 April 1984-31 March 1985	June 1985
	BIS	Fifty-ninth Annual Report, 1 April 1988 – 31 March 1989	12 June 1989
	BIS	Forty-fifth Annual Report, 1 April 1974-31 March 1975	June 1975
	IOSCO	Comments on the New Basel Capital Accord	2001
	Joint Forum	Operational risk transfer across financial sectors	August 2003

Non-Governmental Responses to Basel II

	ABA	Response to Consultative Paper – Basel II	June 1999
	ABA	Response to Basel II Consultative Paper (CP2)	January 2001
	ABA	Response to Basel II Consultative Paper (CP3)	April 2003
	FBE	Comments on the BCBS' Revised Sound Practices for the Management & Supervision of Operational Risk	30 Sept. 2002
	FBE	Comments on Consultative Paper 3 (CP 3)	30 July 2003
	IAA	Response to Consultation on Basel II	31 May 2001
	Moody's	Entering A New Regulatory Environment: Proposed Revisions to the 1988 Basel Accord May Raise Costs and Squeeze Availability of ABCP Liquidity	20 April 2001
	Moody's	Response to Consultation on Basel II (2nd draft)	30 May 2001
	Moody's	Response to Consultation on Basel II (3rd draft)	31 May 2001
	John Thirwell	Response to Consultation Paper Basel II (CP3)	April 2003
	Standard & Poor's	Response to Consultation on Basel II (2nd draft)	2001
	Standard & Poor's	Response to Consultation on Basel II (3rd draft)	22 August 2003
	UBS	Response to the New Basel Capital Accord	

COLLECTIVE INVESTMENT SCHEMES

Intergovernmental Standards and Documents

*	IOSCO	Consultation Report: Examination of Governance for Collective Investment Schemes	February 2005
	IOSCO	Anti-money Laundering Guidance for Collective Investment Schemes	February 2005
	IOSCO	Collective Investment Schemes as Shareholders: Responsibilities and Disclosure	May 2002
*	IOSCO	Collective Investment Schemes in Emerging Markets	September 1996
*	IOSCO	Consultation Report: Examination of Governance for Collective Investment Schemes - Part II (Independence Criteria, Empowerment Conditions and Functions to be performed by the 'Independent Oversight Entities')	June 2006
*	IOSCO	Discussion Paper on the Role of Investor Education in the Effective Regulation of CIS and CIS Operators	March 2001
	IOSCO	Elements of International Regulatory Standards on Fees and Expenses on Investment Funds	February 2004
*	IOSCO	Examination of Governance for Collective Investment Schemes - Final Report, Part I	June 2006
	IOSCO	Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds	November 2004
	IOSCO	Investment Management: Areas of Regulatory Concern and Risk Assessment Methods, Report of the Technical Committee	October 2002
*	IOSCO	Investor Education in the Effective Regulation of CIS and CIS Operators	March 2001
	IOSCO	Objectives and Principles of Securities Regulation	May 2003
	IOSCO	Performance Presentation Standards for Collective Investment Schemes (Report)	May 2002
*	IOSCO	Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards	May 2004
	IOSCO	Performance Presentation Standards for Collective Investment Schemes (Report #1)	December 2000
*	IOSCO	Principles for the Regulation of Collective Investment Schemes: Report on Investment Management	July 1995
*	IOSCO	Principles for the Supervision of Operators of Collective Investment Schemes	September 1997

	IOSCO	Public Comments received on the IOSCO Technical Committee Report Entitled Anti-money Laundering Guidance for Collective Investment Schemes	October 2005
	IOSCO	Risk Management and Control Guidance for Securities Firms and their Supervisors	May 1998
	IOSCO	Summary of Responses to the Questionnaire on Principles and Best Practice Standards on Infrastructure for Decision Making for CIS Operators	May 2000
*	OECD	Discussion Draft – Governance of Collective Investment Schemes (CIS)	July 2004
*	OECD	Standard Rules for the Operations of Institutions for Collective Investment in Securities	1972
*	OECD	White Paper on Governance of Collective Investment Schemes (CIS)	March 2005
	FSA (UK)	The Collective Investment Scheme Information Guide	No date

Non-Governmental Documents/Responses

	BVI	Public Comment on Examination of Governance for Collective Investment Schemes	11 May 2006
	EAMA	Report - Risks and Regulation in European Asset Management: Is there a role for Capital Requirements	January 2001
	EFAMA	Reply to IOSCO's Report - "Examination of Governance for Collective Investment Schemes"	15 October 2006

Hedge Funds

	FSF	The FSF Recommendations and Concerns Raised by Highly Leveraged Institutions (HLIs)	March 2002
	FSF	Update on the FSF's 2000 HLI Report	May 2007
	IOSCO	Hedge Funds and Other Highly Leveraged Institutions	November 1999
	IOSCO	The Regulatory Environment for Hedge Funds: A Survey & Comparison - Consultation Report	March 2006
	IOSCO	The Regulatory Environment for Hedge Funds: A Survey & Comparison – Final Report	November 2006

REINSURANCE

(Inter)Governmental Standards and Documents

	EU	DIRECTIVE 2005/68/EC of the European Parliament and of the Council	November 2005
	FSA (UK)	Review of UK Insurers Risk Management Practices	2004
	FSF	Report of the Working Group on Offshore Centres	5 April 2000
*	G30	Reinsurance and International Financial Markets	2006
	IAIS	Global Reinsurance Market Report 2004	December 2005
*	IAIS	Principles on Minimum Requirements for Supervision of Reinsurers (Principle no. 6)	October 2002
	IAIS	Principles and Terms of Use of Databases for Contributors	October 2005
	IAIS	Standard on Disclosure Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers (Supervisory Standard no. 9)	October 2004
	IAIS	Standard on Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers (Supervisory Standard no. 11)	October 2005
*	IAIS	Standard on Supervision of Reinsurers (Supervisory Standard no. 8)	October 2003
*	IAIS	Supervisory Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers (Supervisory Standard no. 7)	January 2002
	Nutter, Franklin (US)	Testimony before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the House Committee on Financial Services	2002
*	OECD	Decision of the Council on the Exchange of Information on Reinsurers	1998
*	United Nations	Transnational Reinsurance Operations: A Technical Paper	1980
*	World Bank	The World Bank Primer on Reinsurance	1995

Relevant Non-Governmental Reports

	American Academy of Actuaries	Actuarial Update: Academy Rebuts S&P Report	January 2004
	Casualty Actuarial Society (US)	Report to the Board of Directors – Task Force on Actuarial Credibility	2005
	European Commission/ KPMG	Study into the methodologies to assess the overall financial position of an insurance undertaking from the perspective of prudential supervision: *A study by KPMG*	May 2002
	Standard & Poor's	Insurance Actuaries: A Crisis in Credibility	2003
*	Pvk studies (Stichting Pensioen- & Verzekeri-ngskamer te Apeldoorn)	Reinsurance and reinsurers: relevant issues for establishing general supervisory principles, standards and practices An Issues Paper on reinsurance initiated by the IAIS	April 2000
*	Swiss Re	Reinsurance: A systemic risk? (sigma, No. 5/2003)	2003

GENERAL - FINANCIAL REGULATION relevant to MULTIPLE CASES

	ECB	Financial Stability Review	December 2004
	ECB	Financial Stability Review	December 2005
	ECB	Financial Stability Review	December 2006
	ECB	Financial Stability Review	December 2007
	FSF	Financial Stability Forum reviews vulnerabilities and efforts to strengthen the international financial system (Press Release)	September 2002
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	April 1999
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 1999

	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	August 2000
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2001
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	August 2001
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2002
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2003
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2003
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2004
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2004
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2005
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2005
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2006
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2006
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	March 2007
	FSF	Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)	September 2007

