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The Hardening of Soft Law in Securities Regulation

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THE HARDENING OF SOFT LAW IN SECURITIES REGULATION

Roberta S. Karmel* & Claire R. Kelly**

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INTRODUCTION

Securities law has long existed at the intersections of private and public law, and also state and federal law. Currently, securities law, like the capital markets, is becoming international. This Article will address how international securities regulation relies upon soft law, but frequently becomes hard law.

Soft law is nonbinding standards and principles of conduct. It may emanate from international organizations such as the Organisation for Economic Co-operation and Development ("OECD"), where state members agree to resolutions or recommendations. Or it may be the result of international organizations such as the International Organization of Securities Commissions ("IOSCO"), where individual regulators espouse principles and best practices. A large part of the soft law of securities regulation is standard setting by self-regulatory organizations ("SROs") such as the International Accounting Standards Board ("IASB"), which formulates accounting principles for use by companies.

Hard law, on the other hand, is statutes, regulations, and treaties and is binding. Soft law sometimes can harden law when it is incorporated into statutes, regulations, and even treaties. For example, after establishing norms through soft law, the OECD concluded a treaty combating bribery that States adopted and ratified. Congress may implement standards set by private bodies in a statute. Frequently, statutes in the securities field are passed in response to financial crises and, to some extent, incorporate pre-existing soft law into statutory language. Soft law may be codified through regulation. For example, the Securities and Exchange Commission ("SEC") has adopted rules codifying best practices established by IOSCO. Alternatively, self-regulatory law can become subject to government oversight and consequently become binding.

In the United States, securities regulation is primarily found in the federal securities laws enacted from 1933 to 1940 and their subsequent amendments, as well as in the implementing regulations of the SEC. Some securities regulation also comes from state corporate and securities laws. Much of federal securities regulation is based upon SRO standards, and today, securities industry SROs are subject to extensive SEC oversight. In other countries, a similar trajectory—from SRO standard setting to regulation by government securities commissions—has been followed. In the European Union, although there are numerous securities regulation directives, there is not an EU securities commission. Nevertheless, the Committee of European Securities Regulators ("CESR") coordinates regulation by the various EU Member States, each of which has a securities regulatory commission.
Numerous international bodies are involved in the development of securities standards. IOSCO, for instance, is an international body composed of securities regulators from all over the world, which formulates standards for securities regulation. Its members pledge to implement these standards in their home countries to the extent they are able to do so, but IOSCO standards do not have the force of either international or national law. Other bodies that work on establishing regulatory standards in the securities field include the OECD, the World Bank and similar regional banks, and the World Federation of Stock Exchanges. But any standard setting by such bodies is soft law, although it may influence national legislatures or even lead to treaties.

One issue that this Article will address is why so much standard setting in the field of securities regulation is accomplished through soft law. We believe this occurs because of the need for speed, flexibility, and expertise in dealing with fast-breaking developments in capital markets. Since SRO standards and other soft law are based on a consensus by participants in the markets, soft law is frequently more informed and more effective than statutory law, although it may eventually be translated into statutes or rules for enforcement purposes. The soft law of securities regulation also can become hard law when it is recognized as custom and usage in the securities industry; this is the content of many SRO standards. National legislatures are often leery of interfering with financial markets and may be even more divided than players in those markets as to how to address problems that threaten the markets or investors. International regulatory bodies find it even more difficult to agree on appropriate regulation for the securities markets, in part because national market centers and firms compete with one another. Treaties take much too long to become law to rectify most problems that arise in capital markets.

Despite the advantages of soft securities regulatory law, its use has some drawbacks. Not all concerned parties necessarily have input into its formulation. To some extent, this deficit can be addressed through appropriate consultative processes by standard-setting organizations. In terms of U.S. constitutional law, the widespread use of soft law in the regulation of global capital markets seems to contradict the treaty-making powers of Congress and the President. Indeed, the SEC, an independent regulatory agency, negotiates and utilizes memoranda of understanding ("MOUs"), which are treaty-like agreements, but are soft law. Even though MOUs and other forms of soft law may survive constitutional scrutiny, they still raise some serious questions concerning checks and balances, accountability, and transparency.

The plethora of regulators and organizations engaged in the production of both hard and soft law in the securities field can lead to a race to the
bottom in standard setting, and to the under-enforcement of the established regulations. While some academics argue that regulatory competition is salutary, the authors are skeptical that such competition in the international realm produces sufficiently robust legal standards. Until relatively recently, the U.S. economy and capital markets were so much stronger than any other national economy that the SEC could impose rigorous standards upon the issuers and investment bankers of other nations. In a world where there is no economic hegemony by any one country, it is necessary for all of the major players in the global capital markets to agree upon the regulation of these markets. The development of standards through soft law is probably the only realistic method of doing so.

Part I of this Article will discuss the use of soft law in securities regulation, and why soft law works in this field. It will also introduce some international soft-law generators. Part II will set forth four examples of the use and hardening of soft law in the international realm, specifically, the establishment of international financial reporting standards ("IFRS") by the IASB; the development of MOUs by securities regulators; the negotiation of an anti-bribery treaty in the OECD; and the development of standards regulating credit rating agencies ("CRAs"). Part III will discuss some of the costs and benefits of the widespread use of soft law to regulate capital markets.

I. THE USE OF SOFT LAW FOR SECURITIES REGULATION

A. A Short History of Soft Law in Securities Regulation

Before there were any state or federal securities laws, securities regulation was a matter of contract between stock exchanges and other SROs and their members and listed companies. The New York Stock Exchange ("NYSE") was organized in 1792 by brokers to govern securities trading in the wake of a scandal in the government bond market after the Revolutionary War. See Ron Chernow, Alexander Hamilton 383-84 (2004).


2. The fixing of commission rates was the keystone of SRO regulation, not only for the NYSE, but later for the National Association of Securities Dealers, Inc. ("NASD"), which was formed in 1936, in a restructuring of a trade group previously known as the Investment Bankers Association of America. See Donna Nagy, Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status, 80 Notre Dame L. Rev. 975, 1023-24 (2005). Members of the NASD, and later, the Nasdaq Stock Market ("Nasdaq") did not trade on an agency basis and charge commissions, but did trade as dealers with members at preferential prices. See Roger D. Blanc, Intermarket Competition and
setting standards of conduct for the trading of securities, the NYSE also regulated the corporate governance of large public corporations by contractual agreements so that the exchange could advertise that its listed issuers were "blue chip" companies. Prior to the twentieth century, such listing agreements were individually negotiated with companies and were flexible and subject to ad hoc enforcement.\(^3\)

As early as 1869, the Stock List Committee of the NYSE evaluated the qualitative character of listed companies regarding business, management, capitalization structure, financials, and accounting policies to determine whether a company should be listed.\(^4\) It was not until the early twentieth century that listing criteria became more standardized and included such investor protections as requirements that listed companies have an annual shareholders' meeting and distribute financial information to shareholders.\(^5\)

After the 1929 stock market crash the first federal securities laws were passed. The Securities Act of 1933 ("Securities Act")\(^6\) covers initial distributions of securities and requires that securities issuances be registered with the SEC prior to sale unless an appropriate exemption from registration was available.\(^7\) The Securities Exchange Act of 1934 ("Exchange Act")\(^8\) covers postdistribution trading of securities and gives the SEC oversight of stock exchanges and trading markets, including listed companies, as well as securities industry intermediaries. Many matters previously dealt with in NYSE listing agreements, such as quarterly and annual financial reporting, the holding of annual meetings, and the need for independent audits, became matters of federal law.\(^9\) Nevertheless, stock exchanges continued to formulate and enforce listing standards, and in 1996 Congress pre-empted blue sky securities laws.\(^10\) Then, in

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5. See *Special Study on Market Structure, Listing Standards and Corporate Governance*, 57 BUS. LAW. 1487, 1498–99 (2002) [hereinafter *Special Study on Listing Standards*]. At about this same time, the states began to pass securities regulation statutes designed to assure that public offerings of securities were based on fair, just, and equitable capital structures. *Id. See also* Hall v. Geiger-Jones Co., 242 U.S. 539 (1917).


9. Special Study on Listing Standards, supra note 5, at 1500.

response to the Enron and WorldCom debacles and the bursting of the stock market technology bubble, the Sarbanes-Oxley Act of 2002\textsuperscript{11} authorized the SEC to oversee SROs.\textsuperscript{12}

SRO ratemaking had a somewhat different history. The fixed minimum commission rate for NYSE and other stock exchange trades was undermined by market practices and the growth of institutional investors in the 1970s. The NYSE, however, resisted the unfixing of commission rates, while the Supreme Court held that antitrust laws did not apply to the system of fixed commission rates because direct and active SEC supervision negated antitrust liability.\textsuperscript{13} Then, both Congress and the SEC provided that fixed commission rates be abolished.\textsuperscript{14} Under a threat similar to Congressional legislation, the SROs also moved from the one-eighth securities trading convention to decimal pricing.\textsuperscript{15}

Both the NYSE and NASD engaged in regulation of their members with respect to the protection of customers, and disciplined members for unfair or improper conduct. Prior to 1975, any SEC oversight of SRO rulemaking and disciplinary activities was loose and informal. In the Securities Act Amendments of 1975, the SEC was given the power to initiate, as well as to approve, SRO rulemaking, and the SEC's role in SRO enforcement and discipline was expanded.\textsuperscript{16} The Exchange Act now provides that new SRO rules and rule changes must be filed with the SEC and approved by the SEC before they can become effective.\textsuperscript{17}

At one time, SROs denied their members certain fundamental rights. For example, persons under investigation were not entitled to bring

\textsuperscript{12} This included changing SRO listing rules to meet certain corporate governance standards as to board and committee structures. Sarbanes-Oxley, § 301, 15 U.S.C. § 78j-1 (2002).
\textsuperscript{16} Exchange Act §§ 11A, 19(c).
\textsuperscript{17} ld. § 19(b).
HARDENING OF SOFT LAW

Since 1975, however, the SEC’s oversight of SROs has assured that all members of SROs would be treated fairly in connection with investigations and disciplinary proceedings. SROs must provide a “fair procedure,” which includes bringing specific charges, notifying a person subject to discipline, giving him or her an opportunity to defend against such charges, and keeping a record. Further, in order to impose a sanction, there needs to be a statement setting forth the act or practice in which the member engaged or omitted, the provision(s) of the regulation(s) violated, and the sanction and reason for its imposition. Sanctioned individuals have a right to appeal a decision to the SRO board or other committee. A further appeal to the SEC also is provided. In most respects, all of these due process rights are similar to the rights granted to persons subject to SEC disciplinary proceedings.

