

Paper presented at the SGIR Conference 2010 in
Stockholm, Section 17, Panel: The Politics of Global
Regulation: New Research Agenda

Taking Actors Seriously

What can an actor-based analysis tell us about determinants of
international financial regulation?*

Roman Goldbach[†]

9 September 2010

1 Introduction

The recent financial crisis questions our understanding how financial markets function as well as how state actors of financial regulation and market actors govern international financial markets. Although some adjustments are underway, it seems that the transgovernmental regulatory framework will remain – based on unchanged principles.

This contribution sets out to deliver some answers to the question: How is it possible that during the last three decades a regulatory equilibrium was achieved that resulted in such a systemic breakdown (and, furthermore, seems to persist)? The main objective is to delineate and test an actor-centered explanation of the determinants of international financial regulation that is based on a thorough analysis of the relevant actors' interests and political preferences towards financial regulation and the harmonization of such.

A complex result like internationally harmonized financial regulation originates in an interdependent mixture of actors with specific interest, institutional constraints, cognitive limits and ideas, and informational distributions. However, the focus in this paper is on the actors and their preferences, since these have been underresearched in the transnational/transgovernmental regulation of international finance.

In analyzing economic and political actors as strategic utility-maximizers, it aims to offer some initial understanding about the distributive causes and consequences of transnational and transgovernmental governance of financial regulation, which has been

*Work in Progress.

[†]Department of Political Sciences, Georg-August-University Göttingen; Roman.Goldbach@sowi.uni-goettingen.de

neglected so far (Milner 2009, Mosley 2009). Therefore, in this paper two objectives are pursued: first, a structured analysis of societal and political actors within the realm of financial governance, and second a tentative test whether preferences of certain actors are systematically reflected in the international regulation of finance. Beginning with two sections on the domestic societal and political actors, a discussion of transnational actor constellations follows. Subsequently four basic models of actor-centered determinants of global financial regulation are defined. The fifth section offers a description of financial derivatives regulation. Finally, the four models' distinctiveness with regard to derivatives regulation is analyzed.

2 Domestic Demand for International Financial Regulation and the Structure of Domestic Preferences

It is established that domestic politics are a pivotal determinant of international coordination (Keohane & Milner 1996, Milner 1997). As Milner (1997, 9) demonstrated, "Cooperation is affected [...] by the *domestic distributional consequences* of cooperative endeavors. Cooperative agreements create winners and losers domestically."

International or transnational harmonization of and cooperation in financial regulation is strongly rooted in national preferences for economic prosperity and domestic special interest politics (Rosenbluth & Schaap 2003). This however creates two theoretical challenges: on the one hand a deeper understanding of domestic political settings has to be complemented into research, and on the other comparative variation in domestic settings needs to be accounted for. Both problems can be addressed by political economy based structuring of actors that can be applied to all domestic contexts, but that delivers distinct descriptions for states with different settings along the suggested relevant structures. As (Milner 1997, 10) puts it: "[t]he central problem of theory building is to develop a parsimonious way to categorize the differences among states that are relevant to international politics".

In the following paragraphs these structures are discussed and outlined for the specific policy field of financial regulation and the international harmonization of this field. International or transnational cooperation is understood as a polyarchy of domestic and international politics – as opposed to being on either of the extreme poles of the hierarchy–anarchy continuum. As a result power and authority over decision-making is shared – domestically as well as internationally. Within this interdependent setting this section's focus is on identifying the relevant actors with their interests as well as their preferences towards policy strategies. Along with convention (Milner 1997) two subsets of actors are discussed, namely political and societal actors.

The analysis is rooted in the assumption that understanding actors – with their interests, strategic preferences, and institutional constraints – is at the heart of the explanation of social and political choices and outcomes. In this context it is reasonable to differentiate between interests and policy preferences, where the latter are derived from the former in that the policy preferences are formed which maximize the utility function and hence the interest of the concerned actor (Milner 1997, 33). In other words, while

interests describe the basic goals that actors and groups of actors pursue, preferences relate to strategic policy options that are targeted in order to achieve their interests, and consequently maximize their utility functions.

The discussion of interests and preferences is based upon the assumption of rationality of choice as main driving determinant of actors within business contexts, here economic as well as political spheres. This baseline assumption (Keohane 1984) is adjusted by two limitations, namely bounded rationality and external constraints. Bounded rationality refers to the internal constraints of individuals to calculate all available information in a way that derives the one optimal strategy. The second constraint is of external nature, where institutional restrictions – used in the broader sense of formal, informal and cultural institutions (Scharpf 1997, Keohane 1984) – affect behavioral choices, by restricting options, and framing decisions normatively/socially.

Within this context the two subsets of utility maximizing actors are understood as having steady interests, but potentially altering policy preferences (to achieve their interests). While political actors are understood as being predominantly office-seeking, societal actors are viewed as largely income-maximizing (Milner 1997, 33-66).

Certainly voters, customers, and tax-payers constitute relevant actors with regard to the policy formation process. Taking a strategic action view on the policy formation process allows us to consider these as indirect actors, or not directly involved players (who will, nevertheless, have an impact on the decisions of the involved actors by having an influence on the utility maximization of these actors). Consequently, non-commercial societal actors are excluded from the analysis, as these have a relatively minor impact with regard to negotiating regulatory standards (Mosley 2009). However, they can have an effect on the politicians to be elected, which will be accounted for within the approach here by indirectly integrating public pressure on domestic politicians to implement certain regulations.

2.1 Societal Actors

While the relevance of domestic political actors – principal or agent – has been the focus of many contributions within international cooperation research (see e.g. Keohane & Milner 1996, Milner 1997, Singer 2007, Milner & Moravcsik 2009), a growing literature, particularly within the realm of international finance, has stressed the importance of private actors as influence on and authority for international political harmonization¹ (see e.g. Mosley 2009, Cerny 2005, Coleman 2003, Tsingou 2006). However, a thorough discussion together with a clear explication of the structural reasons behind specific economic interests and according political preferences has so far been neglected.

Here the aim is to discuss explicitly interests and according political preferences of societal, or economic, actors in financial intermediation. Usually, when scholars are referring to “markets” this relates to a multitude of actors, and the relevant groups – from this contribution’s policy perspective – remain somewhat blurry. The goal is to clearly name the relevant actors’ and delineate along which lines they can be grouped.

¹International harmonization, cooperation, and coordination are used interchangeably within this contribution – whilst this is a convenient simplification, legalization issues are not considered as irrelevant.

The analytical explanation offered here builds on two strands of political economy theoretical thought, namely trade theory and regulatory costs. The aim is to come from the perspective of utility and, consequently, income maximizing economic actors to clear-cut expectations about these actors' preferences about (international) financial regulation. Therefore, first, the interests of firms in an increasingly internationalized economy towards internationalization are outlined, derived from the two workhorse models of classic comparative advantage and economies of scale. Once abstract interest structures are derived, these will be substantiated for the policy field at hand and the actors of the finance industry are investigated. In a third step the costs and benefits of (international) financial regulation on these financial interests are analyzed and, finally, resulting actor preferences about policies are defined.

The theories of international trade and the effects of trade liberalization are adequate explanations of the interests of financial market actors, because the international harmonization of financial regulation affects economic exchange between and within nations in largely the same way. Just like the liberalization of international trade has resulted in reduced transaction costs of global exchange and thereby altered relative price levels of factors and products between and within nations (Frieden & Rogowski 1996), the internationally coordinated harmonization of financial regulation lowers transaction costs from adjustment to different regulatory stipulations. The Basel Accord of 1988 created a level-playing field just as the World Trade Organisation did – apart from the issue of magnitudes, both reduced costs for firms of exporting products to foreign markets.