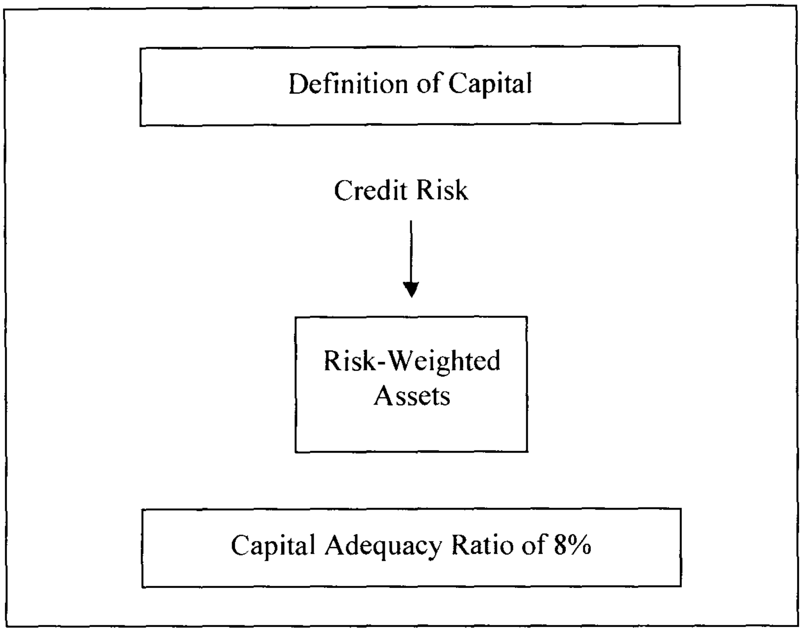
Appendix B:
Articles including the term 'systemic risk': 1980s-1990s

Periodical / Year	Wall Street Journal[1]	New York Times	Sub-Total	Financial Times	Total
1984 -1989	3 (O)	1	4	9	14
1990	4 (O)	0	4	8	13
1991	5 (O)	3	8	8	18
1992	2 (O)	1	3	4	7
1993	3 (O) 3 (A) 1 (E)	0	7	18	26
1994	6 (O) 3 (E)	3	12	16	30
1995	7 (O) 1 (E)	2	10	26 (Barings Bank)	39
1996	4 (A) 1 (O) 1 (E)	0	6	13	19
1997	11 (A) 4 (O) 1 (E)	2	19	34	53
1998	14 (O) 14 (A) 5 (E)	7	40	56	97
1999	8 (O) 6 (E) 6 (A)	3	23	20	44
Total	119	22	141	212	360

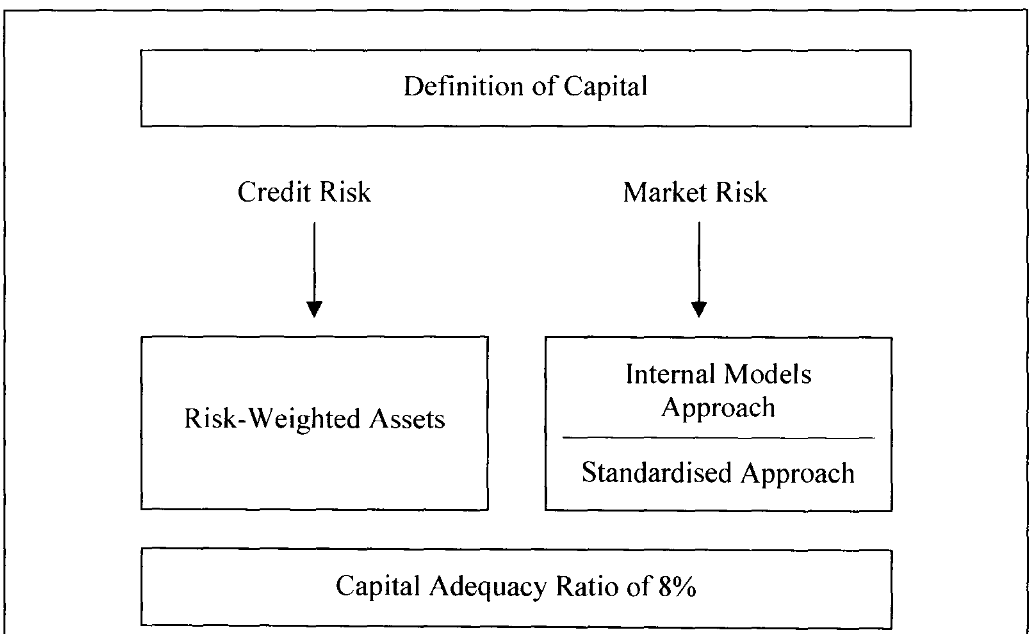
[1] The Wall Street Journal – O: Original / E – Europe / A – Asia
'Original' denotes the primary (United States) edition. However, stories in the Asian Wall Street Journal and the Wall Street Journal Europe were also assessed. A story published in multiple versions was only included once and assigned to its primary source.

Appendix C:
Graphical Representations of the Basel Accords

The original Capital Adequacy Accord (1988)



After the 1996-1998 Market Risk Amendments



Source: Lastra, p. 228

Structure of the Basel II Capital Adequacy Accord[526]
(definition of capital remains the same)

<table>
<tr><th>Pillar</th><th>Goal:</th><th colspan="3">Components:</th><th></th></tr>
<tr><td rowspan="2">Pillar 1</td><td rowspan="2">Establish minimum capital requirements to cover:</td><td>Credit Risk ↓</td><td>Market Risk ↓</td><td>Operational Risk ↓</td><td rowspan="2">One method is required listed from:
Least Complex
↓
Most Complex</td></tr>
<tr><td>Standardised Approach (risk weighted)<hr>Internal Ratings-Based Approach (IRB - Foundation)<hr>Internal Ratings-Based Approach (IRB - Advanced)</td><td>Standardised Approach<hr>Internal Models Approach (same as 1996/1998)</td><td>Basic Indicator Approach<hr>Standardised Approach<hr>Advanced Measurement Approaches (AMA)</td></tr>
<tr><td>Pillar 2</td><td>Supervisory review process of capital adequacy</td><td colspan="4">4 Principles to complement to the Core Principles for Effective Banking Supervision and the Core Principles Methodology<hr>1. Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.<hr>2. Supervisors should review and evaluate banks' internal capital adequacy assessments and strategies, as well as their ability to monitor and ensure their compliance with regulatory capital ratios. Supervisors should take appropriate supervisory action if not satisfied with the result of process.<hr>3. Supervisors should expect banks to operate above the minimum regulatory capital ratios and should have the ability to require banks to hold capital in excess of the minimum.<hr>4. Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.</td></tr>
<tr><td>Pillar 3</td><td>Market Discipline and Disclosure</td><td colspan="4">Specifically this involves a set of disclosure requirements which allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution.
• Disclosures are semi-annual except qualitative disclosures that provide a general summary of a bank's risk management objectives and policies, reporting system and definitions which may be annually</td></tr>
</table>

[526] Chart based on Basel Committee on Banking Supervision (2005) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* Basel: Bank for International Settlements (Updated November 2005)

Literature Cited

Adam, Barbara and Joost van Loon (2000) "Repositioning Risk: The Challenge for Social Theory" in B. Adam, U. Beck and J. van Loon (eds.) *The Risk Society and Beyond*, London: SAGE, pp. 1–33

Adam, Barbara, Ulrich Beck and Joost van Loon, eds. (2000) *The Risk Society and Beyond*, London: SAGE

Adler, Emanuel (1992) "The Emergence of Cooperation: National Epistemic Communities and the International Evolution of the Idea of Nuclear Arms Control", *International Organization,* Vol. 46, no. 1, pp. 101-145

Alexander, Carol (2003) *Operational Risk: Regulation, Analysis and Management,* Financial Times Prentice Hall (1st edition)

Alexander, J.C. (1996) "Critical Reflections on 'Reflexive Modernization'" *Theory, Culture and Society,* Vol. 13, no. 4, pp. 133–8

Alexander, Kern (2001) "The Need for Efficient International Regulation and the Role of a Global Supervisor" in Ferran, Eilis and Charles A.E. Goodhart (eds.) *Regulating Financial Services and Markets in the Twenty First Century*, Portland: Hart Publishing