Whether or not securities industry SROs have become—or should be considered—government agencies for various purposes, the soft law of SROs, which began as private contract law between SROs and their listed companies and members, has been transformed into hard law and is legally binding upon public corporations and SRO members as a matter of federal securities regulation. Indeed, in some instances, SRO rules have been held to preempt state law. This hardening was a gradual

20. In the case of the NASD, this committee has been the National Adjudicatory Council. See National Adjudicatory Council, FINRA Regulatory Enforcement (NAC), http://www.finra.org/Industry/Enforcement/Adjudication/NAC/index.htm (last visited Feb. 17, 2009).
22. See SEC Rules of Practice, 17 C.F.R. pt. 201 (2009). Prior to 1975, these procedural rights were afforded to persons subject to NASD discipline, but not stock exchange discipline. See S. Doc. No. 13, at 145 (1973). As pointed out by the Senate Committee on Banking, Housing and Urban Affairs when the 1975 Act Amendments were drafted, since the SROs “exercise government power . . . by imposing a disciplinary sanction, broadly defined, on a member or person affiliated with a member . . . [they] must be required to conform their activities to fundamental standards of due process.” S. REP. No. 94-75, at 24–25 (1975). The Committee also noted that SROs can adversely affect the interests of particular persons by denying membership to an applicant or requiring members to cease doing business in specified ways. Id.
24. See NASD Dispute Resolution, Inc. v. Judicial Council, 488 F.3d 1065 (9th Cir. 2007); Credit Suisse First Boston Corp. v. Grunwald, 400 F.3d 1119 (9th Cir. 2005).
process, brought about by the Congressional and SEC view that SROs should not be private clubs, looking out for the interests of their members, but public bodies, looking out for the interests of investors.

From time to time, self-regulation has been seriously questioned due to stock market abuses that were not prevented, but SROs have continued to exist and formulate new standards of conduct under SEC oversight. These soft law standards come under the rubric of "just and equitable principles of trade." The theory justifying self-regulation is that it is more flexible than government regulation and is based on a superior knowledge of industry practices and capabilities. Further, it can promote ethical as well as legal standards. These arguments also apply to the production of soft law in international financial regulation. But as can be seen from the experience of SRO regulation, soft law frequently hardens into statutes and government regulations, particularly when soft law is used for anticompetitive purposes or has been ineffective in preventing securities fraud. Despite some failings, soft law works well for securities regulation. Not surprisingly it has continued to work well as securities law has become international.

B. Why Soft Law Works for International Securities Regulation

The long history of national soft law securities regulation has continued in the international sphere out of necessity. Neither treaty law nor customary international law can provide the speed, flexibility, and expertise that international securities regulation requires. The treaty process is not easy. Typically treaties take years to conclude. Thereafter, they


need to be ratified by a number of countries in order to enter into force.\textsuperscript{29} Ratification can be a long and complicated process in many countries and often may not occur.\textsuperscript{30} For example, the United Nations Commission on International Trade Law ("UNCITRAL") has been very successful in developing a number of treaties that have broad support such as the United Nations Convention on the Carriage of Goods by Sea (1978),\textsuperscript{31} the United Nations Convention on Contracts for the International Sale of Goods (1980),\textsuperscript{32} and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) ("New York Convention").\textsuperscript{33}


29. Vienna Convention on the Law of Treaties art. 24(2), May 23, 1969, 1155 U.N.T.S. 331 (stating that "a treaty enters into force as soon as consent to be bound by the treaty has been established for all the negotiating States"); id. art. 2(b) (defining "ratification" as "the international act so named whereby a State establishes . . . its consent to be bound").

30. \textsc{Restatement (Third) of Foreign Relations Law of the United States} § 303 cmt. d (1987) (stating that the president may only ratify a treaty after the Senate gives its consent and ratification must be subject to any conditions imposed by the Senate); id. § 312 cmt. j (stating that a treaty may not enter into force in the United States unless it is also in force internationally and even if the treaty is in force, "it will not be given effect as law of the United States" if it is inconsistent with the U.S. Constitution).


The first two of these agreements took over twenty years to negotiate and enter into force, while the New York Convention took a mere four years to establish. Other efforts have resulted in treaties that failed to enter into force or gain widespread acceptance: the United Nations Convention on International Bills of Exchange and International Promissory Notes (1988), which has five States parties but requires ten for entry into force;\textsuperscript{34} and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (1991), which has four signatories and requires five for entry into force.\textsuperscript{35} Thus, developing rules through formal international agreements is by no means swift or sure.

Even when formal international agreements are reached, their place in domestic law is uncertain. In dualist countries, the international legal effect is separate and distinct from the national legal effect.\textsuperscript{36} In the United States, for example, unless the treaty is "self-executing" it lacks domestic force until it is codified in domestic legislation.\textsuperscript{37} Whether a treaty is self-executing in the United States is not always clear. Recently, the U.S. Supreme Court, for example, found that the Vienna Convention on Consular Notification was not a self-executing treaty because the treaty text itself lacked a clear indication of such status.\textsuperscript{38} Thus, the treaty lacked force to override an inconsistent federal statute.\textsuperscript{39} Other dualist
countries do not even recognize the possibility of a self-executing treaty and always require implementing legislation.\textsuperscript{40}

Customary international law develops in a different but equally arduous fashion. Customary international laws are norms that most States follow out of a sense of obligation.\textsuperscript{41} They are not really custom; they are binding law.\textsuperscript{42} But parties can disagree as to whether a practice has risen to the level of customary international law.\textsuperscript{43} Identifying and tracking state practice on a particular issue takes time.\textsuperscript{44} Moreover, the requirement that States follow the norm out of a sense of obligation creates an interpretive ambiguity that can lead to disputes over what is customary international law.\textsuperscript{45} Not surprisingly, it takes time for norms to evolve to the point where most would agree that States follow the norms out of a

\textsuperscript{1360} Further, the relief sought by Medellin was not supported by “the postratification understanding” of any other Convention signatories. \textit{Id.} at 1363.

\textsuperscript{40} Jackson, \textit{Status of Treaties}, supra note 36, at 315 (discussing that dualist States require “act[s] of transformation” before treaty norms can be incorporated into domestic law). \textit{See also}, e.g., Carl Baudenbacher, \textit{Judicialization: Can the European Model Be Exported to Other Parts of the World?}, 39 \textit{TEX. INT’L L.J.} 381, 391 (2004) (stating that, as a dualist country, Norway had to implement the Convention establishing the European Court of Human Rights into its domestic law to give the court legal effect); David Dyzenhaus, \textit{The Rule of (Administrative) Law in International Law}, 68 \textit{LAW \& CONTEMP. PROBS.} 127, 141–42 (2005) (noting that the dualist legal system of Canada requires parliamentary approval); Michael H. Lee, \textit{Revolution, Evolution, Devolution: Confusion? The Erosion of the “Supremacy of Parliament” and the Expanding Powers of the Courts in the United Kingdom}, 23 \textit{SUFFOLK TRANSNAT’L L. REV.} 465, 466 (2000) (stating that treaties do not become part of domestic law in the United Kingdom unless the provisions are passed in an act of parliament).

\textsuperscript{41} \textsc{Mark E. Villiger, Customary International Law and Treaties: A Manual on the Theory and Practice of Interrelation of Sources} 53–54 (2d ed. 1997) (describing a pattern by which practices are “hardened” and become “generally regarded as obligatory”). \textit{See also} North Sea Continental Shelf (F.R.G. v. Den.; F.R.G. v. Neth.), 1969 \textit{I.C.J.} 4, 44 (Feb. 20) (“Not only must the acts concerned amount to a settled practice, [but] . . . [t]he States concerned must . . . [also] feel that they are conforming to what amounts to a legal obligation.”). \textsc{Sir Hersch Lauterpacht, The Development of International Law by the International Court} 379 (1958) (discussing that international customary law primarily consists of a “psychological conception” that a practice should be followed out of obligation).

\textsuperscript{42} \textit{See} \textsc{Lauterpacht}, \textit{supra} note 41, at 377 (noting that legally binding rules are manifestations of the general and gradual acceptance of international customs).


\textsuperscript{44} \textit{See id.} at 126–27.

\textsuperscript{45} \textit{See id.} at 124–25 (noting the circularity of the subjective \textit{opinio juris} requirement and the resultant vagueness regarding when a practice is customary).
sense of obligation. Some never agree. For example, the United States and Switzerland often disagree over the U.S. desires to prosecute insider trading and to seek information in connection with an alleged crime in the United States, where revealing that information would violate Swiss bank secrecy laws. The Swiss norms value bank secrecy, while the U.S. norms criminalize insider trading and support the production of evidence in connection with criminal activity.

Unlike treaty or customary international law, soft law is nonbinding law that can form in a variety of relatively timely ways. It may be developed through resolutions, practices, aspirational agreements, and the promulgation of norms in various forms that guide behavior. Although soft law is not customary international law—norms that most States follow out of a sense of obligation—it can evolve into customary international law and thus into hard law. International soft law may also evolve from self-regulatory bodies, such as the IASB, and voluntary international standard-setting bodies, such as IOSCO. Paradoxically, soft law, while nonbinding, may also be found in treaties, which do bind. The parts of treaty law that are soft law (and thus nonbinding) are so because they are imprecise or lack an obligatory command.


49. *See infra* notes 153–57 and accompanying text.


may speak in aspirational terms. For example, the Organization of American States ("OAS") in its Inter-American Convention Against Corruption asks States parties to agree "to consider the applicability of measures within their own institutional system."\textsuperscript{53} Even though such aspirations are contained within a treaty, they are nonetheless "soft law." Soft law, unlike customary international law or treaty law (hard law), does not purport to bind States.

To understand the close relationship among these different sources of norms, it is helpful to compare hard and soft law more generally. Professors Abbott and Snidal explain hard and soft law through a legalization optic. Legalization refers to the degree of precision, obligation, and delegation contained in any rule or norm.\textsuperscript{54} Rules or norms with high degrees of each of these characteristics reflect hard law; those instances where States have bound themselves to precise rules that can be adjudicated by a body having the authority to pass on the rules.\textsuperscript{55} Rules or norms that lack precision, obligation, and/or delegation are soft law.\textsuperscript{56} Thus, soft law may be "soft" because, although it is contained in a treaty and therefore has a high degree of obligation, it is not precise or lacks an interpretive forum.\textsuperscript{57} Alternatively, soft law may be precise in terms of its requirements, by establishing technical standards in a fair degree of detail, for example, but States may not commit to those standards as binding (even though they may use them consistently).\textsuperscript{58}

Snidal reference these side agreements as instances where States used "hortatory or imprecise provisions to deal with the difficult issues, allowing them to proceed with the rest of the bargain." Abbott & Snidal, \textit{Hard and Soft Law}, \textit{supra} note 50, at 445. See also the Vienna Convention for the Protection of the Ozone Layer, Mar. 22, 1985, 1513 U.N.T.S. 324, as discussed in Kenneth W. Abbott et al., \textit{The Concept of Legalization}, 54 INT'L ORG. 401, 407 (2000). As the authors explain, the agreement "imposed binding treaty obligations, but most of its substantive commitments were expressed in general, even hortatory language and were not connected to an institutional framework with independent authority." \textit{Id.}


55. \textit{Id.} at 421–22.

56. \textit{Id.} at 422.

57. \textit{Id.} at 441–43 (stating that precision and delegation can be reduced or even unattainable in response to concerns regarding uncertainty, and referencing the Vienna Ozone Convention as legally binding yet imprecise and arms control agreements as "precise and binding[,] but limit[ing] delegation to forums that promote political bargaining").

58. \textit{Id.} at 442 (noting the advantages of hortatory rules utilizing precision to limit obligations and maintain flexibility).
The difficulty of developing international law through the treaty process or customary international law reveals the comparative advantage of soft law. Soft law often evolves over time with less of a commitment than treaty law. For example, the IOSCO nonfinancial disclosure standards took a decade to develop.\(^5\)\(^9\) The SEC adopted the substance of the IOSCO standards when it codified them through the regulatory process.\(^6\)\(^0\) Additionally, self-regulatory organizations that develop soft law build upon expertise and fashion norms through consensus. As a result, soft law norms face less resistance and thus may be better able to secure compliance.