The bottom line of the causal argument behind preference formation among economic actors is the distinction between competitive and uncompetitive actors (Frieden & Rogowski 1996, 46). However, this is outlined in more detail, as the competitiveness concept can result in fundamentally different expectations about political pressure from societal groups, especially varying between policy issue areas.

The pursuit of international exchange by nations can be subdued to two concepts (Krugman & Obstfeld 2009, Chapter 3): on the one hand, comparative advantage, which is largely reflected in inter-industry trade, and, on the other hand, Economies of Scale, as reflected in intra-industry trade. Translating this macro-perspective trade theory into this study's micro-foundational perspective of societal or economic actors, demonstrates that firms can export their products and services to other countries based on two broad competitive advantages vis-a-vis its foreign competitors, namely factor productivity and operational size. A discussion of these concepts and their relevance in this study's context is in order.

Factor productivity as key element of international comparative advantage explains a substantial amount of international inter-industry trade, where nations specialize in those sectors where their production costs are comparatively low (Krugman & Obstfeld 2009, Chapter 3). Economic actors' competitiveness in the global market place is highly affected by this. Yet, the pure factor-related perspective – i.e. Heckscher-Ohlin like production and Stolper-Samuelson like redistribution structures – is less suitable from a political economy vantage point (Frieden 1991). This is the case, since in the short run – which is the predominant perspective with regard to lobbying and policy decisions – most production factors are immobile and hence specific to sectors (Frieden & Rogowski

1996). Due to path-dependencies, such short-term orientation of short-sighted economic and political leaders (mainly rent and office seeking) result in path-dependent, lasting sectoral structures of interest representation and political support. In this particular societal-political setting the sector-specific production factor, or Ricardo-Viner, approach is particularly suited to understand lines of competitiveness within economies. According to this view, many factors of production are specialized so that changes in factor prices are often borne by relative price changes in complete products and the distributional consequences by whole sectoral groups. In contrast to the “all factors are immediately mobile world” of Heckscher and Ohlin, where political conflict arises between factor owners (e.g. all workers in a society against all capital owners), stakeholders of the automobile industry might be opposed to constituents of the banking sector.

The sectoral perspective implies that the ability to sustain a firm’s competitiveness in the face of relative price changes will vary with the specificity of the relevant actors’ assets (most notably their human and physical capital). If economic actors have invested heavily in very specific factors – like expensive technology or highly trained staff – they will not be able to adjust to altered factor prices by shifting to other production purposes, but are rather forced to find strategies that allow to keep producing in its business, while remaining competitiveness in its relevant market(s).

As a result, a divide between relatively competitive and uncompetitive sectors emerges. Relatively uncompetitive are those sectors with utilization of production factors that are relative losers of internationalization, winners are those with widespread mobile factors and benefiting immobile factors utilization. Political pressure and cleavages along this sectoral strategy should evolve.

Owners of sector-specific assets have consequently incentives to lobby for protection (import-competitors) or liberalization (export-oriented firms). However, without a clear factor definition, in order to catch the economic reality of factor owners, this theoretical insight is with only marginal real meaning. We turn to this when discussing the concept with regard to the financial industry more specifically below. So far, the concept of sector-specific production factors suggests that international competition largely operates along sectoral lines.

The literature on economies of scale and geography of trade complements the comparative advantage perspective of international competitiveness. These approaches demonstrate that several imperfect market conditions can lead to distinct trading patterns that produce intra-industry trade among nations. Economies of scale means that a firm, by increasing its production volume whilst utilizing the largely identical production process, can increase its competitiveness and its per-unit profits. This is due to reduced per-unit costs based on constant fixed costs. Hence market size (i.e. volume of products with unitary [or at least similar] characteristics) becomes a relevant interest for firms and the border-less access to foreign markets a substantive goal (Frieden & Rogowski 1996, 39-41). In the international trade environment this has proven to be a realistic description, where international markets are widely characterized by a phenomenon that Krugman & Obstfeld (2009) call monopolistic competition and are governed by international monopolies/oligopolies.

Economies of scale and accompanying efficiency gains through size can occur due to

either external and/or internal economies of scale (Krugman & Obstfeld 2009, Chapter 6). In contrast to the firm-internal perspective, external economies of scale refer to geographically close located firms who gain from the reduced transaction costs and positive externalities of these metropolitan regions – Silicon Valley being one well-known example.

Recapitulaing the economies of scale and geography of trade perspective, firms with large production volumes, international monopolies/oligopolies, and geographical clusters have been demonstrated to profit from internationalization of economic exchange, since their competitiveness can be regarded as relatively high vis-a-vis potential competitors. It is these actor groups that have a particular interest in international harmonization of regulation.

In sum, demand for the easing of international exchange, and consequently a global level-playing field enacted by international financial regulation, should *ceteris paribus* rise with the specificity of deployed production factors (tangible and intangible ones), the size of output volumes and firm, and previous experience in international trading. From this we can deduct several theoretically relevant abstract actor groups. For practical purposes these groups of firms are categorized into economic actors with an interest in international harmonization of financial regulation vis-a-vis such actors against harmonization. The categories offered in table 1 are naturally not exclusive, actors can offer more than one characteristic.

Table 1: Economic actor interests towards harmonization of regulation

Economic actors pro harmonization	Economic actors contra harmonization
<ul style="list-style-type: none"> – Export-oriented sectors – Big firms, employing highly specific production factors – Previously trading firms – International monopolies/oligopolies – Geographical clusters of export-oriented sectors 	<ul style="list-style-type: none"> – National import-competing sectors – Small firms, without interest in foreign markets – Previously non-trading firms – National monopolies/oligopolies – Geographical clusters of national import-competing sectors

Issue-specificity of actor constellations and institutional structures are a prevalent subject for the determinants of international harmonization (see e.g. Milner 2009, Mosley 2009). The above deducted channels of economic interests manifest in a distinct manner within finance and financial regulation.

The industry’s production/provision of services relies heavily on three distinctively important production factors. First, capital or the depositor/customer base. Institu-

tions can rely on a domestic or/and an international customer base. The second decisive production factor is investment opportunities, where enterprises can trade in domestic (national and local) assets and liabilities or have rather international investment strategies. The third relevant production input is human, managerial, and technological capital. As service-providing industry, where concepts, strategies, and business plans are substantial, competitiveness in financial intermediation is dependent on high investments in these specific factors.²

Reconsidering sector-specific expectations, sectors with high investments – relatively to other parts of the industry – in these factors share a preference for international harmonization towards a global level playing field. Sectors or firms with substantial international customer bases, global investment strategies,³ highly trained employees, and specific technology will be interested in easing of the exporting of their services. Among these are certainly investment banking, diversified/wholesale banking, financial insurance, exchanges, hedge funds, and private equity. In contrast, opposition to a strengthening of global competition will originate from nationally oriented sectors with local customers and investment focusses: mutual savings banks, thrift institutions, local and state public savings and loans institutions.