Alexander, Kern, Rahul Dhumale and John Eatwell (2006) *Global Governance of Financial Systems: The International Regulation of Systemic Risk*, Oxford: Oxford University Press

Allen, Nigel (2005) "Dividing Responsibilities" *Global Reinsurance*, July 15, 2005

Allen, Nigel (2006) "Getting a grip" *Global Reinsurance*, April 1, 2006

Baker, Andrew (2003) "The G7 and architecture debates: norms, authority and global financial governance" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 324-342

Baker, Andrew (2006) *The Group of Seven: Finance ministerial, central banks and global financial governance*, New York: Routledge

Baker, Andrew, David Hudson and Richard Woodward, eds. (2005) *Governing Financial Globalisation: The Political Economy of Multi-Level Governance*, New York: Routledge

Baker, Tom and Jonathan Simon, eds. (2002) *Embracing Risk: The Changing Culture of Insurance and Responsibility*, Chicago, IL: University of Chicago Press

Bakker, R.C.L. and D.N. Davies, et al (2000) *Reinsurance and reinsurers: relevant issues for establishing general supervisory principles, standards and practices An Issues Paper on reinsurance initiated by the IAIS*, pvk studies 20 (Stichting Pensioen- & Verzekeringska-mer te Apeldoorn)

Bank for International Settlements (BIS) (1975) *Forty-fifth Annual Report*, 1 April 1974-31 March 1975, Basle: Author, published: 9th June 1975

Bank for International Settlements (BIS) (1985) *Fifty-fifth Annual Report*, 1 April 1984-31 March 1985, Basle: Author, published: 10th June 1985

Bank for International Settlements (BIS) (1989) *59th Annual Report*, 1 April 1988 – 31 March 1989, Basle: Bank for International Settlements, published: 12 June 1989

Banking for International Settlements website (http://www.bis.org)

Barth, James R., Gerard Caprio Jr. and Ross Levine, *Rethinking Bank Regulation: Till Angels Govern,* Cambridge: Cambridge University Press, 2006

Barfield, Richard (2004) "The nature of risk: Deep impact - Basel in the European Union" Balance Sheet, Vol. 12, no. 5, pp. 32-37

Basel Committee on Banking Supervision (1988) *International Convergence of Capital Measurement and Capital Standards,* Basel: Bank for International Settlements

Basel Committee on Banking Supervision (1994) *Amendment to the Capital Accord of July 1988*, p. 1

Basel Committee on Banking Supervision (1996) *Overview of the Amendment to the Capital Accord to Incorporate Market Risks*, January 1996

Basel Committee on Banking Supervision (1998) *International Convergence of Capital Measurement and Capital Standards - A revised Framework*, Basel: Bank for International Settlements, July 1988, Updated to April 1998

Basel Committee on Banking Supervision (1998b) *Operational Risk Management*, Basel: Bank for International Settlements

Basel Committee on Banking Supervision (2000) *Credit Ratings and Complementary Sources of Credit Quality Information.* Basel Committee on Banking Supervision Working Paper No. 3. August. Basel: BIS.

Basel Committee on Banking Supervision (2001) *Consultative Document: The New Basel Accord*, Basel: Bank for International Settlements (Issued for comment by 31 May 2001)

Basel Committee on Banking Supervision (2001b) *The New Basel Capital Accord: an explanatory note*, Basel: Bank for International Settlements

Basel Committee on Banking Supervision (April 2003) *Consultative Document: The New Basel Capital Accord, Issued for comment by 31 July 2003.* Basel: Bank for International Settlements

Basel Committee on Banking Supervision (April 2003b) *Consultative Document: Overview of The New Basel Capital Accord,* Basel: Bank for International Settlements (Issued for comment by 31 July 2003)

Basel Committee on Banking Supervision (2004) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework,* Basel: Bank for International Settlements,

Basel Committee on Banking Supervision (July 2004) *Implementation of Basel II: Practical Considerations,* Basel: Bank for International Settlements

Basel Committee on Banking Supervision (2004c) *History of the Basel Committee and its Membership.* Basel: BIS. October 2004

Basel Committee on Banking Supervision (2005) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework,* Basel: Bank for International Settlements (Updated November 2005)

Basel Committee on Banking Supervision (2006) *Report for the G7 Summit on the activities of the Basel Committee*

Basel Committee on Banking Supervision (2006b) *Enhancing corporate governance for banking organizations*, Basel: Bank for International Settlements

Baur, Patricia and Rudolf Enz (2003) "Reinsurance – a systemic risk?" *Swiss Re sigma No. 5/2003*, Zurich: Swiss Re, p. 4 <http://www.swissre.com/sigma>

Bebear, Claude (2002) "Remarks on the Development of Global Regulation for Financial Services Industries and its Impact on Insurance" *The Geneva Papers on Risk and Insurance*, vol. 27, no. 1, January, pp. 46-65

Beck, Ulrich (1992) *Risk Society: Towards a New Modernity*, London: SAGE Publications

Beck, Ulrich (1999) *World Risk Society*, Cambridge: Polity Press

Beck, Ulrich and Johannes Willms (2004) *Conversations with Ulrich Beck* Cambridge: Polity Press (translated by Michael Pollak)

Bernstein, Peter L. (1998) *Against the Gods: The Remarkable Story of Risk*, Toronto: John Wiley & Sons, Inc.

Best, Jacqueline (2005). *The Limits of Transparency: Ambiguity and the History of International Finance*. Ithaca, NY: Cornell University Press.

Best, Jacqueline (2006) "Ambiguity, Uncertainty and Risk: Rethinking Indeterminacy" Paper presented at British International Studies Association, Cork, Ireland, December

BestWire (2004a) "Insurers take a closer look at their need for Reinsurance", *BestWire*, June 9, 2004

Bielski, Lauren (2003) "Getting a framework", *ABA Banking Journal*, FEATURES: Special Section- Operational Risk Measurement, November, pp. 55

Bisignano, Joseph (1998) Towards an Understanding of the Changing Structure of Financial Intermediation: An Evolutionary Theory of Institutional Survival, Amsterdam: Société Universitaire Européenne de Recherches Financières

Börzel, Tanya (1998) "Organizing Babylon: On the Different Conceptions of Policy Networks" *Public Administration - London* Vol. 76, Summer, pp. 253-273.

Bouwen, Pieter (2002) "Corporate lobbying in the European Union: the logic of access." *Journal of European Public Policy*, Vol. 9, n. 3, pp. 365-390

Bouwen, Pieter (2004) "Exchanging access goods for access: a comparative study of business lobbying in the European Union institutions." *European Journal of Political Research*, Vol. 43, n. 3, pp. 337-369.

Bowe, Amanda (2004) "Regulation: European News" *Global Reinsurance*, February 1, 2004

Boyne, Roy (2003) *Risk*, Philadelphia: Open University Press

Bradbury, Judith A. (1989) "The Policy Implications of Differing Conceptions of Risk", *Science, Technology, & Human Values*, Vol. 14, no. 4, Autumn, pp. 380-399

Busch, Andreas (2001). "Managing Innovation: Regulating the Banking Sector in a Rapidly Changing Environment" in Mark Bovens *et al.* eds., *Success and Failure in Public Governance: A Comparative Analysis.* Cheltenham: Edward Elgar, pp. 311–25.