Soft law’s ability to secure compliance, despite its nonbinding status, enhances its appeal internationally. International rules developed through treaty, customary international law, or soft law may go unheeded. Despite *pacta sunt servanda*, the principle that agreements are to be obeyed,\(^6\)\(^1\) all international law sources generally face a compliance challenge. Treaties typically do not provide remedies for their breach and even where they do, parties usually retain the option to withdraw from the treaty altogether.\(^6\)\(^2\) Customary international law and soft law also lack explicit compliance mechanisms.\(^6\)\(^3\) Some claim that international law is

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60. See infra note 122 and accompanying text.

61. Vienna Convention on the Law of Treaties, *supra* note 29, art. 26 (“Every treaty in force is binding upon the parties to it and must be performed by them in good faith.”). See also Norwegian Loans (Fr. v. Nor.), 1957 I.C.J. 9, 53 (July 6) (separate opinion of Judge Lauterpacht) (stating that the obligation to act in good faith is “a general principle of law, [and] is also part of international law”); Vienna Convention on the Law of Treaties, *supra* note 29, art. 31(1) (stating that all treaties “shall be interpreted in good faith”); *id.* pmbl. (“[n]oting that the principle[] of . . . good faith and the *pacta sunt servanda* rule are universally recognized”).

62. Vienna Convention on the Law of Treaties, *supra* note 29, art. 54 (stating that a party may withdraw from a treaty as provided in the treaty’s provisions or following consultations with other signatories); *id.* art. 56 (stating that a party may withdraw from a treaty where its provisions do not indicate the right to withdrawal if the right was either intended or implied).

not law at all because there is no means of enforcement.\textsuperscript{64} This claim overemphasizes coercion as a compliance tool.\textsuperscript{65} In international law, compliance can stem not only from coercion but also from self-interest\textsuperscript{66} and/or from the sense that the law ought to be obeyed, i.e., the "legitimacy pull." Some have argued that a State's commitment to honor an international agreement exists whether that commitment comes in the form of treaty law or soft law.\textsuperscript{67} In fact, soft law may be followed more consistently than a rule adopted by treaty or acknowledged as customary international law. Even when soft law rules eventually harden, there is often a great deal of regulatory discretion regarding enforcement. Thus, hard law rules are not necessarily more likely to be enforced simply because they are "hard law." Rather, compliance stems from self-interest and legitimacy.

In sum, treaties are not easy to conclude, their effect in domestic law often awaits domestic legislation, and compliance stems less from the written agreement and more from the compliance benefits or the recognition that the rules contained in those treaties are legitimate. So too with customary international law. Although its creation takes a different path than treaty law, it is still a cumbersome, complicated, and time-consuming process. It is also fraught with ambiguities and disagreement. While soft law is certainly not free from ambiguities, its less threatening nature allows it to develop more swiftly. At the same time, it may be able to guide conduct as effectively as treaty or customary international law. It, too, must look to tangible benefits and legitimacy to secure compliance. Soft law, however, has its own problems. Examining the international organizations that create soft law, as well as how soft law develops and hardens, will help illustrate these problems.

\begin{itemize}
\item \textsuperscript{64} E.g., John R. Bolton, \textit{Is There Really "Law" in International Affairs?}, 10 \textit{TRANSNAT'L L. \& CONTEMP. PROBS.} 1, 7 (2000) (discussing that international law is not law because "there are certainly no agreed-upon enforcement, execution, or compliance mechanisms").
\item \textsuperscript{65} H. L. A. Hart, \textit{The Concept of Law} 217–18 (2d ed. 1994) (stating that identifying binding obligations with the threat of punishment distorts the concepts of duty and obligation in international law).
\item \textsuperscript{66} See Ian Hurd, \textit{After Anarchy: Legitimacy and Power in the United Nations Security Council} 37–38 (2007) [hereinafter Hurd, \textit{After Anarchy}] (noting that self-interest as a means of compliance is preferable to coercion because the latter necessarily "leaves the coerced worse off than before").
\item \textsuperscript{67} Jan Klabbers, \textit{The Concept of Treaty in International Law} 165–217 (1996) (arguing that soft law is no less binding than hard law by detailing various cases in which the World Court held that parties were legally bound to agreements or commitments regardless of their form).
\end{itemize}
C. Important Soft Law Organizations

There are a number of soft law norm generators in the securities field. It is helpful to understand how some of them are structured.

1. IOSCO

IOSCO is an "international association of securities regulators" with tremendous influence on the development of international norms for the regulation of securities. The IOSCO membership has agreed to cooperate together to promote high standards of regulation in order to maintain just, efficient and sound markets; to exchange information on their respective experiences in order to promote the development of domestic markets; to unite [their] efforts to establish standards and an effective surveillance of international securities transactions; and to provide mutual assistance to promote the integrity of the markets by a


70. IOSCO's membership is broken down into three categories: "ordinary" members (who possess a single vote); "associate" members (who do not possess voting power and may not become members of the Executive Committee, though they are eligible to become members of the Presidents Committee); and "affiliate" members (who possess no vote and cannot become members of either the Executive Committee or the Presidents Committee). There are currently 109 ordinary members, eleven associate members, and seventy-one affiliate members. See IOSCO Membership Lists, http://www.iosco.org/lists/index.cfm?section=general (last visited Feb. 16, 2009) (follow "Ordinary," "Associate," and "Affiliate" hyperlinks for individual lists). Ordinary membership is available to securities commissions and similar government bodies, and in the event that a given jurisdiction does have a regulatory government body, a self-regulatory body (e.g., a stock exchange) may become eligible. IOSCO, ANNUAL REPORT, supra note 68, at 37. Ordinary members include the SEC, the United Kingdom's Financial Services Authority ("FSA"), and Hong Kong's Securities and Futures Commission. IOSCO Membership Lists, supra. Associate membership is available to public regulatory bodies of countries that are already ordinary members: the Commodity Futures Trading Commissions ("CFTC") is a notable example. Affiliate membership is available to SROs and international bodies with "an appropriate interest in securities regulation," IOSCO, ANNUAL REPORT, supra note 68, at 37, including the London Stock Exchange, the New York Stock Exchange, and the International Monetary Fund ("IMF"). IOSCO Membership Lists, supra.
rigorous application of the standards and by effective enforcement against offenses.\textsuperscript{71}

The resulting dialogue established at IOSCO has led to a set of principles and best practices for securities regulation.\textsuperscript{72} For example, IOSCO's Objectives and Principles of Securities Regulation\textsuperscript{73} ("OPSR") sets forth thirty principles of securities regulation based upon three objectives: (1) the protection of investors; (2) ensuring that markets are fair, efficient, and transparent; and (3) the reduction of systemic risk.\textsuperscript{74} The principles promulgated by IOSCO are nonbinding on its members, though members undertake "to use their best endeavors within their jurisdiction to ensure adherence" to the organization's principles.\textsuperscript{75} The nonbinding nature of IOSCO's resolutions is reflective of the organization's predilection towards flexibility.\textsuperscript{76}

IOSCO is set apart from many other international regulatory organizations insofar as it has become formalized enough to justify a general secretariat, even though it merits "no place on the landscape of the international legal system."\textsuperscript{77} The General Secretariat, based in Madrid, Spain, organizes IOSCO's business (including the collection of dues and planning of annual conferences)\textsuperscript{78} and handles all requests for information from members and nonmembers.\textsuperscript{79} IOSCO has a number of committees,\textsuperscript{80} but the Technical Committee is responsible for developing finan-

\begin{thebibliography}{99}
\bibitem{71} IOSCO, \textit{Annual Report}, \textit{supra} note 68, at 3.
\bibitem{72} \textit{Anne-Marie Slaughter}, \textit{A New World Order} 53-54 (2004).
\bibitem{74} \textit{Id.} at i.
\bibitem{75} \textit{Id.} at 3.
\bibitem{76} The essence of this flexibility is captured in the OPSR's declaration that "there is often no single correct approach to a regulatory issue" and, therefore, local developments and history must be taken into account in order for members to implement the organization's principles domestically. \textit{Id.}
\bibitem{77} \textit{Slaughter}, \textit{supra} note 72, at 38.
\bibitem{78} IOSCO, \textit{Annual Report}, \textit{supra} note 68, at 37.
\bibitem{80} There are ten IOSCO committees. IOSCO, \textit{Annual Report}, \textit{supra} note 68, at 35. The Presidents' Committee is composed of the presidents of regular and associate member agencies, meets annually, and "has all the powers necessary or convenient to achieve the purpose of IOSCO." \textit{Id.} at 34. The Executive Committee is composed of nineteen
\end{thebibliography}
cial regulatory standards and recommendations of best practices, and has therefore garnered the majority of IOSCO's press.\textsuperscript{81} It has been characterized by one commentator as the place where "most of the important work is done."	extsuperscript{82} Its meetings are closed to the public and its work is divided into five subject areas, each deliberated upon by a working group: (1) multinational disclosure and accounting, (2) regulation of secondary markets, (3) regulation of market intermediaries, (4) enforcement and the exchange of information, and (5) investment management.\textsuperscript{83} After reviewing the issues in each of these defined areas, the recommendations of these working groups are forwarded to the Presidents and Executive Committees, where they are ultimately promulgated.\textsuperscript{84} 

members, meets periodically, is "subject to the By-Laws of IOSCO, [and] takes all decisions and undertakes all actions necessary or convenient to achieve the objectives of IOSCO." \textit{Id}. Membership of the Executive Committee is comprised of "the Chairmen of the Technical and Emerging Markets Committees, the Chairmen of each Regional Committee, one ordinary member elected by each Regional Committee from among the ordinary members elected by the Presidents Committee, and nine ordinary members elected by the Presidents Committee." \textit{Id}. The Executive Committee consists of two highly specialized working committees: the Technical Committee and the Emerging Markets Committee. IOSCO Working Committees, http://www.iosco.org/about/index.cfm?section=workingcmts (last visited Mar. 18, 2009). The Technical Committee is composed of financial regulators from the world's most developed markets, and its stated objective is "to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns." \textit{Id}. Membership currently includes representatives from the SEC, the CFTC, and the FSA. \textit{Id}. (follow "Executive Committee" hyperlink). The Emerging Markets Committee was established to promote efficiency in the world's emerging securities and futures markets through the establishment of standards and principles. \textit{Id}. The SRO Consultative Committee ("SROCC") is comprised of self-regulatory organizations that are affiliate members, and its primary function is to provide information regarding SRO rules and regulations to individuals contemplating investment in the global securities market. Nichols, \textit{supra} note 79, at 407. The SROCC also interacts with the Technical Committee in order to provide information about domestic markets to aid in the drafting of regulatory initiatives. \textit{See} IOSCO, \textit{ANNUAL REPORT}, \textit{supra} note 68.