An example that underlines the sector-specific explanation can be seen in the Basel II process, during which big banks lobbied successfully for the inclusion of internal risk management techniques into the regulatory framework, while in contrast smaller, import-competing institutes without these internal risk management instruments lobbied against these policies (Lütz 2002). Consequently, when financial regulation changes the prices of financial intermediation products (in that regulatory costs are altered) this will affect financial firms differently, depending on the specific factors utilized within the firm. This can be illustrated, referring to the Basel II example from above: The inclusion of internal risk management models into the capital adequacy regulation increased the value of the factor risk management knowledge. This knowledge was extensively available within big banks, but rather not in smaller domestic banks. Changing the costs of financial intermediation by building upon these risk management techniques, altered the firms' costs and created advantages for those that were producing under extensive usage of that knowledge factor (relatively to their competitors).

Adding the relevant economies of scale and geography of trade characteristics of the finance industry, highlights the importance of (1) large transnational financial conglomerates with pre-existing international investment, customers, and foreign branches, (2) regarding customer and investment rather locally oriented financial services firms, and (3) specialized boutiques, i.e. financial intermediaries and advisors with tightly focused business activities and strongly international investment strategies. This, again puts em-

²Further input factors are relevant considering the share of total firm costs – these are particularly low- to medium-skilled labor as well as consumptive, land and other factors. However, these are not considered within the analysis, since financial regulation does not impact on these factors' prices.

³Or an interest in these international options, if the status quo of is only a neglect-able amount of international trading and firms simply are able to produce at lower cost than foreign competitors, due to relative price advantages in their production factors at home: capital size, human and technological capital.

phasis on the decisive importance of investment and wholesale banks, from an oligopolistic competition perspective. Furthermore, it stresses the big auditors substantial interest in global harmonization, as well as a potential role for the leading financial centers (London, New York, Tokyo, Frankfurt, Paris etc.). However, it outlines the potential opposition of small domestic, local or state exchanges

Table 2: Financial industry positions towards harmonization of financial regulation

Finance actors pro harmonization	Finance actors contra harmonization
<ul style="list-style-type: none"> – Wholesale banking – Investment banking – Big/global exchanges – Big service providers, particularly auditors – Financial insurance – Specialized Boutiques, hedge funds and private equity – Financial centers 	<ul style="list-style-type: none"> – Domestic/local commercial banks – Local and state public savings and investment institutions – Small domestic, local or state exchanges – Small, local service providers, particularly auditors

Regarding harmonization we would expect sectoral interest groups arise around investment banking and wholesale banking that both have substantial interests in market making, proprietary trading, and investment diversification strategies, as well as around large, globally oriented exchanges, auditors, and specialized financial intermediators. Oligopolistic structures should be reflected in interest representation encompassing big, powerful, international conglomerates with substantial interests in market making, proprietary trading, and investment diversification strategies. Import-competing interests should be resembled nationally along small, locally oriented financial intermediation businesses.

What does internationalization or transnationalization mean for the involved actors in terms of relative prices? From an empirical perspective this means asking how does the concerned regulatory policy enter the utility functions of actors (and for the political actors how do these relative price changes translate into politicians' utility).

So far we have considered economic actors' interest in international financial regulation from the harmonization of pre-existing national rules perspective. However, this view is not always appropriate, since in several instances potential additional regulatory costs become increasingly more relevant to firms and sectors than the question of international

harmonization. Economic actors have such a rather complementary understanding of global regulation.

All involved actors will have different attitudes towards international financial regulation depending on its specific content. An important distinction exists between efforts of mere harmonization of preexisting national regulatory rules and those activities that create new rules (and regulatory burdens) for firms from all involved countries that are incepted internationally. Whereas the former means the reduction of transaction costs for international trade and hence opportunities of market access and threat of foreign competition, the latter is valued rather as additional regulatory burden (or potentially asset, if the new regulation is market-building). Thus one decisive question is, whether economic actors regard international financial regulation as a policy to level playing fields in international finance or as additional regulatory burden or as regulatory stipulations that could enable the establishment of new markets. In most instances, firms will be confronted with mixed consequences – while harmonization will open up markets or increase domestic competition, the same policy might incorporate a regulatory dimension that increases or reduces operational costs due to stricter rules or more *laissez-faire*.

Largely rational actors, even though the rationality of their choices might be bound due to internal calculation limitations and external perceptive constraints, can be seen as predominantly driven by the goal of profit maximization. This does mean that financial firms and their agents are devoted towards maximizing income and minimizing costs. In terms of *regulatory costs* preferences about regulatory policy options are mainly valued to this end. Regulatory actions then depict either additional (lower) costs in cases of additional (less or cheaper) stipulations to meet, or increased (reduced) production volumes with smaller (higher) transaction costs in cases of market establishing (delimiting) regulation.

A striking example is given by the Lehman Brothers Chief Executive Officer Dick Fuld's position towards short-selling (Sorkin 2010). While Fuld has been increasingly supportive to the possibility of unrestricted short-selling, due to the firm's large clients like hedge funds and private equity firms substantial interest in it, the Lehman CEO demanded repeatedly from US public authorities (Securities and Exchange Commission, Treasury, and Fed) the banning of short-selling in the run-up to the investment bank's failure – because, Fuld claimed, the short-selling bets drove the Lehman stock price down without any substantial footing. These profit maximizing choices are further amplified by up-or-out promotion clauses and success-dependent payment schemes, which drives the behavioral rules within these business environments.

Consequently, what matters is relative price changes through financial regulation that increase/lower *regulatory costs*, as well as potential additional or foregone profits from market-creating/enhancing or delimiting stipulations.

While transnationally oriented actors, positive towards harmonization, and nationally oriented ones, rather against such harmonization, might have similar positions towards regulation as it enhances/deteriorates both parties operational costs similarly, at the same time their evaluation might diverge on another aspect/effect of such rules. As outlined above, these actor categories might differ in their factor utilization (specificity and intensity) as well as in their size- and experience-related assets. Due to their different

operational and strategic orientations they might each prefer other distinct regulatory stipulations (the Basel II example of Banks with substantial investments in highly specialized technology and staff is stressed again). Furthermore, the transnationally and the rather nationally oriented actor groups might differ on regulation, as new or altered rules might result in additional costs but also in additional foreign market access or foreign competition, which would enter the transnational actors utility function as benefit, but the national ones as even further cost.

Combining the insights from trade-related and regulatory costs theory, we would expect a the transnationally oriented actors to be pro regulation, even if additional costs are involved, as long as access to additional market volumes are offered. Furthermore, we expect firms with international experience and internationally competitive operational factors to favor different regulation than nationally oriented firms and sectors. The three-fold grouping of main economic interests is largely supported by the regulatory costs perspective – sectoral interest groups around investment and wholesale banking, oligopolistic international conglomerates, and small, locally oriented financial intermediation businesses. However, the differentiation between issues of harmonization and regulation and how these policies affect the involved actors (table 2) allows further distinct interest coalitions that should be regarded in detailed analysis.

One important question remains subject of detailed analysis: how these theoretically derived interests form coalitions in reality. Particularly the economies of scale and geography of trade perspective opens complex modes of interest representation within the national and transnational arena. This will be covered in later sections.

2.2 Political Actors

Previous studies have taken the domestic constellations as relevant determinants of international regulatory cooperation into account and investigated them more thoroughly (See e.g. Singer 2004, Singer 2007, Oatley & Nabors 1998, Rosenbluth & Schaap 2003). Accordingly, on the political side one can identify the national legislature, domestic government, and national regulators as relevant actors. So far two questions remain unresolved, namely which of these actors are relevant (under which circumstances) for policy formation, and, furthermore, which actor is the pivotal, the agenda-setting one.