Busch, Andreas (2004) "National Filters: Europeanisation, Institutions, and Discourse in the Case of Banking Regulation" *West European Politics*, Vol.27, no.2, March, pp.310–333

Campbell, David (1992) *Writing Security: United States Foreign Policy and the Politics of Identity*, Minneapolis: University of Minnesota Press

Campbell, Scott and Greg Currie (2006) "Against Beck: In Defence of Risk Analysis", *Philosophy of the Social Sciences*, Vol. 36, no. 2, June, pp. 149 - 172

Carmichael, Jeffrey and Michael Pomerleano (2002) *The Development and Regulation of Non-Bank Financial Institutions*, Washington, DC: The World Bank

Cerny, Philip G. (2002) "Webs of Governance and the Privatization of Transnational Regulation" in Andrews, David M., C. Randall Henning and Louis W. Pauly, eds. *Governing the World's Money*, Ithaca: Cornell University Press, pp 194–216

Cioffari, Vincenzo (1947) "The Function of Fortune in Dante, Boccaccio and Machiavelli" *Italica*, Vol. 24, no. 1, March. pp. 1-13

Clapp, Jennifer (2003) "Transnational corporate interests and global environmental governance: negotiating rules for agricultural biotechnology and chemicals" *Environmental Politics*, Vol. 12, no. 4, pp. 1-23

CNA Re "Reinsurance Basics" www.business.uiuc.edu

Cohen, Benjamin (1998) *The Geography of Money*, Ithaca: Cornell University Press

Coleman, William D. (2002) "Policy Networks" *International Encyclopedia of the Social and Behavioral Sciences*, Oxford: Pergamon, p. 11608

Coleman, William D. and Anthony Perl (1999) "Internationalized Policy Environments and Policy Network Analysis" *Political Studies* Vol. XLVII No. 4, pp.691-709

Committee on the Global Financial System (2002) *Risk measurement and systemic risk: Proceedings of the Third Joint Central Bank Research Conference*, October 2002, (http://www.bis.org/cgfs/conf/mar02.pdf)

Cox, Robert W. with Timothy Sinclair (1996) *Approaches to World Order*, New York: Cambridge University Press

Crockett, Andrew (2002) "Introductory Remarks" in Committee on the Global Financial System (2002) *Risk measurement and systemic risk: Proceedings of the Third Joint Central Bank Research Conference*, October 2002, (http://www.bis.org/cgfs/conf/mar02 .pdf)

Culpeper, Roy (2003) "Systemic Reform At A Standstill: A Flock Of "Gs" In Search Of Global Financial Stability" in Albert Berry and Gustavo Indart (eds.) *Critical Issues in International Financial Reform*, New Brunswick: Transaction Publishers, pp. 203-236

Cutler, David M. and Richard J. Zeckhauser (1997) "Reinsurance for Catastrophes and Cataclysms" *National Bureau of Economic Research Working Paper 5913*, Cambridge, MA: National Bureau of Economic Research

De Bandt, Olivier and Philipp Hartmann (2000) "Systemic Risk: A Survey", Centre for Economic Policy Research (CEPR) Discussion Paper No. 2634, December

De Goede, Marieke (2001) "Discourses of Scientific Finance and the Failure of Long-Term Capital Management" *New Political Economy*, Vol. 6, no. 2, pp. 149-170

De Goede, Marieke (2004) "Repoliticizing financial risk", *Economy and Society*, Vol 33, no 2, May. pp. 197–217

De Goede, Marieke (2005) *Virtue, Fortune, and Faith: A Genealogy of Finance*, Minneapolis: University of Minnesota Press

De Goede, Marieke, ed. (2006) *International Political Economy and Poststructural Politics*, New York: Palgrave Macmillan

De Goede, Marieke (2008) "Beyond Risk: Premediation and the Post-9/11 Security Imagination" *Security Dialogue*, Vol. 39, no.2-3, pp. 155-176

Dean, Mitchell (1999a) *Governmentality: Power and Rule in Modern Society*, London: SAGE Publications

Dean, Mitchell (1999b) "Risk, calculable and incalculable" in Lupton, Deborah (ed.) *Risk and sociocultural theory: new directions and perspectives*, Cambridge: Cambridge University Press, pp. 131 – 159

Deuchars, Robert (2004) *The International Political Economy of Risk: Rationalism, Calculation and Power*, Burlington, VT: Ashgate Publishing Ltd.

Doherty, Neil and Kent Smetters (2005) "Moral Hazard in Reinsurance Markets" *The Journal of Risk and Insurance*, Vol. 72, no. 3, p. 377

Doty, Roxanne (1993) "Foreign policy as social construction: A post-positivist analysis of US counterinsurgency policy in the Philippines", International Studies Quarterly, Vol. 37, no. 3, pp. 297- 320

Doty, Roxanne Lynn (2003) "Response to James Richter and Jutta Weldes, Critiques of Imperial Encounters" *Identity Matters and How Conference*, Mershon Center, Ohio State University, May 30-31, 2003 < https://kb.osu.edu/dspace/bitstream/1811/31957/6/Doty%20Response.pdf>

Dow, James (2000) "What Is Systemic Risk?: Moral Hazard, Initial Shocks, and Propagation" *Monetary and Economics* Studies, Vol.18, no.2, December

Eatwell, John (2001) "New Issues in International Financial Regulation" in Ferran, Eilis and Charles A.E. Goodhart (eds.) *Regulating Financial Services and Markets in the Twenty First Century*, Portland: Hart Publishing

Eatwell, John and Lance Taylor (2000) *Global Finance at Risk*, New York: Free Press

Edelman, Colin, Andrew Burns, David Craig and Akashi Nawbatt (2005) *The Law of Reinsurance*, Oxford: Oxford University Press, pp. 3-4

Edwards, Franklin R. (1996) *The New Finance: Regulation and Financial Stability*, Washington, D.C.: The AEI Press

Egoavil, Marco (2003) "The intersection of corporate governance and operational risk", *Bank Accounting & Finance*, Vol. 16, no. 5, August

Elliot, Anthony (2002) "Beck's Sociology of Risk: A Critical Assessment" *Sociology*, Vol. 36, no. 2, pp. 293–315

Ericson, Richard V., Aaron Doyle and Dean Barry (2003) *Insurance as Governance*, Toronto: University of Toronto Press

Ericson, Richard V. and Kevin D. Haggerty (1997) *Policing the risk society*, Toronto: University of Toronto Press

Ewald, François (1991) 'Insurance and risk', in Graham Burchell, Colin Gordon and Peter Miller (eds.) *The Foucault Effect: Studies in Governmentality*, Chicago, IL: University of Chicago Press, pp. 197–210.

Felsenfeld, Carl and Genci Bilali (2004) "The Role of the Bank for International Settlements in Shaping the World Financial System" *University of Pennsylvania Journal of International Economic Law*, Vol. 25, Fall, pp. 945

Ferguson, jr., Roger W. (2004) "Statement" *International Monetary and Financial Committee, Ninth Meeting April 24, 2004*, Washington, D.C. <http://imf.org/External/spring/2004/imfc/statem/eng/fsf.pdf> Last access: 6 May 2007

Financial Services Authority (2004) *Review of UK Insurers Risk Management Practices*

Financial Stability Forum (2000) *Report of the Working Group on Offshore Centres*, 5 April 2000, <http://www.fsforum.org/publications/OFC_Report__5_April_2000a.pdf>

Financial Stability Forum (2002) "Financial Stability Forum reviews vulnerabilities and efforts to strengthen the international financial system" Press Release Ref no: 17/2002E, 4 September 2002 < http://www.fsforum.org/press/PR_Toronto02.pdf>

Financial Stability Forum (2004) "Ongoing and Recent Work Relevant to Sound Financial Systems: Note by the FSF Secretariat (with inputs from various bodies)" for the Financial Stability Forum Meeting on 8-9 September 2004

Financial Stability Forum website (http://www.fsforum.org/home/home.html) Last Access – 27 April 2006

Finnemore, Martha and Kathryn Sikkink (1998) "International Norm Dynamics and Political Change" *International Organization*, Vol. 52, no. 4, Autumn, pp. 887–917

Finnemore, Martha and Kathryn Sikkink (2001) "TAKING STOCK: The Constructivist Research Program in International Relations and Comparative Politics" Annual Review Political Science, Vol. 4, pp. 391–416

Foucault, Michel (1968) "Politics and the Study of Discourse" in Burchell, Graham, Colin Gordon and Peter Miller, eds. (1991) *The Foucault Effect: Studies in Governmentality*, Chicago: University of Chicago Press, pp. 53 – 72 (originally translated to English 1972)