\textsuperscript{81} Zaring, \textit{supra} note 79, at 564.
\textsuperscript{82} SLAUGHTER, \textit{supra} note 72, at 227.
\textsuperscript{83} IOSCO, \textit{ANNUAL REPORT}, \textit{supra} note 68.
2. IASB

The IASB is "an independent, privately-funded accounting standard setter based in London, [United Kingdom]."85 It was created to meet the increasing demand for international accounting rules.86 Its goal is "to provide the world's integrating capital markets with a common language for financial reporting,"87 through the creation of a universal, understandable, and enforceable set of accounting standards.88

The oversight of the IASB, which includes the appointment of its members and fundraising, is handled by the twenty-two trustees of the International Accounting Standards Committee Foundation ("IASC").89 In the interest of ensuring that the makeup of the board of trustees reflects the diversity of the world’s capital markets, six trustees must be appointed from North America, Europe, and the Asia/Oceania region, respectively, and the remaining four trustees can come from anywhere so long as the "overall geographical balance" is maintained.90

The IASB is comprised of fourteen members, twelve on a full-time basis and two on a part-time basis, and unlike the IASC trustees, membership is not based upon geographical criteria.91 The most important quali-

85. About the IASB, http://www.iasb.org/About+Us/About+the+IASB/About+the+IASB.htm (last visited Mar. 18, 2009). The IASB is the standard-setting body of IASC Foundation. Int'l Accounting Standards Comm. [IASC], IASC Foundation Constitution 14, available at http://www.iasb.org/NR/rdonlyres/1904AEEE-3554-49C6-BD96-A4611A6964BE/0/IASCFoundationConstitution2.pdf [hereinafter IASC, Constitution]. The IASB exists under the umbrella of its parent entity, the IASC, a not-for-profit corporation incorporated in the State of Delaware. About the IASB, supra. The IASC was formed in 1973 through an agreement among nine national accounting bodies: Australia, Canada, France, Germany, Japan, Mexico, Holland, the United Kingdom, and the United States. Mark J. Hanson, Becoming One: The SEC Should Join the World in Adopting the International Financial Reporting Standards, 28 LOY. L.A. INT'L & COMP. L. REV. 521, 524 (2006). The IASC was criticized for being a part-time accounting principle setter whose structure would hinder its ability to promulgate fair and efficient global accounting standards, so it overhauled its infrastructure, creating the IASB and delegating most of the technical rulemaking power to it. Id. at 524–25.


89. IASC, Constitution, supra note 85, at 19.

90. Id.

91. Id. at 18.
fications for membership are that individuals shall have the professional and practical experience to ensure that the membership is comprised of "the best available combination of technical expertise and diversity of international business and market experience in order to contribute to the development of high quality, global accounting standards." Each member possesses a single vote, and nine votes are required for the promulgation of any standard.

The IASB is solely responsible for drafting and promulgating International Accounting Standards ("IAS"), most notably IFRS. However, the IASB consults with two other bodies, the Standards Advisory Council ("SAC") and the International Financial Reporting Interpretations Committee ("IFRIC"), and reports to the IASC. The SAC is responsible for providing comments and advice on the development of IASB projects, and IFRIC is charged with reviewing any potential accounting concerns that arise from IASB projects, though any interpretation that it proffers is subject to the approval of the IASB. The IASB's meetings are open to the public (as well as publicly available on its website). It also solicits public comments on its standards.

The IASB is also given the authority by the IASC to "have full discretion in developing and pursuing the technical agenda of the IASB and over project assignments on technical matters: in organising the conduct of its work, the IASB may outsource detailed research or other work to

92. Id. Current board members include Professor Mary E. Barth from the Stanford University Graduate School of Business, Stephen Cooper from the UBS Investment Bank in London, and Tatsumi Yamada, a former Partner of ChuoAoyama Audit Corporation (PricewaterhouseCoopers) in Japan. See About IASB: Board Members, http://www.iasb.org/About+Us/About+the+IASB/IASB+members.htm (last visited Feb. 15, 2009).


94. Mattli & Buthe, supra note 86, at 251.


96. IASB, DUE PROCESS HANDBOOK, supra note 95, ¶¶ 94–98 (discussing public comments on published proposals and exposure drafts, and duration of comment periods); id. ¶ 103–06 (discussing IASB's usage of public hearings, round-table discussions, and the possibility that IASB will send representatives to meetings initiated by the public to address concerns about the organization's agenda). For documents currently open to public comment, see International Accounting Standards Board—Open to Comment, http://www.iasb.org/Open+to+Comment/International+Accounting+Standards+Board+-+Open+to+Comment.htm (last visited Feb. 16, 2009).
national standard setters or other organizations.”97 One notable example of this is the fact that IFRS were originally a recommendation of IOSCO.98

Due to the fact that the IASB derives its funding from private sector firms, some commentators have argued that the international accounting standards that it promulgates are rife with potential conflicts of interest.99 Since the IASB’s funding and budgetary concerns are handled by the IASC, it may be argued that the IASB’s members are insulated from the influence of the donors.100

3. OECD

The OECD, an international organization with its general secretariat headquartered in Paris, France, “provides a forum where governments can compare and exchange policy experiences, identify good practices and promote decisions and recommendations” with respect to “the economic, social and governance challenges that can accompany [globalization].”101 As others have pointed out, it is a forum for national regulators to tackle common problems.102 The OECD develops guidelines and models of best practices, and sometimes formal agreements.103

The thirty market democracies that comprise the OECD’s current membership are represented by ambassadors, and unlike many international organizations, membership is contingent upon approval by the Council of members following the “accession process.”104 The OECD is

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97. IASC, Constitution, supra note 85, at 20.
98. See Hanson, supra note 85, at 526. IOSCO released an “International Equity Offers” report in 1989, which “called for a single worldwide securities disclosure document that would use internationally accepted accounting standards.” Id.
100. Nevertheless, some commentators have admonished that the case of the FASB and Sarbanes-Oxley in the United States provides a strong argument that “alternative sources of funding are required to guarantee effective independence.” Mattli & Buthe, supra note 86, at 254.
102. SLAUGHTER, supra note 72, at 17.
103. See id.
104. OECD, Members and Partners, http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html (last visited Jan. 25, 2009). The “accession process” in-
funded by contributions from its member countries, which are based upon a percentage of the member's economy.\textsuperscript{105}

The OECD largely functions through its General Secretariat, specialized committees, and the Council.\textsuperscript{106} There are approximately 200 specialized committees, working groups, and expert groups, all of which are comprised of representatives from member countries that discuss, exchange information, and evaluate the progress of policy areas ranging from economics to employment and education.\textsuperscript{107} The Council is where "decision-making power is vested."\textsuperscript{108} "It is made up of one representative per member country, plus a representative from the European Commission."\textsuperscript{109} Council meetings involve discussion of key issues and lead to the delegation of work projects to the General Secretariat.\textsuperscript{110} The OECD has described the manner in which it functions as "consist[ing] of a highly effective process that begins with data collection and analysis and moves on to collective discussion of policy, then decision-making and implementation."\textsuperscript{111}

None of these organizations develop soft law in the same way; thus, it is helpful to consider some concrete examples of how soft law develops and how it subsequently hardens. Although a variety of international organizations, primarily SROs, trade associations, and international banks, develop soft securities regulation, IOSCO, the IASB, and the OECD are the bodies focused upon in this Article.\textsuperscript{112}

\begin{footnotes}
\item[105] CESR is composed of representatives from the securities regulatory agencies of the EU and functions as a coordinating and advisory group under the European Commission. CESR’s determinations are soft law, but CESR is influential in formulating a Euro-
\end{footnotes}
II. STORIES ABOUT THE HARDENING OF SOFT LAW

A. IFRS

The U.S. federal securities laws establish mandatory disclosure of the business and financial affairs of all companies that make public offerings of securities in the United States or that have 500 shareholders and $10 million in assets and trade in the U.S. securities markets. Public offering documents must include audited financial statements prepared according to U.S. generally accepted accounting principles ("GAAP"), and publicly traded companies must file annual and periodic reports that include audited annual financial statements prepared according to U.S. GAAP. Although it has been argued for some time that international accounting standards would better serve the needs of investors in the global capital markets, the SEC has been slow to accept any non-U.S. GAAP financial statements for SEC filings. But in response to pressures from the European Union and foreign issuers, the SEC is currently in the process of shifting its requirements from U.S. GAAP to IFRS. Although accounting standards are promulgated by private sector bodies, they become hard law when regulators require their inclusion in financial statements given to investors.

The most important part of an SEC registration statement is the prospectus circulated to investors. Information required in a prospectus is specified in § 7 of the Securities Act. Under § 19(a) of the Securities Act, a prospectus must contain full, fair, accurate, and understandable information about the issuer and the securities offered.


Act, the SEC may adopt rules and regulations and define terms. Pursuant to this authority, the SEC has adopted forms for the registration of securities offerings, regulations specifying the narrative contents of such forms, and the accounting statements required to be included in SEC filings. The SEC's rulemaking power is very broad and gives the SEC authority to formulate accounting principles, but the SEC has delegated this authority to the accounting profession, specifically the Financial Accounting Standards Board ("FASB"), by recognizing its standards as "authoritative" for filed documents. In Sarbanes-Oxley, Congress set forth requirements as to board composition, funding, and other matters for a body that would promulgate accounting standards that the SEC could recognize as "authoritative." Such a body is required to be from the private sector, rather than a government body. The IASB is such a private sector body, although, as will be explained below, its governance was changed at the insistence of the SEC so that the SEC could eventually recognize its standards as "authoritative."

The SEC generally requires foreign (that is, non-U.S.) issuers that publicly raise capital in the United States or list their shares on a U.S. securities exchange to comply with the registration requirements of the Securities Act and the Exchange Act, unless appropriate exemptions from registration are available. Although the SEC's approach to foreign issuer disclosure is essentially a national treatment approach, the SEC has designed special registration forms for foreign issuers that relax some of the rigors of the registration process. In October 1999, the SEC amended the foreign issuer disclosure forms to substantially replace the nonfinancial disclosure requirements with disclosure standards endorsed by IOSCO. The development of these international disclosure stan-

117. Id. § 77s(a).

118. Form S-1 is the general form of registration statement; Form S-3 is a form for seasoned issuers. Regulation S-K, specifying the contents of such forms, is set forth at 17 C.F.R. §§ 229.101 et seq. Regulation S-X, specifying the contents of accounting statements, is set forth at 17 C.F.R. §§ 210.2-01 et seq.


121. Form 20-F is the core document authorized by the SEC for use by foreign issuers. 17 C.F.R. § 249.220f. Forms F-1 and F-3 are registration forms for foreign private issuers. 17 C.F.R. §§ 239.31, 239.33.

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Standards by IOSCO was an important step in the convergence of U.S. and EU narrative and financial disclosure standards, and influenced Asian and other countries to move toward international accounting standards.

In adopting IOSCO’s disclosure standards for foreign private issuers, the SEC significantly changed the form, although not the content, of previous disclosure standards. At that time, the SEC did not change its accounting disclosure regulations for foreign private issuers, which were still required to reconcile their financial statements to U.S. GAAP. The SEC nevertheless issued a Concept Release requesting comments to determine under what conditions it would accept financial statements of foreign private issuers prepared using international accounting standards.

Previously, in 1988, the SEC “explicitly supported the establishment of . . . international accounting standards . . . to reduce regulatory impediments [resulting] from disparate national accounting standards,” but continued to reject a mutual recognition approach. But at this time, the SEC decided not to adopt a process-oriented approach to IASB standards, recognizing them as “authoritative” and therefore comparable to U.S. GAAP standards promulgated by the FASB. However, after a decade of considering IASB standards, the SEC’s 2000 Concept Release was part of an assessment process possibly leading to the SEC’s acceptance of IFRS. IOSCO, as well as the SEC and others, were working on financial disclosure harmonization, and by May 2000, IOSCO had assessed all thirty core standards in the IASB work program and recommended to its members that multinational issuers use the core standards, supplemented by reconciliation, and such disclosure interpretation as might be necessary.