Here the principal model is a political realm of two composite actors, namely the government and parliament as *political principal*, and the financial regulatory agencies as *executive agent*. The regulator is understood as agent with a high amount of leeway and own interests, that can design financial regulation without political intervention in decisive details. However, this depends on and changes with public scrutiny of financial regulation and resulting political pressure to redistribute between finance industry and tax-payers respectively voters. After outlining the basic political actors' interest in finance, financial regulation and the international harmonization of it, the political principal vs. executive agent perspective is outlined.

As described above, political actors are driven by their office-seeking nature – an elected politician basically has an interest in maximizing votes and campaign contributions. Given the office-seeking nature of political actors' interests, the executive princi-

pal and the legislature can be considered as rather short-term oriented, where they care about the economic development until the next election (Milner 1997, 47-59).

The executive's as well as the legislature's utility function consists of two elements (Grossman & Helpman 1994, Milner 1997, 34-5): the performance of the overall economy (as incumbents receive punishment or reward for domestic economic performance), and their constituent interest groups profits. Although the legislature's and the executive's utility functions consist of the same two elements, their specific preference formations can diverge.

Rosenbluth & Schaap (2003, 307) have suggested that “[...] politicians do care about banking at a very basic level: in good times, banks can be profitable businesses that make large campaign contributions; in bad times, bank failures can get politicians into electoral hot water. Whether politicians like it or not, they are forced to make trade-offs between the well-being of banks and of bank customers”.

The pithy statement summarizes the main interest of political actors in financial regulation. The finance industry has a predominant weight in an economy since it is a motor for investments by its intermediation between savings and investments, it can attract highly valued mobile finance capital from around the world, and its firms, especially banks, are decisive sectors. Hence, from the political actors' viewpoint it is a particularly important source of growth as it is a dangerous source of instability. Furthermore, its powerful sectors and firms constitute decisive campaign contributors and information providers.

Given these basic elements of politicians' interest, these care about the domestic economy's growth (and consequently the stability of that growth and the financial system) as well as about the competitiveness of influential economic actors. For incumbents the interest in international financial regulation is then determined by its influence on the overall economy and the influential economic interests. As with the societal actors this should be divided into an analysis of the effects of international harmonization and of financial regulation.

Politicians care about regulatory costs as these affect domestic firms competitiveness and the overall economy's stability with regard to negative systemic externalities from individual institutes failures. Given that financial turmoil occurs less frequently as elections, therefore, the upcoming election is more relevant to political authorities than potential financial turmoil.

As long as financial stability prevails and competitiveness is a predominant issue within debates about financial regulation, firms with a high primary concern about profitability and low/no concern about stability (due to too-big-to-fail frameworks and rational herding behavior) are the stakeholders mainly served by regulatory decisions. This stems from the fact that in times without turmoil the pressure on governments and regulators to refrain from constraining competitiveness will be high. Then the competitiveness/growth considerations have a (much) higher weight in the calculations of public authorities, as compared to stability, for crisis seems rather remote.⁴ Hence regulation is expected to

⁴Once this constellation changes – e.g. due to high public scrutiny in the follow-up of a crisis – the assumption about a regulator/legislator favoring the “enabling” strategy would be no longer valid.

prevail, which a) fosters short-term growth and b) favors the most influential part of the sector.

Political actors tend to keep the regulatory costs on financial capital low, as long as the distribution from tax-payers to finance, as inherent in bail-out schemes, remains opaque, as overall economic growth is assumed to depend heavily on the finance sector, and as long as campaign contributions (or public support) from the pivotal economic actors weighs heavier than the additional votes gained by more restraining financial regulation.

Political actors' preferences regarding international harmonization of the financial industry tends to be characterized by two conflicting interests: on the one hand high demand for international coordination in the containment of substantial negative externalities from foreign financial instabilities; and on the other hand the interest in unilaterally setting policy in favor of the national economy's competitiveness.

Generally, there is political interest in international harmonization when substantial international spill-overs of financial stability are experienced and further are expected. However, the positive aspect of risk reduction from foreign externalities comes potentially at the price of increased regulatory costs for the domestic finance industry, and potentially the entire economy. Whether political actors are positive towards international financial regulation depends on the relative effect magnitudes from harmonization vs. regulation on growth/stability and competitiveness.

Within financial regulation one reasonable modeling perspective is to pitch executive and legislative as the *political principal* against the *executive agent*, the regulatory authority that has the delegated responsibility of translating the abstract legal provisions into hands-on administrable rules as well as monitoring and enforcement mechanisms. In such a highly technical and specialized policy field as financial regulation the *executive agent* becomes an important, if not decisive actor, which has considerable leeway in executing his duties (Slaughter 2004, 36-64).

It is derived theoretically that the main distinction lies in the divergent interest in votes for reelection. While campaign contributions are important the political future relies particularly on votes and accordingly the economy's overall development is of decisive importance. However, how much political actors care about the effect of finance on the overall economy depends on public scrutiny. The political authorities perspective on financial regulation might change, once their utility is threatened from consumer, tax-payer, and eventually voter behavior. This can only happen, once they gain interest into the topic of regulating financial firms. Recent experience, once again, suggests that this is likely only in times of financial turmoil, if it negatively affects private wealth. This argument goes along with a study by Oatley & Nabors (1998), who depict US Congress as main domestic driver behind the initiation of Basel I negotiations. In other words, these authors consider political principals as central national actor, as opposed to e.g. Singer's (2007) view of the executive agency as pivotal actor.

In contrast, the regulator follows his utility-maximizing path by increasing incumbency, which can be derived by balancing the principals and the stakeholders interests. Basically the regulator has an incentive of keeping the principals unalarmed and the regulatees competitive (Singer 2007). In this constellation, the regulator as agent has substantial freedom in exploiting his information advantage. The agency tries to es-

establish a regulatory equilibrium within the political vs. economic conflict – here the regulator can use its agenda-setting power vis-a-vis its political principals on the one hand, and the stakeholders of the financial sector on the other hand. The agency needs to implement regulatory practices or suggest new rules, that lie within its “win set” (Singer 2007).

3 The Transnational Arena of Finance and Financial Regulation

The domestic constellation is of decisive importance towards international coordinative outcomes. However, also transnational actors (as well as transnational settings) play a substantial role within a two-level world of international politics. Introducing the international level of analysis adds three elements. First, societal as well as political actors can build interest groups across borders. Second, the political constellation within the transnational arena alters political opportunities. Finally, the internationalization of policy issues alters its content (and consequently the interest of actors therein). These three elements result in three distinct actor interest coalitions, namely transnational oligopolistic interest groups, transgovernmental regulator committees, and transnational epistemic communities.

As outlined above, particularly the economies of scale and geography of trade perspective opens complex modes of interest representation within the national and transnational arena. International oligopolies amongst transnationally oriented sectors, as well as oligopolistic structures along with specific production factor investments or market orientations that cut across sectors might emerge. The International Swaps and Derivatives Association (ISDA) being one particularly influential group. A further being the Institute for International Finance (IIF) whose members include most of the world’s largest commercial and investment banks, as well as a growing number of insurance companies and investment management firms. Furthermore, associate members include multinational corporations, trading companies, export credit agencies, and multilateral agencies.

Within the highly technical and poorly voter-mobilizing policy-field of (international) finance regulators might have their very own policy preferences (Singer 2004, Singer 2007). The institutional structures of the Bank for International Settlements and particularly the Basel Committee on Banking Supervision has become a central forum for regulators to discuss common challenges and interests. With reference to Putnam’s (1988) two-level game the regulators might utilize this framework to develop new policy strategies to achieve their interests (either uni- or multi-laterally), as well as to put pressure on domestic political principals.