Foucault, Michel (1979) *Discipline and Punish*, New York: Random House

Foucault, Michel (1980) "Two Lectures" in Colin Gordon (ed.) *Power/Knowledge*, Brighton: Harvester, pp.80-105

Foucault, Michel (1981) "The order of discourse" in Young, Robert, (ed.) *Untying the Test: A Poststructuralist Reader*, Boston: Routledge and Kegan Paul

Foucault, Michel And Paul Rabinow (1997) "Polemics, Politics, and Problematization: An Interview with Michel Foucault", in Rabinow, Paul (ed.) *The Essential Works of Michel Foucault - Ethics: subjectivity and truth (Volume 1)*, New York : New Press, pp. 111-11

Franklin, Jane, ed. (1998) *The Politics of Risk Society*, Cambridge: Polity Press

Franks, Julian and Colin Mayer (2001) Risks and Regulation in European Asset Management: Is there a Role for Capital Requirements? *Oxford Economic Research Associates,* January 2001

Gambill, David (2006) "Reinsurance Outlook 2006: Hunger for Premium" *Canadian Underwriter*, July 2005

Garcia, R., E. Ghysels and E. Renault (2000) "Econometric methods for derivative securities and risk management" *Journal of Econometrics*, Vol. 94, iss. 1-2, January-February, pp. 1 - 17

Garland, David (2003) "The Rise of Risk" in Ericson, Richard V. and Aaron Doyle (eds.) *Risk and Morality*, Toronto: University of Toronto Press, pp. 48-86

Garsten, Christina and Anna Hasselström (2003) "Risky Business: Discourses of Risk and (Ir)responsibility in Globalizing Markets" *Ethnos*, Vol. 68, no. 2, June, pp. 249–270

Giddens, Anthony (1990) *The Consequences of Modernity*, Stanford, CA: Stanford University Press

Gill, Stephen (1990) American Hegemony and the Trilateral Commission, Cambridge: Cambridge University Press.

Gill, Stephen (2003) *Power and Resistance in the New World Order*, New York: Palgrave Macmillan

Global Reinsurance (2004) "Accounting for Actuaries" *Global Reinsurance*, February 1, 2004

Goldstein Judith and Robert O. Keohane, eds. (1993) *Ideas and Foreign Policy: Beliefs, Institutions and Political Change*. Ithaca, NY: Cornell University Press

Goodman, John B. and Louis W. Pauly (2000) "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets" in Frieden, Jeffry and David A. Lake, eds. *International Political Economy: Perspectives on Global Power and Wealth*, 4th edition, New York: Palgrave

Grace, Martin F., Robert W. Klein and Richard D. Phillips (2001) "Regulating onshore special purpose reinsurance vehicles" *Journal of Insurance Regulation*, vol. 19, iss. 4, Summer, pp. 551-591

Green, Stephen (2000) "Negotiating with the future: the culture of modern risk in global financial markets" *Environment and Planning D: Society and Space*, Vol. 18, pp. 77-89

Group of Thirty (2006) *Reinsurance and International Financial Markets*

Groves, Jason (2002) "News Analysis – Consider this one carefully" *The Review: Worldwide Reinsurance*, November 1, 2002

Ha, Michael (2004) "Carriers See More Stable Reinsurance Marketplace" *National Underwriter*, vol. 018, no. 6, February 16, 2004, pp. 14-15

Haas, Peter (1992) "Introduction: Epistemic Communities and International Policy Coordination" *International Organization*, Vol. 46 no. 1, pp. 1 –35

Hall, Stuart (2001) "Foucault: Power; Knowledge and Discourse" in Margaret Wetherell, Stephanie Taylor and Simeon J. Yates (eds.) *Discourse Theory and Practice: A Reader*, London: Sage Publications

Hansclever, Andreas, Peter Mayer and Volker Rittberger (1997) *Theories of International Regimes*, Cambridge: Cambridge University Press

Harmes, Adam (1998) "Institutional investors and the reproduction of neoliberalism, *Review of International Political Economy*, Vol. 5, no. 1, pp. 92-121

Harmes, Adam (2001) Unseen Power: How Mutual Funds Threaten the Political and Economic Wealth of Nations, Toronto: Stoddart Publishing Co.

Haufler, Virginia (1997) *Dangerous Commerce: Insurance and the Management of International Risk*, Ithaca: Cornell University Press

Helleiner, Eric (1994) *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s*, Ithaca: Cornell University Press

Helleiner, Eric (1995) "Explaining the Globalization of Financial Markets: Bringing States Back In" *Review of International Political Economy*, Vol. 2, no. 2, Spring, pp. 315-342

Herring, Richard J. (2002) "The Basel 2 Approach to Bank Operational Risk: Regulation on the Wrong Track", *The Journal of Risk Finance*, Fall, pp. 42-45

Hocking, Brian (2004) "Beyond Seattle: Adapting the Trade Policy process" in Hocking, Brian and Steven McGuire, eds. *Trade Politics: International, Domestic and Regional Perspectives*, London: Routledge

Hooks, Linda M. (1994) *Capital, Asset Risk and Bank Failure*, Group of Thirty Occasional Paper no. 47, Washington, DC: Group of Thirty

Horlick-Jones, Tom (2004) "Experts in risk? ... do they exist?" Health, Risk & Society, Vol. 6, No. 2, June, pp. pp. 107-114

Hudson, David (2005) "Locating and understanding the marketplace in financial governance" IPE, interdisciplinarity and multi-level governance" in Baker, Andrew, David Hudson and Richard Woodward (eds.) *Governing Financial Globalisation: The Political Economy of Multi-Level Governance*, New York: Routledge

International Association of Insurance Supervisors (IAIS) (2002) *Principles on Minimum Requirements for Supervision of Reinsurers*, Principles no. 6, October 2002

International Association of Insurance Supervisors (IAIS) (2002b) *Supervisory Standard on the Evaluation of the Reinsurance Cover of Primary Insurers and the Security of their Reinsurers, Supervisory standard no.* 7, January 2002

International Association of Insurance Supervisors (IAIS) (2003) *Guidance paper on the use of actuaries as part of a supervisory model*, October

International Association of Insurance Supervisors (IAIS) (2003b) *Standard on Supervision of Reinsurers*, Supervisory Standard no. 8, October

International Association of Insurance Supervisors (IAIS) (2004) *Standard on Disclosure Concerning Technical Performance and Risks for Non-life Insurers and Reinsurers*, Supervisory Standard no. 9, October 2004

International Association of Insurance Supervisors (2004b) *Task Force Re: Enhancing Transparency and Disclosure in the Reinsurance Sector,* a report presented to the Financial Stability Forum, March 2004

International Association of Insurance Supervisors (IAIS) (2005) *Standard on Disclosures Concerning Investment Risks and Performance for Insurers and Reinsurers*, Supervisory Standard no. 11, October 2005

International Association of Insurance Supervisors (IAIS) (2005b) *Principles and Terms of Use of Databases for Contributors*, October 2005

International Association of Insurance Supervisors (IAIS) (2007) *Discussion Paper on the Mutual Recognition of Reinsurance Supervision*, October 2007

International Association of Insurance Supervisors website, <http://www.iaisweb.org>, Last Access: 13 November 2008

International Investment Funds Association website <http://www.iifa.ca/public/default.aspx>

International Monetary Fund (1999) *International Capital Markets: Developments, Prospects, and Key Policy Issues.* Washington, DC: IMF.