At this time, the SEC was not concerned about particular IFRS standards, with a few exceptions, but it questioned whether these standards could be rigorously interpreted and applied. In particular, the SEC criticized the structure and financing of the IASB and took a heavy hand in restructuring it. A new constitution was adopted in May 2000 that estab-

123. See id. at 53,908.
127. See IAS Concept Release, supra note 124, at 8901–02.
lished this body as an independent organization with two main bodies, the Trustees and the Board, as well as a Standing Interpretations Committee and a Standards Advisory Council. The Trustees appoint the Board Members, exercise oversight, and fundraise, whereas the Board has sole responsibility for setting accounting standards. The Chairman of the Nominating Committee established for the purpose of selecting the initial Trustees for the restructured IASB was then-SEC Chairman Arthur Levitt, Jr. The Chairman selected to head the new body of Trustees was Paul A. Volker, Former Chairman of the U.S. Federal Reserve Board.

It appeared that, despite SEC staff reservations about IFRS, momentum for mutual recognition of accounting standards based on convergence, if not harmonization, was moving along. But the spirit of cooperation that had been established between the SEC and the IASB was unfortunately dampened by the stock market collapse of 2000–2001 and the enactment of the Sarbanes-Oxley Act. The provisions of Sarbanes-Oxley dealing with the structure of audit committees and the registration and regulation of auditors by the newly created Public Company Accounting Oversight Board ("PCAOB") were met with strenuous objections abroad because they were applicable to foreign issuers and their auditors. Relations between U.S. and foreign regulators soured to some extent, and the SEC became too preoccupied with implementing various mandates in Sarbanes-Oxley, and structuring necessary accommodations for foreign auditors and audit committees, to focus on mutual recognition in financial disclosure.


The European Union then seized the initiative with respect to international accounting standards, undermining those European issuers that had been considering reporting in U.S. GAAP rather than their home country GAAP, by mandating that all listed companies report in IFRS and threatening to make U.S. EU-listed companies also report in IFRS. Moreover, Asian and other issuers also began looking at IFRS, rather than U.S. GAAP, as an alternative to reporting in their national GAAPs for offerings in the international capital markets.\(^{132}\) As the markets in Europe and Asia strengthened, relative to the U.S. markets, New York was no longer the only place where multinational corporations could raise capital, and the SEC was no longer a regulator that could force its regulations on foreign issuers.

In April 2005, the Chief Accountant of the SEC set forth a “roadmap” for eliminating the need for non-U.S. companies to reconcile to U.S. GAAP financial statements prepared according to IFRS.\(^{133}\) This roadmap was explicitly affirmed by successive SEC chairmen in meetings with EU Internal Market Commissioner Charlie McCreevy.\(^{134}\)

On July 2, 2007, the SEC issued a release proposing to accept from foreign private issuers financial statements prepared in accordance with IFRS.\(^{135}\) In that release, the SEC pointed out that almost 100 countries, including the twenty-seven EU Member States, were using IFRS, with more countries considering adopting IFRS.\(^{136}\) The SEC made two arguments in favor of allowing foreign issuers to report in IFRS, which were a somewhat remarkable turnaround from its prior resistance to a foreign GAAP. First, the SEC asserted that it had long advocated reducing the disparity between U.S. accounting and disclosure regulations and those of other countries as a means to facilitate cross-border capital formation. Second, the SEC asserted that an international accounting standard may be adequate for investor protection even if it is not the same as the U.S. standard.\(^{137}\) Therefore, based on increasing convergence between U.S. GAAP and IFRS, and cooperation among the SEC, IOSCO, and CESR,

133. Nicolaensen, supra note 130.
136. Id. at 37,965.
137. Id. at 37,965–66.
the SEC proposed amendments to its rules that would allow a foreign private issuer to file financial statements without reconciliation to U.S. GAAP, if those financial statements are in full compliance with the English language version of IFRS as published by the IASB. The SEC also then issued a Concept Release proposing possible reporting in IFRS by U.S. corporations. The SEC adopted final rules permitting foreign issuers to report in IFRS, substantially as proposed, based primarily on the progress of the IASB and the FASB toward convergence, their expressed intention to work toward further convergence in the future, and a finding that IFRS are high-quality standards.

The interplay and negotiations among the SEC, IOSCO, the EU, CESR, and the IASB leading to the SEC's acceptance of IFRS were arduous and complex. As a practical matter, this is not a result that could have been accomplished by treaty. Further, whether IFRS is soft or hard law is debatable, but once it becomes the accounting standard for SEC filings, adherence to IFRS is legally binding for public companies regulated by the SEC. Moreover, it already is legally required for EU confirmations.

B. MOUs

Although growth of the global capital markets has proceeded rapidly, and linkages between various markets have become quite efficient, the harmonization of regulation, surveillance, and enforcement has progressed at a much slower pace. As was stated in a congressional report in 1989, and continues to be true, there is "no global regulatory structure to

138. Id. at 37,970.
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oversee the markets and coordinate harmonization of laws and regulations to ensure efficiency and honesty. Therefore, securities regulators in each nation must work with their foreign counterparts to seek coordinated international solutions to assure fairer as well as more efficient market operations across borders. One consequence of the dramatic increase in foreign participation in U.S. securities markets is the increased opportunity for transnational securities fraud.

The SEC has been particularly concerned about insider trading, market manipulation, and financial fraud where information and evidence relating to suspicious conduct is located beyond the agency's jurisdictional reach. Many foreign countries have secrecy or blocking statutes that prohibit the disclosure of information. Bank secrecy laws provide (criminal) sanctions against banks that breach client confidentiality. Blocking laws prevent evidence gathering under U.S. law in foreign jurisdictions. A blocking statute forbids the communication of information except as provided by treaty or international agreement. It would generally apply to domestic courts and prevent such courts from forwarding information to another jurisdiction. Therefore, even if a subpoena can be served on a foreign bank, the bank is prohibited by secrecy or blocking statutes from giving the SEC any information pursuant to its national law.

For example, in SEC v. Tome, there was substantial insider trading in the common stock and options of St. Joe Minerals shortly before a tender offer by Seagram. The day before the tender offer was announced, accounts at Banca Della Svizzera Italiana ("BSI") purchased 3000 shares and options for over 100,000 shares. Showing a strong probability of insider trading, the SEC obtained a temporary restraining order and a freeze order on profits in BSI's account at Irving Trust. The SEC did not know the identity of BSI's customers and did not identify them in the complaint. BSI refused to disclose their identity because of Swiss bank secrecy laws. The SEC obtained a discovery order on the basis that it would be a "travesty of justice" for foreign companies to "invade American markets, violate American laws . . . , withdraw profits, and resist ac-

BSI's client turned out to be an Italian national operating a firm in Switzerland, and the SEC was able to permanently enjoin him and order disgorgement of over $4 million in profits. In this case, the SEC was able to crack Swiss bank secrecy laws, but it was able to do so only because it froze the profits of illegal activity so soon after trading on inside information.

International agreements for the production of evidence can be used to obtain evidence abroad, even from banks in countries that have secrecy or blocking statutes, but the pursuit of evidence under these agreements is painfully slow and makes it difficult for the SEC or other securities commissions to proceed. The first U.S. Mutual Legal Assistance Treaty entered into force with Switzerland in 1977. The United States then entered into treaties to provide mutual assistance in criminal matters with many other countries. The SEC was able to make use of the Swiss treaty in the Santa Fe case.

After the entry of a preliminary injunction in 1981, the SEC sought to learn the identities of certain account holders who had directed purchases of Santa Fe stock and options through Swiss banks just prior to the announcement of a merger, making a profit of $6.2 million. The Swiss banks refused to respond to the SEC request. In March 1982, the SEC submitted a request for assistance under the Swiss Treaty with the United States. In May 1984, the request was finally granted, and in February 1986, the SEC was successful in obtaining disgorgement of $7.8 million, but this took over three years, and if the SEC had not frozen the funds from the insider trading transactions, the profits from this illegal activity would probably have been long dissipated. As this case demonstrates, although the SEC can use mutual assistance treaties for the production of information, the coverage of the agreements is limited, and the

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151. Id. at *2.
152. In addition to the $6.2 million in profits made by the "unknown purchasers," a Santa Fe director and his business associate also traded on the stock in violation of insider trading laws, realizing profits in excess of $3.5 million. Id. at *1–2.
procedures that must be followed are cumbersome and entail lengthy negotiations. Further, generally there must be dual criminality. Until 1988, insider trading was not criminal in Switzerland, and the absence of dual criminality hampered SEC investigations.153

The SEC set out to solve its problems in obtaining evidence of illegal behavior from foreign regulators by negotiating MOUs. MOUs are statements of cooperative intent, not legally binding obligations.154 They do not override domestic law or preclude other avenues for obtaining evidence abroad.155 The first MOU that the SEC negotiated was with Switzerland in 1982.156 Since insider trading was not then illegal, the MOU stated that the parties would rely on a private agreement between the SEC and the Swiss Bankers Association until the Swiss legislature criminalized insider trading.157 The MOU between the SEC and Switzerland was followed by numerous negotiated MOUs between the SEC and foreign regulators. MOUs formalize methods of requesting and providing information between like-minded regulators. The Swiss MOU was limited, however, in that it allowed private parties to challenge SEC requests and restricted the SEC's use of information provided. In the next few years, the SEC negotiated MOUs with the U.K. Department of Trade and Industry, the Japanese Ministry of Finance, and the Brazilian Securities Commission.158 Also, in 1989, the SEC created the Office of International Affairs, reporting directly to the Chairman, specifically to negotiate MOUs.159

Seeking a more global solution to the problems of gathering evidence in foreign countries, the SEC sought and received assistance from IOSCO. In November 1986, an IOSCO resolution called on all securities authorities, to the extent permitted by law, to provide assistance on a re-

156. See id. at 218.
157. Id. The mechanism for such cooperation was that a private group of Swiss bankers required their customers to waive Swiss bank secrecy as a condition to conducting U.S. securities transactions. Goelzer et al., supra note 153, at 87. See also Jonathan R. Macey, Regulatory Globalization as a Response to Regulatory Competition, 52 Emory L.J. 1353, 1368 (2003) (noting that the Swiss eventually criminalized insider trading in 1988).
ciprocal basis for obtaining information relating to market oversight and protection of markets against fraud.\textsuperscript{160} When questions arose as to the SEC's authority to collect evidence for foreign regulators, Congress passed the International Securities Enforcement Cooperation Act of 1990\textsuperscript{161} to confirm the SEC's authority to enter into MOUs and to gather evidence for foreign regulators. In addition, the statute created a confidentiality exception from the Freedom of Information Act for evidence that the SEC obtains from foreign regulators.\textsuperscript{162}

In 2002, IOSCO created a Multilateral Memorandum of Understanding ("MMOU") for enforcement cooperation among securities regulators. The SEC was an initial signatory to the agreement, and by December 2007, there were forty-three securities and derivatives regulators that were signatories.\textsuperscript{163} Before the IOSCO MMOU came into existence, the SEC had signed bilateral information-sharing MOUs with the securities authorities of twenty different countries, and in 2007, the SEC made 556 requests to foreign regulators for assistance and responded to 454 requests.\textsuperscript{164} Yet, the IOSCO MMOU is neither a treaty nor an international agreement, and it specifically states that its provisions "are not intended to create legally binding obligations or supersede domestic laws."\textsuperscript{165}

The globalization of the securities markets has created the need for the sharing of information and cooperation among securities regulators beyond the sharing of evidence in a particular enforcement investigation. Demutualization of securities exchanges and their search for cross-border merger partners have raised questions about how these new multinational markets should be regulated.\textsuperscript{166} In 2007, the SEC approved the combina-

\begin{thebibliography}{9}
\bibitem{USCA} 15 U.S.C. § 78x(d) (1934).
\bibitem{SEC} SEC Speaks in 2008, \textit{supra} note 163, at 1201–02.
\end{thebibliography}
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The SEC speaks in 2008, supra note 163, at 1194–95.