Consequently, regulators might rationally exploit the transnational two-level game nature in order to implement policies (1) either in pursuit of their own interests, or (2) their predominant economic constituent. The transgovernmental setting can then be enabling certain policies by using leeway against diverging pressure from domestic political principals as well as against certain economic actors at home, or transnationally.

A frequently voiced alternative – in contrast to rational choice based – explana-

tion of international financial regulation is seen in transnational epistemic communities (Braithwaite & Drahos 2000). Such epistemic communities arise in complex societal constellations where the knowledge about policy options and their effects is far from complete (Haas 1992). Haas (1992, 16) describes the causal logic of epistemic communities as an uncertainty–information–institutionalization nexus – uncertainty about a certain issue’s development and the effects of policy strategies to deal with challenges, lead to the demand for information. The surge for and the interpretation of these information becomes a driving force behind the framing of domestic preferences and international politics: “If rationality is bounded, epistemic communities may be responsible for circumscribing the boundaries and delimiting options”. In the international or transnational context, such information deficits are particularly important due to international externalities as well as the complexity of different states with different interests and institutional constraints.

Haas (1992, 3) and the authors of the 1992 special International Organization issue define epistemic communities as “[1] Network of professionals with [2] recognized expertise and competence in a particular domain and [3] an authoritative claim to policy-relevant knowledge within that domain or issue-area” (numbers added). Four characteristics are shared among the members of such a network: normative beliefs, causal beliefs, notions of validity, common policy enterprise.

However, the identification whether epistemic or material interests are driving actors choices is hard to disentangle, as both basic interests might result in identical or at least similar policy preferences. As Haas (1992, 17) has outlined himself, the decisive difference lies in the missing material interest of epistemic communities. In other words, for an empirical investigation it becomes decisive to identify cases of actors pushing for certain policy strategies without a substantial material interest.

4 Four Actor-driven Models

While there are three levels of analysis with regard to international coordination, namely systemic (or structural), domestic (or unit), and cognitive (Cohen 1996), here the focus lies on the unit perspective, particularly actor-centered perspectives. From the above discussion several actors were derived as potentially driving forces behind international financial regulation. These expectations can be generalized in four theoretical models, which will be put to a tentative test in the following section.

Liberal / Political Principal Model: The level of international cooperation in financial regulation is largely affected by the domestic political principles (government and parliament).

Transgovernmental / Executive Agent Model: The level of international cooperation in financial regulation is largely affected by the regulatory agency’s attempt to preserve missions and budgets.

TNC (Transnational Corporation) Capture Model: This is a subtle though important

modification of the transgovernmental model, in that the regulatory agency's interest is captured by transnational corporations and international financial regulation consequently affected by these transnationally oriented actors. The regulatory agencies are mere agents of this industry section. The alternative explanation is the *Domestic Industry Capture Model*.

Epistemic Model: The level of international cooperation in financial regulation is largely affected by the epistemic circles of transgovernmental regulatory actors and institutions.

However, the identification whether epistemic or material interests are driving actors choices is hard to disentangle, as both basic interests might result in identical or at least similar policy preferences. As Haas (1992, 17) has outlined himself, the decisive difference lies in the missing material interest of epistemic communities. In other words, for an empirical investigation it becomes decisive to identify cases of actors pushing for certain policy strategies without a substantial material interest.

5 Derivatives and Global Regulation

Financial derivatives are a predominant force of financial innovation and play a pivotal role in the context of financial globalization (Duffie & Hu 2008). As a central factor within the causal web of the recent crisis' determinants (Goldbach, Hasche, Müller & Schüder 2010, Section D), it merits particular attention. These instruments have not only been one of the key determinants causing the recent financial crisis. Moreover, they altered the very structure and risk environment of financial intermediation, severely complicating the regulatory environment in prudential as well as in systemic regard. Derivatives in their various forms depict a systemic global challenge in that they change the structure of financial intermediation at its core.

Two questions merit particular attention: On the one hand it still seems not completely clear in the political domain, how (if at all) derivatives are regulated and what the concrete consequences are. On the other hand, an actor-centered analysis promises new explanations about how the regulatory decisions – especially within an increasingly transnational framework – operate.

Derivatives are a prominent force of financial innovation, since they create unrivaled opportunities of (1) *trading on future expectations* and securing against suspected future dangers, as well as (2) sophisticated *risk management*. The general, and central characteristics of derivatives stem from its nature as instrument that enables someone to *trade on the future*, or in other words manage her expectations about the future. As such it can have two potential functions, one similar to an insurance, the other comparable to a bet. As insurance⁵ derivatives – in their dissociation from its underlying asset – allow anyone to purchase a contract that will payout, if she suffers a loss from a future event. The Farmer, who buys futures to gain the right to sell his crops for a specified

⁵The fact that insurance contracts are legally restricted to those with an insurable interest, differentiates derivatives, as these are free to (gambling) interests that have no insurable interest (Hazen 2009).

price in the future and thereby insures his income level against losses from unforeseen price fluctuations being one of the most cited examples – this is commonly referred to as the hedging function of derivatives. In its second function as a bet derivatives enable “gamblers” to speculate on future price movements and gain from these speculations without necessitating the speculator to make the costly and capital intensive purchase of the underlying asset – e.g. to speculate about oil price shocks, without being forced to engage in serious oil trading.

This contribution’s focus is on over-the-counter (OTC) derivatives markets for three reasons: first, these are the markets that are characterized by a high degree of opacity, second, they depict the markets where the innovative force was most prominent,⁶ and third, are those where the contention about regulation is most intense.⁷

The period under investigation ranges from the early 1980s until 1999. The choice of the beginning is made due to the origination of the widespread predominance of derivatives as risk management and profit maximizing financial instrument in the 1980s. The ending is chosen due to the beginning of the Basel II process in 1999. Most of the relevant regulation regarding the financial crisis 2007-10 is covered by this period (Basel II regulation was either not in place or only recently playing a role). In a nutshell, the chronology of derivatives regulation can be separated in four phases: The first long period from the early 1980s to the early 1990s is largely characterized by private self-regulatory efforts in order to enable market functioning. The second phase beginning in the early 1990s depicts first public attention towards derivatives and the potentially arising effects, and then private preventive strikes to avoid far-reaching public regulation. The third episode started around 1995 with the Barings Bank failure and led eventually to the market Risk Amendment to the Basel Accord (Basel Committee on Banking Supervision 1996). The fourth broad time window can be seen in the private-public reactions to the Asian crisis and the inception of the Basel II process.

The first phase of development in the derivatives field ranges from the early 1980s to the early 1990s and is largely characterized by private self-regulatory efforts in order to enable market functioning particularly through the pivotal organization ISDA. Morgan (2008) argues that OTC derivatives markets have been driven by a selective group of highly influential global players building a new, highly profitable market. The global financial intermediaries – starting to realize the potential of derivative instruments – began in the early 1980s to organize within ISDA, which until today was not only able to build a globally reaching network of all relevant derivatives dealers, but also engage in far-reaching, successful lobbying activities.

The organization established a standardization framework, mainly depicted in the

⁶Duffie & Hu (2008, 15-20) provide qualitative empirical substantiation for highly specialized OTC derivatives as vanguard of the financial industry, that is viewed by market participants as pivotal highly profitable instrument that also results in several follow-up services to be requested.