International Organization of Securities Commissions (IOSCO) (1994) *Principles for the Regulation of Collective Investment Schemes, Report on Investment Management*, July

International Organization of Securities Commissions (IOSCO) (1997) *Principles for the Supervision of Operators of Collective Investment Schemes, Report of the Technical Committee*, September 1997

International Organization of Securities Commissions (IOSCO) (May 1998) *Risk Management and Control Guidance for Securities Firms and their Supervisors*

International Organization of Securities Commissions (IOSCO) (2000) *Summary of Responses to the Questionnaire on Principles and Best Practice Standards on Infrastructure for Decision Making for CIS Operators*, May 2000

International Organization of Securities Commissions (IOSCO) (2000b) *Conflict of Interests of CIS Operators*, May 2000, p. 2

International Organization of Securities Commissions (IOSCO) (2001) *Investor Education in the Effective Regulation of CIS and CIS Operators,* March 2001

International Organization of Securities Commissions (IOSCO) (2002) *Investment Management: Areas of Regulatory Concern and Risk Assessment Methods, Report of the Technical Committee*, October 2002

International Organization of Securities Commissions (IOSCO) (2003) *Objectives and Principles of Securities Regulation*, May 2003

International Organization of Securities Commissions (IOSCO) (2004) *Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds*, November 2004

International Organization of Securities Commissions (IOSCO) (2004b) *Performance Presentation Standards for Collective Investment Schemes: Best Practice Standards*, May 2004

International Organization of Securities Commissions (IOSCO) (2005) *Consultation Report: Examination of Governance for Collective Investment Schemes*, February 2005

International Organization of Securities Commissions (IOSCO) (2005b) *Consultation Report: Anti-Money Laundering Guidance for Collective Investment Schemes*, February 2005

International Organization of Securities Commissions (IOSCO) (2006) *Examination of Governance for Collective Investment Schemes - Final Report, Part I*, June 2006

Investment Company Institute (2006) *2006 Investment Company Fact Book*, <http:// www.icifactbook.org/2006/pdf/2006_factbook.pdf >

Izquierdo, A. Javier (2001) 'Reliability at risk: the supervision of financial models as a case study for reflexive economic sociology', *European Societies,* Vol. 3, iss. 1, pp. 69–90.

Kapstein, Ethan B. (1989) "Resolving the Regulator's Dilemma: International Coordination of Banking Regulations" *International Organization*, Vol. 43, no. 2, Spring, pp. 323-247

Kapstein, Ethan B. (1991) *Supervising International Banks : Origins and Implications of the Basle Accord,* Princeton: Essays in International Finance No. 185

Kapstein, Ethan B. (1994) *Governing the Global Economy: International Finance and the State*, Cambridge, MA: Harvard University Press

Karmel, Roberta S. (2004-5) "Mutual Funds, Pension Funds, Hedge Funds and Stock Market Volatility - What Regulation by the Securities and Exchange Commission is Appropriate?" Notre Dame Law Review, Vol. 80, pp. 909 – 950

Katzenstein Peter J., ed. (1996) *The Culture of National Security Norms and Identity in World Politics*. New York: Columbia University Press

Keck, Margaret and Sikkink, Kathryn (1998) *Activists Beyond Borders: Advocacy Networks in International Politics*, Ithaca, NY: Cornell University Press.

Keeley, James F. (1990) "Toward a Foucauldian Analysis of International Regimes" *International Organization*, Vol. 44, No. 1., Winter, pp. 83-105.

Keohane, Robert O. Nye, Joseph (1977). *Power and Independence. World Politics in transition*, Boston & Toronto : Little Brown

Key, Sydney J. (1999) "Trade liberalization and prudential regulation: the international framework for financial services", *International Affairs,* Vol. 75, no. 1, pp. 61-74

Khorana, Ajay, Henri Servaes and Peter Tufano (2005) "Explaining the Size of the Mutual Fund Industry Around the World" *Journal of Financial Economics,* Vol. 78, iss. 1, pp. 145-185

Kielmas, Maria (2005) "Reinventing Risk Management" *Global Reinsurance*, March 1, 2005

Kindleberger, Charles P. (2000) *Manias, Panics and Crashes: A History of Financial Crises*, Fourth Edition, Toronto: John Wiley & Sons Inc.

King, Michael R. and Timothy J. Sinclair (2003) "Private Actors and Public Policy: A Requiem for the New Basel Capital Accord" *International Political Science Review*, Vol. 24, No. 3, pp. 345-362

Knight, Frank H. (1964) *Risk, Uncertainty and Profit*, New York: Century Press

Kozlowski, R.T. and S.B. Mathewson (1997) "A primer on catastrophe modeling"., *Journal of Insurance Regulation*, Vol. 15, no. 3, 322-341

Laclau, Ernesto and Chantal Mouffe (1985) *Hegemony and Socialist Strategy: Towards a Radical Democratic Politics*, trans. by Winston Moore and Paul Cammack, London: Verso

Lam, Chun H., Rajat Deb and Tom Fomby (1989) "Deregulation and the Demand for Money Market Mutual Funds" *Journal of Macroeconomics*, Vol. 11, No. 2, Spring, pp. 297-308

Langley, Paul (2004) "(Re)politicizing global financial governance: what's 'new' about the 'New International Financial Architecture'?" *Global Networks, Vol.* 4, no. 1 pp. 69–87.

Langley, Paul (2006) "The making of investor subjects in Anglo-American pensions" *Environment and Planning D: Society and Space*, Vol. 24, pp. 919- 934

Lastra, Rosa Maria (2004) "Risk-based capital requirement and their impact upon the banking industry: Basel II and CAD III" *Journal of Financial Regulation and Compliance*, Vol. 12, no. 3, August, pp 225- 239

Lupton, Deborah (1999) *Risk*, New York: Routledge

Machiavelli, Niccolo (1908) *The Prince*, translated with introduction by W. K. Marriott, New York: E. P. Dutton,

MacKenzie, Donald (2006) *An Engine, Not a Camera: How Financial Models Shape Markets*, Cambridge, MA: MIT Press

Markham, Jerry W. (2006) "Mutual Funds and Other Collective Investment Mediums — A Comparative Analysis of Their Regulation and Governance" Working Paper 1386, California: The Berkeley Electronic Press (bepress), <http://law.bepress.com/expresso/ eps/1386>

Martin, Randy (2004) "America as Risk/Securitizing the Other", *Interventions,* Vol. 6, no. 3, pp. 351–361

Martinez, Leonardo (2001) *Private Expertise and Global Economic Governance: The Case of International Accounting Standards (1972-2001)*, Masters of Philosophy, University of Oxford.

Matz, Leonard (2005) "Measuring operations risk: are we taxiing down the wrong runways?", *Bank Accounting & Finance*, Vol. 18, no. 2, February, p. 3

Maurice, Alex (1999) "Int'l Re Regulation Still Could be Decades Away" *National Underwriter*, August 30, 1999, pp. S-24 & S-28

McIsaac, Donald A. and David F. Babbel (1995) *The World Bank Primer on Reinsurance*, Washington, D.C.: World Bank Financial Sector Development Department

McKeen-Edwards, Heather (2007) "Calculated Risk and the Role of Expert Knowledge in Governing Global Finance: The Case of Risk and the International Governance of Capital Adequacy in Banking"; Paper presented at the Canadian Political Science Association, Saskatoon, SK. 30 May 2007

McKeen-Edwards, Heather and Ian Roberge (2007) "Striving for Legitimacy: Financial Services Sector Policymaking in the EU after Lamfalussy", *Current Politics and Economics of Europe,* Vol. 18, iss. 2, Special Issue

Merton, Robert C. (1994)" Influence of mathematical models in finance on practice: past, present and future" *Philosophical Transactions of the Royal Society of London – A*, Vol. 347, pp. 451-462

Milligan, Jack (2004) "Who will choose Basel II?" *ABA Banking Journal*, Capital Risk Management Section, November, p. 61

Milliken, Jennifer (1999) "The study of discourse in international relations: A critique of research and methods" *European Journal of International Relations*, Vol. 5, no. 2, pp. 225-254

Milliken, Jennifer (2001)"Discourse Study: Bringing Rigor to Critical Theory" in Fierke, Karin M. and Knud Erik Jorgensen (eds.) *Constructing International Relations: The next generation*, London: M.E. Sharpe, pp. 136-159

Mills, Sara (2004) *Discourse*, New York: Routledge

Moody's Investor Services (2001) "Comment on the Second Consultative Package of the New Basel Capital Accord", May 30, 2001, <http://www.bis.org/bcbs/ca/mooinvser.pdf>

Moran, Michael (2002) "Politics, Banks, and Financial Market Governance in the Euro-Zone", in Kenneth Dyson, ed., *European States and the Euro: Europeanization, Variation, and Convergence.* Oxford: Oxford University Press, pp. 257–77.