C. Anti-bribery

Over a period of thirty years, international anti-bribery norms evolved from national hard law, to soft law, to international treaty law in the form of the 1997 Convention on Combating Bribery of Foreign Officials in International Business Transactions ("OECD Anti-Bribery Convention" or "Convention"). This evolution was prodded by the United States, which saw combating bribery of foreign officials by its own business people (and those from other nations) in its normative and rationalistic interests. The strategic use of soft law instruments as well as diplomatic and public pressure made the commitment to a hard law instrument politically attainable.

In 1977, the United States enacted the Foreign Corrupt Practices Act ("FCPA") in response to evidence of widespread illegal payments to government officials by large U.S. companies. Some of these scandals not only were morally repugnant, but also implicated U.S. foreign policy interests because foreign governments were threatened by the news that their officials had been bribed by U.S. businesses. In response, the United States enacted the FCPA, which criminalized the bribing of any foreign official by any U.S. issuers or domestic concerns.

Initially, the United States believed that other countries would follow suit and enact similar legislation. That did not happen. Instead, U.S. companies faced a disadvantage trying to do business overseas and competing with companies whose national laws did not govern bribery of

171. Following the Watergate scandal, U.S. government investigations revealed that U.S. businesses had used foreign ties to launder illegal financial contributions to President Nixon's campaign, prompting the SEC to launch parallel investigations into other corporate practices. The SEC uncovered similar corrupt actions, most notably Lockheed's bribery of Japanese, Dutch, and Italian officials. During the course of the SEC investigations, over $300 million in bribes to foreign public officials was uncovered, with almost half of the 400 U.S. companies involved ranking in the Fortune 500. Peter W. Schroth, The United States and the International Bribery Conventions, 50 AM. J. COMP. L. SUPP. 593, 593-96 (2002). The moral upheaval that resulted in the United States created a genuine political issue to which legislators responded by enacting the FCPA. Id. at 596-97.
173. 15 U.S.C.A. §§ 78dd-1(a)(1)(B), 78dd-2(a)(1)(B). Following the completion of the OECD Anti-Bribery Convention, a provision was added to the FCPA in 1998, which made it unlawful for "any person other than an issuer . . . or a domestic concern" to bribe a foreign official. Id. § 78dd-3.
foreign officials.\textsuperscript{175} Some of these countries viewed bribery as part of a
developing country’s economy and saw no moral or economic reason to
stop it.\textsuperscript{176} Indeed, even the World Bank failed to condemn corruption.\textsuperscript{177}

At first, efforts to develop soft law principles condemning corruption
failed to produce meaningful commitments. In tracking the development
of the OECD Anti-Bribery Convention, Professors Abbott and Snidal
note the efforts of many international organizations, including “the
[U.N.], the development banks, the [IMF], the [OAS], the Council of
Europe, the European Union . . . and of course the OECD . . . [which]
adopted anticorruption policies, though their enthusiasm and effective-
ness varied widely.”\textsuperscript{178} For example, the OAS first unanimously resolved
in 1975 “to cooperate in the exchange of information” and to “prepare[] a
draft code of conduct,”\textsuperscript{179} and asked that members “clarify their national
laws” accordingly.\textsuperscript{180} There was, however, no provision detailing any
means by which to enforce the statements made in the resolution.\textsuperscript{181} The
OAS then ceased to address the problem again until the 1994 Summit of
the Americas, where it called for multilateral efforts to combat corrup-
tion.\textsuperscript{182}

\begin{enumerate}
\item 175. Alejandro Posadas, \textit{Combating Corruption Under International Law}, 10 Duke J.
Comp. \& Int’l L. 345, 364–65 (2000) (stating that although the U.S.-led investigations
revealed widespread bribery abroad, no other countries addressed the problem); \textit{id.} at 359
(noting that since enacting the FCPA, Congress has amended it twice in an “effort to
strengthen the global competitiveness of American businesses”).
\item 176. Christopher F. Corr \& Judd Lawler, \textit{Damned If You Do, Damned If You Don’t?:
The OECD Convention and the Globalization of Anti-Bribery Measures}, 32 Vand. J.
Transnat’l L. 1249, 1253 (discussing that in developing countries bribery was seen as a
“necessary evil”); Daniel K. Tarullo, \textit{The Limits of Institutional Design: Implementing
many countries did not see corruption and bribery as immoral or “bad,” but rather as
necessary to economic and political progress in developing countries).
\item 177. Posadas, \textit{supra} note 175, at 399–400 (discussing that the World Bank and Interna-
tional Monetary Fund only began taking steps towards combating corruption in the latter
half of the 1990s).
\item 178. Abbott \& Snidal, \textit{Values and Interests}, \textit{supra} note 174, at S159–60.
\item 179. Organization of American States [OAS], Resolution on the Behavior of Transna-
tional Enterprises, ¶¶ 1–2, OAS Doc. OEA/Ser. G, CP/RES. 154 (167/75) (July 10,
1975).
\item 180. OAS, Resolution on the Behavior of Transnational Enterprises, \textit{supra} note 179, ¶
II.
\item 181. See OAS, Resolution on the Behavior of Transnational Enterprises, \textit{supra} note
179. The resolution declared that the Permanent Council should consult experts and de-
vote “appropriate procedures” in developing a code of conduct, but that any resulting
information would only be “placed on the agenda . . . for consideration.” \textit{id.} ¶¶ 2–3.
\item 182. Summit of the Americas, Declaration of Principles and Plan of Action, Dec. 11,
\end{enumerate}
Other organizations dabbled in anticorruption norms in the 1970s as well. In 1977, the International Chamber of Commerce’s Commission on Ethical Practices promulgated a set of recommendations for governments and rules of conduct for corporations and their employees. The recommendations urged countries to negotiate a multilateral treaty and to implement their own domestic legislation. The Rules of Conduct to Combat Extortion and Bribery provided a self-regulatory framework for corporations to adopt if they so chose. Also in the 1970s, the U.N. acted through Resolution 3514 in condemning bribery and urging governments to legislate accordingly. These efforts lacked follow-up.

Finally, in 1993, the OECD, at the behest of the United States, tackled the problem of bribery. In some ways the OECD was a perfect soft law venue. It provided a forum for policy discussion and persuasion. As a club organization with a limited number of members, it was conducive to consensus. It established a Working Group on Bribery in Interna-

184. ICC, Extortion and Bribery in Business Transactions, supra note 183, at 418.
185. Id. at 419.
186. G.A. Res. 3514 (XXX), ¶ 1–5, U.N. Doc. A/10467 (Dec. 15, 1975). Even after the U.N. issued this resolution and bribery scandals in Japan and Iran emerged, U.S. efforts to garner consensus on a mandatory international corporate code of conduct were met with “deafening silence.” Seymour Rubin, International Aspects of the Control of Illicit Payments, 9 SYRACUSE J. INT’L L. & COM. 315, 318–20 (1982). These attempts were apparently doomed from the start as previously the United States had “firmly insisted that the codes of conduct [for other aspects of transnational corporations] be voluntary,” and this inconsistent stance seemed to block further U.N. cooperation. Id. at 321.
187. Schroth, supra note 171, at 610–11 (discussing that Congress had pressed for action within the OECD, but that it was not vigorously pursued until 1993, after which the OECD ultimately issued a Recommendation against bribery in 1994).
188. Abbott and Snidal track the OECD efforts to illustrate the interplay of rationalist and constructivists accounts of international norm development. Abbott & Snidal, Values and Interests, supra note 174, at 314–44.
189. See THE OECD, supra note 105, at 7 (describing the advantages of the OECD forum in discussing issues and persuading other actors to change their policies).
tional Business Transactions, which included member nations as well as members of civil society, including Transparency International, other international organizations such as the World Bank, and prosecutors from the United States and Europe.\footnote{191} In accordance with the Council’s statement condemning bribery, the Working Group issued a recommendation that member countries also abolish the tax deductibility of bribes.\footnote{192} As Abbott and Snidal discuss, these instruments were intended to be soft law instruments that would work towards moving public opinion to pressure governments to attack the problem more forcefully.\footnote{193} Over time, attitudes concerning the effect of bribery on developing nations changed, partly due to public opinion and partly in response to U.S. pressure.\footnote{194} Between 1993 and 1997, the OECD used soft law instruments to move its members towards a firm commitment against bribery in international business transactions.\footnote{195}

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191. Org. for Econ. Co-operation and Dev. [OECD], Recommendation on Bribery in International Business Transactions, ¶ VIII, OECD Doc. C(94)75/FINAL (May 27, 1994) (instructing the Committee on International Investment and Multinational Enterprises to create the Working Group); Abbott & Snidal, Values and Interests, supra note 174, at S166–67 (discussing the various “value activists” that were included in the OECD’s Working Group); OECD, Working Group on Bribery in International Business Transactions, http://www.oecd.org/document/5/0,3343,en_2649_34855_35430021_1_1_1,00.html (last visited June 18, 2008) (describing the establishment and mandate of the Working Group).


193. In pursuing its anticorruption agenda in the OECD, the U.S. State Department relied on the emerging public interest in combating corruption in Europe and the bad press generated by European scandals. Abbott & Snidal, Values and Interests, supra note 174, at S164–65.

194. See Tarullo, supra note 176, at 678–80 (discussing U.S. attempts to persuade other governments to alter their policies on bribery and to address public concern with domestic scandals and their effects on democratization).

195. Kenneth W. Abbott, Rule-Making in the WTO: Lesson from the Case of Bribery and Corruption, 4 J. INT’L ECON. L. 275, 289–90 (2001). At the same time, other soft law efforts to combat corruption proceeded. The OAS efforts picked up again. In a 1992 General Assembly Resolution, the OAS declared that corruption had a negative effect on development, and in 1996 it adopted an anticorruption agreement, the Inter-American Convention Against Corruption (“IACAC”). See OAS, Corrupt International Trade Practices, OAS Doc. AG/RES. 1159(XII–092) (May 22, 1992), available at http://www.oas.org/juridico/english/ga-res97/eres1159.htm; IACAC, supra note 53. The IACAC lacked monitoring and compliance mechanisms and instructed States to “consider” certain preventative measures and to take steps to establish transnational bribery and illicit enrichment as offenses under each country’s national law. IACAC, supra note 53, art. III
The end game for anti-bribery efforts was a hard law convention—soft law was the means to the end. Admittedly, U.S. negotiators thought that obtaining a hard law instrument was not a realistic short-term goal. But, an international hard law commitment was needed to combat the prisoner’s dilemma faced by nations. If any one nation prohibited bribery of foreign officials by its business people, it lost out to a greater extent than if it allowed bribery to continue. Forcing all nations to prohibit bribery maximized gains for all. Initially, negotiators focused on persuasion, and their partners in civil society, namely Transparency International, championed the effectiveness of public opinion as a soft law tool to pressure governments and move them towards the hard law commitment.