⁷As Steinherr (2000, 168) notes, “[...] the playing field is tilted by much less regulation of OTC markets in comparison to the exchanges. One important reason is that exchanges are much more easily regulated than the elusive OTC market.” Furthermore, see (Acharya, Brenner, Engle, Lynch & Richardson 2009, 367).

1992 Master Agreement,⁸ that has generated a self-regulatory environment, which was market-enabling in a remarkable manner, but did not provide any measures of market-restriction or even risk-reduction from a prudential or systemic viewpoint.

The ISDA has been an instrument of collective action for financial firms in that it helped creating the wide global market for derivatives trading with a parsimonious degree of regulation (Tsingou 2006, Flanagan 2001). The organization is frequently referred to as origination of coordination efforts in derivatives activities during the early 1980s, culminating 1984 in the informal inception of ISDA as swap documentation project by eleven financial intermediaries (Flanagan 2001). The years 1984 and 1985 were “a great leap forward in standardization of the swaps market” (Flanagan 2001, 238), and more broadly an important step in creating a large and liquid derivatives market through self-regulatory constraint: what begun as an ad-hoc meeting of several investment banks (initiated by Salomon Brothers) in 1984, eventually resulted in the finalization of the SWAPS code⁹ and the establishment of the ISDA as nonprofit organization to administer the copyright of the Code (and thereby provide substantial incentives to join the organization).

During the latter 1980s and the early 1990s ISDA experienced a tremendous growth of its membership. Moreover, it conquered new provinces of derivatives regulation, when it developed the ISDA Master Agreement, which was first released in 1987 and renewed in 1992. This agreement handles numerous transactions between its parties over a long period – hence, after its agreement, new deals become substantially easier to negotiate and transaction costs decrease significantly.

Once this was established, ISDA went for the bigger picture in the late 1990s and the early years of the new millennium refocusing its efforts towards taking influence on public authorities. Nowadays the organization itself largely lobbies regulators (educates them as the former President Golden explains in one of the interviews cited by Flanagan) in order to achieve introduction of ISDA principles into regulation (or at least toleration), and to prevent further regulation of derivatives markets (Flanagan 2001).

The concordance of several studies (Coleman 2003, Flanagan 2001, Hazen 2009, Morgan 2008, Tsingou 2006) on this early phase seems convincing. Internationally active big players utilized their highly technological advantage and the political environment to create competitiveness-related pressure. Public authorities did respond accordingly passive.

The far-reaching freedom of derivatives market makers and dealers – investment and big commercial banks etc. – to self-regulate these markets and products, as well as the later recognition by regulators strengthens the TNC capture model, but can also be interpreted as supporting an epistemic explanation. However, it seems that substantial material interests rather than epistemic beliefs have driven actors. With regard towards the other models no supporting or falsifying information are identified.

The second episode, beginning in the early 1990s, depicts first public attention towards derivatives and their potential effects, but at the same time private preventive

⁸A standard contract, which nowadays is the basis for almost every derivatives contract (Morgan 2008, 647).

⁹Code of standard wording, assumptions, and provisions for trading in swaps.

activity to avoid too far-reaching public regulation. Tsingou's (2006) study on the policy formation processes of OTC derivatives regulation indicates for the first half of the 1990s an elite regime governing the development and regulation of these key financial instruments. From her analysis it can be derived that this specific field is subject to two major trends. First, a high impact of private interests on the policy formation process, with a far reaching degree of self-regulation of the market actors (including standard definition by the financial institutions). Second, she identifies predominant economic ideas forming policy communities encompassing regulators and regulatees, and these communities increasingly establishing on the transnational level.

The self-regulatory guidelines became the major element of OTC derivatives regulation – the EU and the US mainly relied on regulatory principles developed by the regulatees with the strongest interest in weakly restricted and opaque markets, namely big commercial and investment banks as well as specialized securities traders. The Basle Committee and other transnational organizations strengthened this self-regulatory best practice approach.

One of the early self-regulatory preemptive strikes can be seen in the 1993 G30-Report (Derivatives: Practices and Principles). Here a group of practitioners defined, how firms, trading in derivatives, should ensure proper risk management. It was suggested that the entire control should be based on internal risk management principles such as Value-at-Risk (VaR) models. Tsingou (2006) argues that the group's effort was a preemptive strike to secure self-regulation as primary governance-mode – by convincing public actors that intrusive regulation is not necessary, and that it would impede innovation and growth.

The year 1994 marks the first relevant public intervention into the derivatives business at the transnational level: two reports by the Basel Committee and the technical committee of the IOSCO were issued, which suggested adjustments to the original 1988 Basel accord. Tsingou (2006, 177) outlines that these reports were simply fostering the trend initiated by the G30-Report and put forward reliance on self-regulatory modes.

An alternative view is suggested by Scheerer (2000, 17). According to this author “financial institutions have been required to hold capital to support their on- and off-balance sheet risk exposures” through the original Basel accord in 1988. Since then, he demonstrates, “the Basel Capital Accord has been amended, expanded, and refined in various ways to better reflect and incorporate risk exposure of banks, including risks inherent in derivative activities.” The amendments to the Basel Accord suggested revisions and expansions of the set of conversion factors used to calculate the exposure of derivative contracts and also recognized netting arrangements (Basel Committee on Banking Supervision 1994*a*, Basel Committee on Banking Supervision 1994*b*). With regard to national implementation Scheerer offers evidence for the US, where the amendments to risk-based capital standards have been widely adopted in 1995.

This episode provides limited support for the view of predominant big players of the derivatives market guiding the public authorities. But, in contrast to the argument of unrestricted derivatives markets, it becomes clear that regulators reacted in response to events of instability, and even attained cooperative capital adequacy regulation. Though, these measures were incapable of constraining the actors wide-ranging freedom to utilize derivatives for leveraging operations. And the promotion of internal risk management

as central principle could be interpreted as mirroring the big players (dealers, banks and other institutional investors) advantages in factor utilization.

Such a public-private coalition of regulators and predominant regulatees seems to support the TNC capture model. However, again epistemic communities encompassing (among others) regulators and regulatees seems a possible explanation. The analysis here does not falsify the epistemic communities model, but so far tends to favor the material explanation.

The third phase was initiated in 1995 by the Barings Bank failure and led eventually to the Market Risk Amendment to the Basel Accord, which, according to Steinherr (2000, 158), reduced systemic risk externalities by taxing derivatives utilization, but only in a very limited manner.

In the aftermath of several default events, due to substantial derivatives exposure, that caused international spill-over dynamics, in 1995 the Derivatives Policy Group (DPG, which was constituted by six major derivatives dealers) report was published. This offered a framework for voluntary oversight of the OTC derivatives activities, and proliferated the self-regulatory approach using internal risk-management mechanisms and disseminating best practice standards.

Then, in 1996 the Basel Committee issued its Market Risk Amendment to the Capital Accord (Basel Committee on Banking Supervision 1996). It introduced the measurement of market risks in addition to the credit risk measures already established in Basel I, by making it mandatory to base capital adequacy calculations also on general and specific market risks arising from trading activities. The inclusion of these risks could be undertaken by banks via two routes, namely an internal risk calculation model, or via a standard specific risk charge. In order to qualify for the application of an internal model, qualitative and quantitative criteria had to be met, and the models had to meet outlined stipulations.