Morris, Sir Derek (2005) *Morris Review of the Actuarial Profession: Final Report,* March; London: Crown Copyright <http://www.morrisreview.org.uk>

Moss, David A. (2002) *When all else fails: government as the ultimate risk manager*, Cambridge, MA: Harvard University Press

Mottier, Veronique (2005) "From Welfare to Social Exclusion: Eugenic Social Policies and the Swiss National Order" in David Howarth and Jacob Torfing (eds.) *Discourse Theory in European Politics: Identity, Policy and Governance*, New York: Palgrave Macmillan, pp. 255-274

Mufson, Steven (2006) "Hedge Fund's Collapse Met With a Shrug: Amaranth's Loss in Natural Gas Gamble Not Seen as Affecting Broader Market" *The Washington Post*, Financial Section, September 20, 2006, D01

Munchau, Wolfgang (2007) "The Germans have the right idea on hedge funds" *Financial Times*, London Edition 1, Comment, February 12, 2007, p. 19

Mundy, Chris (2004) "The nature of risk: The nature of systemic risk - trying to achieve a definition", *Balance Sheet*, Vol. 12, no. 5, pp. 29-31

Murray, Mike (2005) "The New Regulatory Landscape" *Global Reinsurance*, February 1, 2005

Mythen, Gabe (2004) *Ulrich Beck: a critical introduction to the risk society*, London: Pluto Press

Nash, Ralph (2003) "The three pillars of operational risk" in Alexander, Carol (ed.) *Operational Risk: Regulation Analysis and Management*, Toronto: Prentice Hall Finance Times, pp. 3-13

Nebel, Rolf (2004) "Regulations as a Source of Systemic Risk: The Need for Economic Impact Analysis" *Geneva Papers on Risk and Insurance*, vol. 29, no. 2, 01.04, pp. 273-283

Nutter, Franklin W. (2002) "Testimony before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the House Committee on Financial Services" Insurance Regulation and Competition for the 21st Century <f:\users\smm\wp\articles\ testimony of Franklin W. Nutter>

Odell, John S. "Bounded Rationality and the World Political Economy" in Andrews, David M., C. Randall Henning and Louis W. Pauly, eds. (2002) *Governing the World's Money*, Ithaca: Cornell University Press, pp. 168 – 1

O'Malley, Pat (2000) "Introduction: configurations of risk" *Economy and Society* Vol. 29, no. 4, November, pp. 457–459

Oatley, Thomas and Robert Nabors (1998) "Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord." *International Organization*, Vol. 52, no. 1, pp. 35–54.

OECD (1972) *Standard Rules for the Operations of Institutions for Collective Investment in Securities*, Committee on Financial Markets, Paris: Organization for Economic Development

OECD (1985) *Trends in Banking in OECD Countries*, Report of the Committee on Financial Markets: Expert Group on Banking

OECD (2005) "White Paper on Governance of Collective Investment Schemes (CIS)" *Financial Market Trends*, No. 88, March 2005

Oxford English Dictionary online (n.d.) "Externality",<http://dictionary.oed.com/cgi/entry/50080908?single=1&query_type=word&queryword=externality&first=1&max_to_show=10>

Pauly, Louis W. (1997) *Who Elected the Bankers?: Surveillance and Control in the World Economy*, Ithaca: Cornell University Press

Pauly, Louis W. (2002) "Global finance, political authority, and the problem of legitimation", in Hall, Rodney Bruce and Thomas J. Biersteker (eds.) *The Emergence of Private Authority in Global Governance*, New York: Cambridge University Press, pp. 76-90

Pielke, Jr., Roger A., Christopher W. Landsea, Rade T. Musulin, and Mary Downton. (1999) "Evaluation of catastrophe models using a normalized historical record: Why it is needed and how to do it". *Journal of Risk and Insurance,* Vol. 18, pp. 177-194.

Pitkin, Hanna Fenichel (1984) *Fortune is a Women: Gender and Politics in the Thought of Niccolò Machiavelli*, Berkeley: University of California Press

Plantin, Guillaume and Jean-Charles Rochet (2007) *When Insurers Go Bust: An Economic Analysis of the Role and Design of Prudential Regulation*, Princeton: Princeton University Press

Porter, Tony (1993) *States, Markets and Regimes in Global Finance*, New York: St. Martin's Press

Porter, Tony (1999) 'The late-modern knowledge structure and world politics', in Martin Hewson and Timothy J. Sinclair (eds.) *Approaches to Global Governance Theory*, New York: State University of New York Press, pp. 137–55.

Porter, Tony (2005) *Globalization and Finance*, Cambridge: Polity Press

Power, Michael.(2003) "The Invention of Operational Risk." *CARR Discussion Paper Series* Centre for the Analysis of Risk and Regulation, LSE DP16.

Power, Michael (2005) "The invention of operational risk" *Review of International Political Economy*, Vol. 12, no. 4, pp. 577-599

Rabinow, Paul and Nikolas Rose (2003) "Foucault Today" in Rabinow, Paul and Nikolas Rose (eds.) *The Essential Foucault: Selections From the Essential Works of Foucault, 1954-1984*, New York: New Press, pp. vii – xxxv

Reactions (2004) "Reaching the peak", *Reactions*, March 2004, p. 1

Reactions (2005) "10 CEOs, 10 questions" *Reactions*, Vol. 25, iss. 9, September, pp. 44-52

Reddy, Sanjay G. (1996) "Claims to expert knowledge and the subversion of democracy: the triumph of risk over uncertainty" *Economy and Society*, Vol. 25, no. 2, pp. 222-254

Reinhart, Len (2004) "Righting the Ship: More regulation and safeguards will solve some- but not all-of the problems uncovered in the recent mutual fund scandals" *Financial Planning*, New York: Jan 1, 2004

Reinsurance (2003) "London Focus - Regulation - Strengthening supervision" *Reinsurance*, 23 June 2003

Renn, Ortwin (1992) "Concepts of Risk: A Classification" in Krimsky, Sheldon and Dominic Golding (eds.) *Social Theories of Risk*, Westport: Praeger, pp. 53-82

Sabatier, Paul A. (1998) "The advocacy coalition framework: revisions and relevance for Europe" *Journal of European Public Policy*, Vol. 5, no.1, March, pp. 98 – 130

Sabatier, Paul A. and Hank C. Jenkins-Smith (1993) "The Advocacy Coalition Framework: Assessment, Revisions, and Implications for Scholars and Practitioners" in Sabatier, Paul A. and Hank C. Jenkins-Smith (eds..) *Policy Change and Learning: An Advocacy Coalition Approach*, Boulder CO: Westview, pp. 211-235

Sachs, Jeffrey D., Aaron Tornell, Andres Velasco, Guillermo A. Calvo and Richard N. Cooper (1996) "Financial Crises in Emerging Markets: The Lessons from 1995", *Brookings Papers on Economic Activity*, Vol. 1996, no. 1, pp. 147-215.

Scholte, Jan Aart with Albrecht Schnabel (2002) *Civil Society and Global Finance, New York: Routledge*

Sell, Susan K. and Aseem Prakash (2004) "Using Ideas Strategically: Examining the Contest between Business and NGO Networks in Intellectual Property Rights", *International Studies Quarterly*, Vol. 48, no. 1, pp. 143-175

Servais, Jean-Paul (2004) "New Challenges in the Regulation of CIS: A European Regulator's Point of Vue." *Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004, p. 6

Shirreff, David (2004) *Dealing with Financial Risk,* Bloomberg Press

Simmons, Beth A, (2001) "The International Politics of Harmonization: The Case of Capital Market Regulation" *International Organization,* Vol. 55, no. 3, Summer, pp. 589– 620

Sinclair, Timothy J. (1994) "Passing Judgement: Credit Rating Processes as Regulatory Mechanisms of Governance in the Emerging World Order." *Review of International Political Economy*, Vol. 1, no. 1, Spring, pp. 133-159.