The process took time and prodding. The OECD first recognized bribery as a problem in its Guidelines for Multinational Enterprises (“Guidelines”) as part of the Declarations and Decisions on International Investment and Multinational Enterprises in 1976. But until U.S. pres-
sure in the 1990s, anti-bribery efforts—even soft law efforts—were at a standstill. A 1994 recommendation of the OECD Council referenced the Guidelines and instructed the corresponding committee to form the Working Group on Bribery in International Business Transactions. It also recommended both domestic legislation and international cooperation (through existing agreements and the formation of new ones) to prohibit bribery. In 1996, the OECD issued another recommendation that further encouraged member countries to eliminate tax deductibility in connection with bribery of foreign public officials. At the same time, the United States was applying pressure amongst its allies and capitalizing on public attitudes towards corruption. The OECD issued a final recommendation regarding bribery on May 23, 1997 (“Final Recommendation”). The Final Recommendation included a list of “Agreed Common Elements” and opened the negotiations for the eventual Anti-Bribery Convention. Ambitiously, the Final Recommendation discussed criminalization, tax deductibility, public procurement, international cooperation, arrangements for a monitoring system, cooperation with non-OECD members, and cooperation with intergovernmental organizations (“IGOs”) and nongovernmental organizations (“NGOs”). These efforts to change the values of the public and governments bore fruit. By 1997, attitudes concerning the appropriateness of bribery and its effect on international business had changed significantly.
After accepting several soft law instruments, OECD members found it easier to accept (or more difficult to resist) a hard law instrument.\footnote{211} The Final Recommendation moved the members to the point where they had agreed to a list of common elements for anti-bribery legislation.\footnote{212} Once these elements had been agreed upon, the task of negotiating a hard law treaty became much easier.\footnote{213} The OECD Anti-Bribery Convention was the result.\footnote{214} It is a legally binding hard law instrument that incorporates the common elements of bribery and requires signatories to implement domestic legislation consistent with the Convention.\footnote{215} While it does not mandate a particular format for that legislation, it does provide for a monitoring system of peer review to ensure that legislation exists and that it is enforced.\footnote{216}

Although negotiators reached their hard law goal, the OECD Anti-Bribery Convention still faces criticisms. It only addresses bribery and not other forms of corruption.\footnote{217} And individual States still define bribery


211. The European countries submitted their own draft of the proposed Convention, which was rejected. Specifically, the United States suspected that the push for a legally binding document was an “obstructionist tactic.” Abbott and Snidal note, however, that once these European countries were “on record” as supporting hard law, it became more difficult for them to back out of negotiations. Abbott & Snidal, Values and Interests, supra note 174, at S167–68.

212. The common elements included definitions, sanctions, and enforcement provisions. Emphasis was placed on international cooperation. Specifically, members were supposed to make efforts to eliminate the delaying effects of dual criminality constraints and to facilitate information sharing between governments. OECD, Revised Recommendation, supra note 207, annex.

213. Abbott & Snidal, Values and Interests, supra note 174, at S168.

214. There are now thirty-seven signatories. See OECD Anti-Bribery Convention: Entry into Force of the Convention, http://www.oecd.org/document/12/0,3343,en_2649_34859_2057484_1_1_1_1,00.html (last visited Jan. 25, 2009).


216. Anti-Bribery Convention, supra note 216, art. 12.

217. Id. pmbl. See also Peter J. Henning, Public Corruption: A Comparative Analysis of International Corruption Conventions and United States Law, 18 ARIZ. J. INT’L &
pursuant to their own national laws.\textsuperscript{218} Broader provisions targeting payments to political candidates are noticeably absent,\textsuperscript{219} and commentators have noted that despite the monitoring provisions, the Convention still has serious enforcement problems.\textsuperscript{220}

What is remarkable about the OECD Anti-Bribery Convention, though, is that it exists at all, especially in light of the fact the U.S. FCPA lessened any incentive for other governments to agree to such a convention. As Daniel Tarullo has discussed, basic game theory illustrates that once the United States enacted the FCPA, it became a winning proposition for other countries to resist any anti-bribery legislation.\textsuperscript{221} The prospect of having countries commit to international hard law mandating such legislation seemed dim.\textsuperscript{222} Soft law brightened those possibilities. As Professors Abbott and Snidal have explained in their work, soft law allowed normative influences to transform rationalist ones.\textsuperscript{223} In other words, while it may not have been in most countries' rationalistic interests to commit to anti-bribery legislation, soft law persuaded them to

\textsuperscript{218} Anti-Bribery Convention, supra note 216, cmt. 3. While the Anti-Bribery Convention may "promote" uniformity, the Commentaries following the official text state that the goal of the Convention is "to assure a functional equivalence among the measures taken by the Parties . . . without requiring uniformity or changes in fundamental principles of a Party's legal system." \textit{Id.} cmt. 2.

\textsuperscript{219} The FCPA's prohibition on bribery includes conveying anything of value to "any foreign political party or official thereof or any candidate for foreign political office." 15 U.S.C. §§ 78dd-1(a)(2), 78dd-2(a)(2) (2008). The Anti-Bribery Convention leaves this language out of its definition of "foreign public officials." Anti-Bribery Convention, supra note 216, art. 1. Additionally, the Commentaries indicate that although "there is a commonly shared concern and intent to address this phenomenon through further work," it is not covered by the Convention. \textit{Id.} cmt. 10.

\textsuperscript{220} Tarullo, supra note 176, at 682–83 (noting the difficulties in enforcing the Convention's requirements through the mechanism of peer review). The primary difficulty in relying on individual members, rather than an overseeing body, is that bribery tends to be the sort of offense that is not readily reported to government officials. Thus, there is no guarantee that these offenses will be investigated and prosecuted. \textit{Id.} Furthermore, "the path of the domestic law enforcement system" is troublesome because many of the members' legal systems are insufficiently organized to allow for investigations overseas, which causes indifference towards ensuring compliance. \textit{Id.} at 688. Taken together, these issues create an "insufficiency of the 'compliance pull'" and States feel less obligated to ensure compliance with the Convention. \textit{Id.} at 687.

\textsuperscript{221} \textit{Id.} at 672–74.

\textsuperscript{222} \textit{Id.} at 674.

\textsuperscript{223} Abbott & Snidal, \textit{Values and Interests}, supra note 174, at S143–44, S163 (discussing that the use of soft law as a vehicle to the OECD Anti-Bribery Convention highlights the effectiveness of the value tactics utilized by the United States to influence interest-based concerns).
change their interests. The calculus that followed allowed for a hard law commitment.

Although soft law was a tool in changing that calculus, it was not the only tool. It is clear that the OECD’s employment of soft law came at the behest of the United States and that the United States was able to exercise its moral and diplomatic influence to spur soft law development beyond the fits and starts that occurred in the 1970s. The persistent use of soft law made the transformation politically attainable.

D. Credit Rating Agencies

Intense focus on the role and appropriate regulation of CRAs has been ongoing in the United States and abroad since at least the collapse of Enron. Until four days before Enron declared bankruptcy, major CRAs continued to rate its debt as “investment grade.” Similarly, WorldCom was rated investment grade three months before filing for bankruptcy, and Global Crossing was rated investment grade in March 2002 and defaulted on loans in July 2002. Such failures to downgrade the debt of failing companies have not been limited to U.S. issuers. Further, the rating agencies did not anticipate the 1997–1998 Asian debt crisis, which adversely impacted sovereign debt issues. More recently, criticism of the conduct and competence of CRAs has focused on the huge number of rating agencies’ write downs of previously highly rated residential mortgage-backed securities (“RMBS”) and collateralized debt obligations (“CDOs”) in the context of the subprime mortgage crisis.

CRAs analyze and evaluate the creditworthiness of corporate and sovereign issuers of debt securities. While CRA ratings are often thought to represent a judgment on the worthiness of an investment because of the use of the term “investment grade” to refer to highly rated securities, the opinions of CRAs relate solely to the likelihood that a particular debt

224. Id. at S164–68 (discussing European incentives to support bribery, the value transformation that occurred during the OECD negotiations, and the relatively smooth evolution from the “soft law” Recommendations to the Anti-Bribery Convention).


228. Id.

security will perform according to its terms. A high credit rating does not purport to be an opinion that the debt instrument is a good investment. Nevertheless, as a surrogate for the riskiness of investments held by regulated entities, specific references to credit ratings in the rules of the SEC and Basel II have given such ratings significance and credibility as a measure of the creditworthiness of issuers. In 1975, the SEC adopted the term “nationally recognized statistical rating organization” (“NRSRO”) to determine capital charges for broker-dealers for purposes of the SEC’s capital adequacy or net capital rule. Marketplace and regulatory reliance on credit ratings then gradually increased, and the concept of an NRSRO became embedded in a wide range of U.S. regulations of financial institutions, as well as state, federal, and foreign laws relating to creditworthiness. The failure of the CRAs to promptly adjust ratings or forecast the demise of issuers that went bankrupt when the stock market technology bubble burst then led to scrutiny of their performance and the lack of government regulation.

The SEC never passed a rule defining NRSROs, but rather, recognized agencies as such through a no-action letter process. The SEC staff considered a number of factors, the most important of which was that the agency was “nationally recognized” for ratings reliability. This opaque process and the highly concentrated number of NRSROs led to criticism of the SEC’s procedures, and in 1997 the SEC proposed codifying its NRSRO criteria and giving rejected organizations a right to appeal denial of the designation. This proposal was not acted upon, however.

Government regulation of CRAs in the United States was controversial and remains so. Some believe that the NRSRO designation is a barrier to competition in the credit rating business. Others have argued that the

232. SARBANES-OXLEY REPORT, supra note 231, at 6.
233. Id. at 7–8.
234. Hill, supra note 225, at 55. Other factors taken into consideration were organizational structure; size and experience of staff; the agency’s independence from the company it rates; and internal procedures to prevent misuse of inside information. Id. at 55–56.
SEC lacks authority to substantively regulate CRAs and that such authority would be inappropriate because the activities of CRAs are journalistic and protected by the First Amendment. Yet, shortcomings by CRAs raised questions as to whether their lack of regulation and the SEC's process for designating NRSROs were appropriate. Accordingly, the Sarbanes-Oxley Act mandated that the SEC study the role and function of CRAs and submit a report to Congress. This study was required to cover the following areas: the role of CRAs in evaluating issuers; the importance of that role to investors and the markets; impediments to accurate appraisals of the financial resources and risks of securities issuers; barriers to entry to the CRA business; measures to improve dissemination of CRA appraisals; and conflicts of interest in rating operations. The SEC issued this required report, but did not draw any firm conclusions concerning how, if at all, CRAs should be regulated. Instead, the SEC stated that it intended to issue a Concept Release covering the following issues: mandating disclosure by NRSROs about the ratings process and other matters; conflicts of interest; anticompetitive or unfair practices; reducing barriers to entry; and ongoing SEC oversight of CRAs.