Scheerer (2000) depicts the 1997 implementation in the US: for institutions measuring specific risk by applying an internal model, the requirement of keeping at least 50% of the standard specific risk capital charge for derivatives and other products was eliminated. According to Scheerer (2000, 179) this reflected the stance that the internal modeling capacities of the relevant institutions had grown substantially since the Market Risk Amendment's adoption.

Steinherr (2000, 158-159) identifies "several characteristics of the derivatives markets [that] pose serious problems for the existing regulatory framework, despite significant recent adaptations" by the Market Risk Amendments: the remaining off-balance-sheet nature of OTC derivatives transactions (especially special investment vehicles (SIVs)), rendering traditional balance-sheet-based bank capital requirements ineffective; the growing product complexity, severely impeding the measurement and control of risk; the flexible and tailor-made product nature, paralyzing the traditional instrument-based approach to asset market regulation; and a wide user range, incapacitating the institution-based approach.

Hence, the public reactions to the first derivatives-initiated instability events resulted in public regulation, but seemingly without a far-reaching success. The analysis suggests

that regulatory responses were largely concerned with internal risk management and market risk provisions. Again, this depicts a situation, where regulatory constraint on derivatives was undertaken – yet, the actors freedom to utilize derivatives were not restricted, and even widened when considering the increased opportunities of internal risk management.

The political principal model could explain the primary heightened public and political scrutiny resulting in regulatory adjustments – though only very modestly constraining the industry. On the other hand, this weak regulatory interference could be interpreted as support for the transgovernmental model as it depicts rather regulatory agencies preferences.

The fourth broad time window can be seen in the private-public reactions to the Asian crisis, which was frequently connected with widespread derivatives usage (among other factors). The financial crisis and especially the LTCM debacle resulted in widespread public debate concerning derivatives and in several initiatives.

In 1998 the BCBS and IOSCO suggested in a joint report that regulators should be aware of credit risks on balance-sheets and off those sheets and that measurement of credit risk exposure should take these instruments both on and off balance sheets into account. The implementation was divergent. For the US, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standard (FAS) 133 “Accounting for Derivative Instruments and Hedging Activities”. It stipulated that (1) all derivatives used for hedging purposes must be reported on the balance sheet, and (2) the mark-to-market approach to derivatives became mandatorily in many instances. Before that, firms were not subject to mandatory accounting of derivatives activities. While this was a clear-cut regulatory intervention, it mainly supported the mark-to-market accounting approach, but regulatory responses did only in a very limited way restrict the use of derivatives or bring more transparency in the governance processes.

In 1999 the Disclosure Recommendations on Derivatives Trading by the BCBS and IOSCO gave recommendations about quantitative and qualitative risk and risk management information to be disclosed to investors.

In the same year the Counter-party Risk Management Policy Group (CRMPG) issued a report (Improving Counter-party Risk Management Practices 2) about the importance of counter-party risks, especially in the context of reducing systemic risks – explicitly in response to the 1997/1998 financial crises and especially the LTCM debacle.

1999 was a busy year, and so the Basel Committee issued Principles for the Management of Credit Risk (Basel Committee on Banking Supervision 1999*b*, 14), recommending to financial firms a “more consistent and economic approach to credit risk mitigation techniques, covering credit derivatives”. Scheerer (2000) demonstrates that the US authorities tried during implementation to amend the regulation more towards allowing banks to utilize the new credit risk reducing instruments of securitization and further credit derivatives products.

Finally in that year the BCBS issued first public guidance and proposed amendments that reflect more accurately the positive impacts of modern innovative risk mitigating techniques in the management of credit portfolios such as credit derivatives (Basel

Committee on Banking Supervision 1999*a*). The proposal seeks to establish a more consistent and economic approach that includes credit derivatives, collateral, guarantees, and on-balance-sheet-netting.

In response to the asian crisis and the LTCM case public authorities became very active and they coordinated on the transnational level. Regulation was actually altered. Yet, *prima facie* it seems that the proposed improvements were advanced internal risk management, as well as more mark-to-market accounting – factors contributing to opacity in derivatives markets and balance sheets, as well as operational risks. Was this due to lack of better knowledge or to a financial sector pushing the right buttons? One reasonable perspective is, that the interpretation of the asian crisis specificities allowed public principals and regulatory agencies to point out other deficiencies than trading in derivatives. Therefore, regulatory approaches failed of going beyond these changes that did not constrain financial intermediation in derivatives substantially.

While the liberal / political principal explanation seems to account for the intense intervention of political governments and parliaments in the aftermath of the asian crisis, the epistemic coalition of financial regulators and regulatees is reasonably explaining why not much changed substantially. Alternatively a material interest driven coalition of the regulators and the regulatees determines why the implemented regulation was meeting both actors interests: the regulatees concern about internal risk management and profit maximizing portfolio strategies as well as the regulators' interest in far-reaching responsibility about financial regulation.

So far cases of regulation have been reviewed, but non-cases have been less the subject. Without going into analysis, I briefly remind of the several relevant cases, where no agreement at all was achieved. In particular the IOSCO failure to device capital requirements for investment firms is significant. It was blocked by the US Securities and Exchange Commission (SEC), in order to protect the interests of big US institutional investment firms. Singer (2007) sees the reason in the US goal to maintain the competitive advantage in derivatives trading.¹⁰

Two further interesting cases are the missing international standardization in insurance regulation, as well as in accounting. It is by no means possible in this study to disentangle the factors stemming from interests in derivatives and other relevant determinants such as institutional environments. Nevertheless, considering the near-collapse of AIG during the recent turmoil and the extreme opacity in balance sheets during the financial crisis of 2007-10 and prior crises, the level of regulation is not self-explanatory.

In accordance with Singer (2007) I attribute these non-harmonization cases to the transgovernmental model, as national regulatory authorities, in particular the US agencies, had no interest in cooperation regarding insurance and substantial interest in no cooperation concerning securities and investment banks.

¹⁰This advantage is due to the possibility of hiding derivatives transactions in subsidiaries: the US did not enforce consolidated supervision as the UK and EU did. And because the SEC's Net Capital Rule excluded derivatives from the need to be traded by broker-dealers, the investment firms and banks were able to do this business within special purpose vehicles outside their regulated accounts.

6 Conclusion

This paper analyzed the actor constellations of international financial regulation, by investigating systematically into interests and preferences of involved actors. Four according models regarding determinants of international cooperation were outlined. Furthermore, a tentative analysis of these models was offered by investigating global regulation of financial derivatives. To sum up the insights are discussed in light of each model.

In favor of the *liberal / political principal model* speaks the regularly heightened public and political scrutiny in the aftermath of financial turmoil that resulted in regulatory adjustments, sometimes substantial in nature and sometimes less so.

The *transgovernmental / political agent model* finds support in several instances, particularly in the third period after the Barings Bank failure and further instability-related events. However, throughout this contribution it was hard to disentangle the regulators own interests from the pressures of the political principal.

Potentially due to specificities of the test subject, the *TNC capture model* found predominant support. Self-regulation and far-reaching freedom, combined with regulators' approval is particularly fostering. Nonetheless, the focus on global regulation of financial derivatives incorporates a bias against national capture explanations.

Finding empirical support for or against the *epistemic model* is challenging. Although the political, economic, and regulatory reactions in the aftermath of the asian crisis show that an epistemic coalition of financial regulators and regulatees is reasonably explaining why not much changed substantially.

The actor-centered approach offers valuable insights and an initial understanding of the determinants of international financial regulation. While all four models offer valuable insights into the mechanisms of financial governance, it became evident that clear-cut structuring in combination with detailed analysis into the actor constellations is necessary to derive at firmer empirical outcomes. Furthermore, institutional, informational, and cognitive constraints have to be regarded as these might alter the viability of political strategies.