Sinclair, Timothy J. (2003)"Global Monitor: Bond Rating Agencies." *New Political Economy.* Vol. 8, no.1, March, pp. 147-161.

Sinclair, Timothy J. (2005) *The New Masters of Capital: American Bond Rating Agencies and the Politics of Creditworthiness*, Ithaca, N.Y.: Cornell University Press.

Singer, David Andrew (2004). "Capital Rules: The Domestic Politics of International Regulatory Harmonization" *International Organization,* Vol. 58, Summer, pp. 531–565

Singer, David Andrew (2007) *Regulating Capital: Setting Standards for the International Financial System*, Ithaca: Cornell University Press

Soederberg, Susanne (2003) "The promotion of 'Anglo-American' corporate governance in the South: who benefits from the new international standard?" *Third World Quarterly*, Vol. 24., no. 1, pp. 7-27

Soederberg, Susanne (2004) *The Politics of the New International Financial Architecture: Reimposing Neoliberal Domination in the Global South*, New York: Zed Books

Soederberg, Susanne (2005) "The New International Financial Architecture (NIFA): An emerging multi-level structure of neo-liberal discipline" in Baker, Andrew, David Hudson and Richard Woodward (eds.) *Governing Financial Globalisation: The Political Economy of Multi-Level Governance*, New York: Routledge

Standard and Poor's (2003) *Insurance Actuaries: A Crisis in Credibility*, November 2003

Standard and Poor's (2001) "Standard and Poor's Response to The New Basel Capital Accord" New York: Standard & Poor's

Stone, Diane (2000) "Non-Governmental Policy Transfer: The Strategies of Independent Policy Institutes" *Governance: An International Journal of Policy and Administration*, Vol. 13, No. 1, January, pp. 45–62

Stone, Diane (2004) "Transfer agents and global networks in the 'transnationalization' of policy", *Journal of European Public Policy* Vol. 11, no. 3, June, pp. 545–566

Strange, Susan (1986) *Casino Capitalism*, Oxford: Blackwell Publishers

Strange, Susan (1998) *Mad Money: When Markets Outgrow Governments*, Ann Arbor: University of Michigan Press

Stubbs, Richard and Geoffrey R. D. Underhill, eds. (1994) *Political Economy and the Changing Global Order*, Toronto: McCelland and Stewart

Syer, David (2003) "Dealing with Basel II: operation risk - encouraging best practice", *Balance Sheet*, Vol. 11, no. 4, pp. 24-5

Tafara, Ethiopis (2004) *Presentation at the Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004, p .3

Tanzer, Greg (2004) "Challenges in the Regulation of Collective Investment Schemes" *Plenary 1: New Challenges in the Regulation of Collective Investment Schemes, 2004 IOSCO Annual Conference*, Amman-Jordan, 19 May 2004

Task Force on Actuarial Credibility (2005) "Report to the Board of Directors", May 15, 2005, United States: Casualty Actuarial Society, pp. 1-43, <http://casualtyactuaries.com/about/reports/tfacrpt.pdf>, Last Access: 8 July 2008

Thompson, John K. and Sang-Mok Choi (2001) "Governance Systems for Collective Investment Schemes in OECD Countries" *OECD Financial Affairs Division Occasional Paper, No. 1*, Paris: Organization for Economic Co-Operation and Development, April.

Thompson, John K. (2004) "OECD Corporate Governance Principles and Governance of Banks", APEC Finance and Development Program Workshop 2004, Shanghai National Accounting Institute, 18-19 May 2004

Thompson, John K. (2006) "Collective Investment Schemes in OECD Countries" presentation notes from Sustainable Capital Markets Development in the Gulf, Middle East and Northern Africa, MENA-OECD Investment Programme, London. 24 July 2006

Trace, John (2004) Current Trends in Reinsurance" *Risk Management*, vol. 51, iss. 8, August, p. 48

True, Jacqui and Michael Mintrom (2001) "Transnational Networks and Policy Diffusion: The Case of Gender Mainstreaming" in International Studies Quarterly, Vol. 45, pp. 72-57

Tsingou, Eleni (2003) "Transnational policy communities and financial governance: the role of private actors in derivatives regulation" *CSGR Working Paper* No. 111/03, January

Tsingou, Eleni (2004) "Policy preferences in financial governance: public-private dynamics and the prevalence of market-based arrangements in the banking industry" *CSGR Working Paper* No. 131/04, March

Tynes, Johannes Skylstad (2000) "Catastrophic Risk Securitization" *Journal of Insurance Regulation*, Vol. 19, no. 1, Fall, p. 23

Underhill, Geoffrey R.D. and Xiaoke Zhang (2003a) "Introduction: global market integration, financial crises and policy imperatives" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 1-20

Underhill, Geoffrey R.D. and Xiaoke Zhang (2003b) "Global structures and political imperatives: in search of normative underpinnings for international financial order" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 77-100

United Nations (1980) *Transnational Reinsurance Operations: A Technical Paper* New York: United Nations Centre on Transnational Corporations

Vaughan, Terri (2002) "NAIC and IAIS: Bringing global insurance regulation closer to home" *Journal of Insurance Regulation*, vol. 21, iss. 1, Fall, pp. 85-87

Vojta, George and Marc Uzan (2003) "The private sector, international standards and the architecture of global finance" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 283-304

Weingast, Barry R. (1995) "A Rational Choice Perspective on the Role of Ideas: Shared Belief Systems and State Sovereignty in International Cooperation" *Politics and Society*, Vol. 23, no. 4, December, pp. 449-64

Weiss, Mary A. (1993) "The economics of reinsurance regulation" *Journal of Insurance Regulation*, vol. 11, iss. 4, Summer, pp. 448-

Wermers, Russ (1999) "Mutual Fund Herding and the Impact on Stock Prices" *Journal of Finance*, Vol. LIV, no. 2 • April 1999, pp. 581-622

Westlake, Melvyn (2003) "EU reinsurance regs loom as Germany fights for changes" *Global Risk Regulator Newsletter*, April <http://www.globalriskregulator.com/archive/April2004-19.html >

Wetherell, Margaret (2001) "Debates in Discourse Research" in Margaret Wetherell, Stephanie Taylor and Simeon J. Yates (eds.) *Discourse Theory and Practice: A Reader*, London: SAGE Publications, pp. 380-399

Whitley, Richard (1986) 'The rise of modern finance theory: its characteristics as a scientific field and connections to the changing structure of capital markets', *Research in the History of Economic Thought and Methodology* 4: 147–78.

Willetts, P., ed. (1982) Pressure groups in the global system: The transnational relations of issue-oriented non-governmental organizations, London: Pinter

Wood, Duncan R. (2005) *Governing global banking: the Basel Committee and the politics of financial globalisation*, Burlington, Vt.: Ashgate

Woods, Ngaire (2000) "Globalization and International Institutions" in Woods, Ngaire, ed. *The Political Economy of Globalization*, New York; St. Martins Press, pp. 202-223

Wynne, Brian (1992) "Risk and Social Learning: Reification to Engagement" in Krimsky, Sheldon and Dominic Golding (eds.) *Social Theories of Risk*, Westport: Praeger, pp. 275-300

Yamaguchi, Yutaka (2002) "Triangular view of systemic risk and central bank responsibility" in *Committee on the Global Financial System: Risk measurement and systemic risk*, Proceedings of the Third Joint Central Bank Research Conference, Basle: Bank for International Settlements, October 2002

Zhang, Xiaoke and Geoffrey R.D. Underhill (2003) "Private capture, policy failures and financial crisis: evidence and lessons from South Korea and Thailand" in Underhill, Geoffrey R.D. and Xiaoke Zhang (eds.) *International Financial Governance Under Stress: Global Structures versus National Imperatives*, New York: Cambridge University Press, pp. 243-262