References

- Acharya, Viral V., Menachem Brenner, Robert F. Engle, Anthony W. Lynch & Matthew Richardson. 2009. Derivatives: The Ultimate Financial Innovation. In *Restoring Financial Stability: How to Repair a failed system*, ed. Viral V. Acharya & Matthew Richardson. Hoboken, New Jersey: John Wiley & Sons chapter 10, pp. 233–249.
- Basel Committee on Banking Supervision. 1994a. Prudential Supervision of Banks' Derivatives Activities. Technical report Basel Committee on Banking Supervision.
URL: <http://www.bis.org/publ/bcbs24.htm>
- Basel Committee on Banking Supervision. 1994b. Risk Management Guidelines for Derivatives. Technical report Basel Committee on Banking Supervision.
URL: <http://www.bis.org/publ/bcbs24.htm>
- Basel Committee on Banking Supervision. 1996. Amendment to the Capital Accord to Incorporate Market Risks. Technical report Bank for International Settlements.
URL: <http://www.bis.org/publ/bcbs24.htm>
- Basel Committee on Banking Supervision. 1999a. A New Capital Adequacy Framework. Consultative paper Bank for International Settlements.
URL: <http://www.bis.org/publ/bcbs50.htm>
- Basel Committee on Banking Supervision. 1999b. Principles for the Management of Credit Risk. Technical report Bank for International Settlements.
URL: <http://www.bis.org/publ/bcbs54.htm>
- Braithwaite, John & Peter Drahos. 2000. *Global Business Regulation*. Cambridge: Cambridge University Press.
- Cerny, Philip G. 2005. Power, Markets and Accountability. The Development of Multi-level Governance in International Finance. In *Governing Financial Globalisation: International Political Economy and Multi-level Governance*, ed. Andrew Baker, David Hudson & Richard Woodward. London and New York: Routledge chapter 2, pp. 24–48.
- Cohen, Benjamin J. 1996. “Phoenix Risen: The Resurrection of Global Finance.” *World Politics* 48(2):268–296.
- Coleman, William D. 2003. Governing Global Finance: Financial Derivatives, Liberal States and Transformative Capacity. In *States in the Global Economy: Bringing Domestic Institutions Back in*, ed. Linda Weiss. Cambridge: Cambridge University Press pp. 271–292.
- Duffie, Darrell & Henry T. Hu. 2008. Competing for a Share of Global Derivatives Markets: Trends and Policy Choices for the United States. Working Paper 50 Rock Center for Corporate Governance at Stanford University.
URL: <http://ssrn.com/abstract=1140869>

- Flanagan, Sean M. 2001. "The Rise of a Trade Association: Group Interactions Within the International Swaps and Derivatives Association." *Harvard Negotiation Law Review* 6:211–264.
- Frieden, Jeffrey A. 1991. "Invested Interests: The Politics of National Economic Policies in a World of Global Finance." *International Organization* 45(4):425–451.
- Frieden, Jeffrey A. & Ronald Rogowski. 1996. The Impact of the International Economy on National Policies: An Analytical Overview. In *Internationalization and Domestic Politics*, ed. Robert O. Keohane & Helen V. Milner. Cambridge: Cambridge University Press chapter 2, pp. 25–47.
- Goldbach, Roman, Thorsten Hasche, Jörn Müller & Stefan Schüder. 2010. "Global Governance of the World Financial Crisis?" *Goettingen Journal of International Law* 1(2):11–42.
- Grossman, Gene M. & Elhanan Helpman. 1994. "Protection for Sale." *American Economic Review* 84(4):833–850.
- Haas, Peter M. 1992. "Introduction: Epistemic Communities and International Policy Coordination." *International Organization* 46(1):1–35.
- Hazen, Thomas Lee. 2009. "Filling a Regulatory Gap: It is Time to Regulate Over-The-Counter Derivatives." *North Carolina Banking Institute* 123(13):123–135.
- Keohane, Robert O. & Helen V. Milner, eds. 1996. *Internationalization and domestic politics*. Cambridge: Cambridge University Press.
- Keohane, Robert Owen. 1984. *After Hegemony: Cooperation and Discord in the World Political Economy*. Princeton: Princeton University Press.
- Krugman, Paul R. & Maurice Obstfeld. 2009. *International Economics: Theory and Policy*. 8. int. ed. Boston: Pearson Addison-Wesley.
- Lütz, Susanne. 2002. *Der Staat und die Globalisierung von Finanzmärkten. Regulative Politik in Deutschland, Großbritannien und den USA*. Frankfurt a.M.: Campus.
- Milner, Helen V. 1997. *Interests, Institutions, and Information: Domestic Politics and International Relations*. Princeton: Princeton University Press.
- Milner, Helen V. 2009. Power, Interdependence and Non-State Actors in World Politics: Research Frontiers. In *Power, Interdependence and Non-State Actors in World Politics*, ed. Helen V. Milner & Andrew Moravcsik. Princeton University Press chapter 1, pp. 3–27.
- Milner, Helen V. & Andrew Moravcsik, eds. 2009. *Power, Interdependence and Non-State Actors in World Politics*. Princeton: Princeton University Press.

- Morgan, Glenn. 2008. "Market Formation and Governance in international Financial Markets: The Case of OTC Derivatives." *Human Relations* 61(5):637–660.
- Mosley, Layna. 2009. Private Governance for the Public Good? Exploring Private Sector Participation in Global Financial Regulation. In *Power, Interdependence and Non-State Actors in World Politics*, ed. Helen V. Milner & Andrew Moravcsik. Princeton University Press chapter 7, pp. 126–146.
- Oatley, Thomas & Robert Nabors. 1998. "Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord." *International Organization* 52(1):35–54.
- Putnam, Robert. 1988. "Diplomacy and Domestic Politics: The Logic of Two-Level Games." *International Organization* 42(3):427–460.
- Rosenbluth, Frances & Ross Schaap. 2003. "The Domestic Politics of Banking Regulation." *International Organization* 57(2):307–336.
- Scharpf, Fritz W. 1997. *Games Real Actors Play. Actor-Centered Institutionalism in Policy Research*. Oxford: Westview Press.
- Scheerer, Andre. 2000. "Credit Derivatives: An Overview of Regulatory Initiatives in the United States and Europe." *Fordham Journal of Corporate & Financial Law* 5(1):149–199.
- Singer, David Andrew. 2004. "Capital Rules: The Domestic Politics of International Regulatory Harmonization." *International Organization* 58(3):531–565.
- Singer, David Andrew. 2007. *Regulating Capital. Setting Standards for the International Financial System*. Ithaca and London: Cornell University Press.
- Slaughter, Anne-Marie. 2004. *A New World Order*. Princeton: Princeton University Press.
- Sorkin, Andrew R. 2010. *Too Big to Fail. Inside the Battle to Save Wall Street*. New York: Penguin.
- Steinherr, Alfred. 2000. *Derivatives. The Wild Beast of Finance: A Path to Effective Globalisation?* Chichester: John Wiley & Sons, LTD.
- Tsingou, Eleni. 2006. The Governance of OTC-Derivatives Markets. In *The Political Economy of Financial Market Regulation. The Dynamics of Inclusion and Exclusion*, ed. Peter Mooslechner, Helene Schuberth & Beat Weber. Cheltenham: Edward Elgar chapter 7, pp. 168–190.