This Concept Release was duly issued in June 2003. In the meantime, the Technical Committee of IOSCO formed a task force to study issues relating to CRAs and released a report in September 2003 describing the role of CRAs in the global capital markets. This task force was chaired by a commissioner of the U.S. SEC and included representatives from Australia, Brazil, France, Germany, Hong Kong, Italy, Japan, Ontario, Canada, Portugal, Spain, and the United Kingdom. At the same time, IOSCO published a set of principles that regulators, CRAs, and other market participants could follow to improve the integrity of the ratings process and help ensure that investors are pro-

237. As will be explained, some authority was given to the SEC in the Credit Rating Agency Reform Act of 1996, Pub. L. No. 109-291 (2006).
239. The report was to be filed not less than 180 days after the passage of the Act. Sarbanes-Oxley § 702, 15 U.S.C. § 78j-1 (2002).
240. SARBANES-OXLEY REPORT, supra note 231, at 43–45.
241. Rating Agencies Concept Release, supra note 238.
243. Id. at 1 n.3. The three largest international CRAs—Moody’s, S & P, and Fitch—are all U.S. companies. Id. at 8.
provided with timely, high-quality ratings. These principles were fairly general and related to the quality and integrity of the ratings process, independence and conflicts of interest, transparency and the timeliness of ratings disclosure, and the use of confidential information.

Responding to suggestions that these principles were insufficient to deal with the problems posed by CRAs, particularly in light of the use of credit ratings in Basel II, IOSCO continued to analyze how CRAs should be regulated. In September 2003, IOSCO issued a report on the activities of CRAs, and a Code of Conduct Fundamentals for CRAs. The Code of Conduct Fundamentals was much more specific than the earlier published principles, and especially focused on the quality of the ratings process, including updating of opinions, conflicts of interest, employee and analyst independence, and transparency. In response, the two largest CRAs, Moody’s and Standard and Poor’s, published their own Code of Professional Conduct in the second half of 2005.

With IOSCO having paved the way for regulation of CRAs, Congress passed the Credit Rating Agency Reform Act (“CRA Reform Act”) in 2006, which established a system of registration and regulation of NRSROs and instructed the SEC to formulate implementing rules. The CRA Reform Act effected three changes in the SEC’s regulation of NRSROs. First, it added definitions of “credit rating,” “credit rating agency,” “nationally recognized statistical rating organization,” and “person associated” with an NRSRO. Second, it replaced the SEC’s no-action letter procedure for recognizing NRSROs with a registration procedure, and also imposed substantive requirements on NRSROs with respect to misuse of nonpublic information, conflicts of interest, and anticompetitive or abusive conduct. Third, it amended the Exchange Act to include NRSROs among the types of entities subject to SEC record-keeping and reporting requirements.

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246. UNCTAD Elkhoury Discussion Paper, supra note 227, at 12
In June 2007, the SEC passed rules implementing the CRA Reform Act. These rules set forth basic registration requirements for NRSROs and obligations to update registration forms. Further rules subject NRSROs to recordkeeping and annual financial reporting rules, and require NRSROs to establish procedures to prevent the misuse of confidential information and to manage conflicts of interest. Finally, NRSROs are prohibited from certain anticompetitive or abusive practices relating to tying the issuance or level of a credit rating to an issuer's purchase of services or products in addition to the credit rating.

IOSCO continued to work on the problems posed by CRAs and in March 2008, issued a Consultation Report on the role of CRAs in structured finance markets, as well as a new Code of Professional Conduct. This new code did not recommend any sweeping overhaul, and Charles McCreevy, the European financial commissioner, called it "toothless" and has been pushing for EU regulation of CRAs. It is unclear what form any such EU regulation would take, but it could involve registration of CRAs with CESR, or the creation of a European rating agency to break the dominance of the big U.S. firms. On December 3, 2009 the SEC adopted new rules aimed at the conflicts of interest at CRAs. These amendments impose additional disclosure requirements on CRAs with respect to verification of structured finance assets; assessments of the quality of structures finance transaction originators; and surveillance. Also, these amendments would add prohibited conflicts to NRSRO rules. Although these rules were welcomed by some, others criticized the rules as not going far enough. EU regulators are also continuing to propose new regulations for CRAs. These rules will regulate conflicts of interests, disclosures, internal policies, and business practices of CRAs, and as stated by SEC Chairman Christopher Cox, reflect the input

259. Id.
of a number of international regulatory organizations, including the Financial Stability Forum and IOSCO. Further, the SEC conducted a sweeping investigation of CRAs. Its findings have now been made public, and it is likely that the SEC will now move forward with enforcement actions.

While it remains to be seen how the SEC or the European Union, or other governmental bodies, will proceed to further regulate CRAs, the move from soft law to hard law in this area is interesting because, unlike the other stories in this Part of the Article, progress was very quick. Confronted with opposition to government regulation of CRAs, the SEC turned to IOSCO to formulate a soft law standard of conduct. But the bursting of the technology bubble, and the subprime meltdown and credit freeze in the global markets allowed government officials to blame CRAs (among others) for these economic debacles and to swiftly pass U.S. legislation giving the SEC statutory authority to exercise oversight of CRAs, and the SEC has proceeded to pass implementing regulations. Quite possibly, the European Union will now move to similarly regulate CRAs, although EU regulations could conflict with U.S. regulations and


then throw this problem back to IOSCO or some other international body to harmonize new regulations.

III. SOFT LAW CONSEQUENCES

Soft law has advantages and may be necessary for securities regulation, but it also raises some concerns. First, there is the problem of soft law’s legitimacy, which is important because of both normative and instrumental concerns. Second, in the United States, the creation of international soft law and its subsequent hardening arguably occurs outside of the constitutional framework for international agreements. We are not overly troubled by what we consider largely academic arguments concerning soft law’s constitutionality, given that most soft law instruments are not treaties as contemplated by the Constitution, and given the power that exists and is exercised in the administrative state by agencies. But we are concerned with the fundamental issues of accountability, checks against abuses, and transparency that these arguments raise. Still, one cannot lose sight of the valuable alternative to regulatory competition that soft law offers, namely cooperation. Multiple regulatory venues foster regulatory competition and the race to the bottom. Commentators disagree over whether such a pattern is detrimental,262 but for those who think it is, soft law serves as a valuable framework in the absence of an economic hegemon that might persuade or pressure others to avoid the race to the bottom.

A. The Legitimacy Problem

States, and the people in them, should reasonably be able to expect that the laws they live under were legitimately established. At first blush, the legitimacy of soft law seems a nonissue. After all, since soft law is non-

binding, a State could simply not adopt or follow it. Since nothing compels a State to follow soft law, one may not care whether the norms embodied in that soft law are legitimate. But States do follow soft law. States sometimes follow soft law until the point where it hardens. Thus, if we care about the idea that laws should possess some basis for compelling behavior, even if the compulsion to follow that norm evolves slowly over time, then soft law’s legitimacy matters.

In addition to normative considerations, legitimacy matters because it affects compliance. International rules generally secure compliance in one (or a combination) of three ways: coercion, self-interest, or legitimacy. Although coercion may initially seem like the most powerful tool, it is not—especially in the international setting. Going to war to enforce a rule is an extraordinary step. More likely, States will follow rules not because of coercion, but because they will benefit by doing so and/or they believe that they should follow the rule because the rule is legitimate. Thus, a rule’s legitimacy causes a compliance pull; States are drawn to comply in part because they perceive the rule as legitimate.

Legitimacy is also important because it mitigates some of the uncertainties created by soft law. While it can be a valuable tool for policymakers, some soft law can leave us without real rules that actually im-

265. Christine Chinkin, Normative Development in the International Legal System, in COMMITMENT AND COMPLIANCE, supra note 263, at 21, 32 (discussing that repetition and compliance may indicate the hardening of soft law into customary international law, but also noting that the level of compliance required for the transformation is uncertain).
267. HURD, AFTER ANARCHY, supra note 66, at 35.
268. HAKT, supra note 65, at 82 (discussing that coercion is a logical starting point when examining compliance with the law, but that it does not fully explore the concept of obligation). See also id. at 217–18 (discussing that coercion undermines the importance of obligation in the international sphere).
269. Id. at 219.
270. See HURD, AFTER ANARCHY, supra note 66, at 37–38 (noting that self-interest and legitimacy as means of compliance are preferable to coercion because the latter necessarily “leaves the coerced worse off than before”).
plement the policies that are needed. As José Alvarez points out: "[w]hen everything—from ‘guidelines’ to commitments made in loan agreements—can be regarded as legally significant, even if not equally legally binding, there is understandable fear that law and lawyers will lose their value to the policymaker, that if everything is ‘law,’ nothing, in the end, will be." Identifying soft law’s legitimacy is thus important, as it not only enhances compliance, but also distinguishes it as law in the first place.

Legitimacy can be assessed by means that can be roughly placed in two categories, input and output legitimacy. Input legitimacy focuses on what goes into the development of norms, while output legitimacy focuses on the usefulness of the end product. One form of input legitimacy is where States consent to be bound to a treaty, for example. Many would agree that the rules contained in the treaty are legitimate. Where democratic States consent to treaties pursuant to nationally accepted procedures, such treaties would appear to be supported by the consent of the State as well as its voting citizenry. Input legitimacy may also be claimed where an international organization allows for the participation of those affected by its rules, i.e., representative legitimacy. Another


273. ALVAREZ, supra note 264, at 627.

274. Keohane & Nye, supra note 190, at 12–16.

275. See ALVAREZ, supra note 264, at 391 (discussing that treaty negotiations derive legitimacy from their processes because of the expectation that the resultant treaty’s rules will be applicable to all States involved and noting that even nonparties may be persuaded to follow the codified norms).

276. Daniel C. Esty, Good Governance at the Supranational Scale: Globalizing Administrative Law, 115 YALE L.J. 1490, 1515–16 (2006) (discussing democratic legitimacy). See also Keohane & Nye, supra note 190, at 12–13 (noting that publics can easily judge whether to accept a product of international negotiations if their respective governments have operated in a transparent manner consistent with the states’ political systems). States also consent to work within international organizations. However, when these organizations create rules, the process of consent is further removed from the people affected by these rules and a democratic deficit is sometimes claimed. Id. at 21. The rules that emanate from these organizations are seen as lacking input legitimacy. See Esty, supra note 276, at 1502–03 (stating that international organizations suffer from “serious legitimacy issues” because the decision-making process is so far removed from the public).

277. See Keohane & Nye, supra note 190, at 14.
form of input legitimacy stems from process.\textsuperscript{278} Rules may be considered legitimate because they are the product of good procedures (and are therefore more likely to be both effective and more representative).\textsuperscript{279}

Alternatively, legitimacy may be claimed by virtue of the fact that the rules are effective—they do what they are supposed to do.\textsuperscript{280} Assessing the effectiveness of rules is a form of output legitimacy.\textsuperscript{281} People perceive the rules as legitimate because they are good rules; they work. Naturally, this assessment requires an assumption about what is a good rule or what works.\textsuperscript{282} Ultimately, as Ian Hurd explains, legitimacy is a matter of perception.\textsuperscript{283} Something is legitimate because one party believes that it is legitimate. It is a subjective understanding that is based upon a claim.\textsuperscript{284} That claim—the claim to legitimacy—can be assessed objectively using representation, process, or effectiveness.\textsuperscript{285}

Assessing the legitimacy of soft law poses some unique challenges. First, since it is typically not treaty law, the claim to legitimacy based upon consent is not available. Moreover, claims of representativeness may be difficult to sustain as well. While organizations representing States may generate soft law, these organizations may suffer from the democratic deficit charge.\textsuperscript{286} For example, state agencies comprise IOSCO, but as others have argued, the United States dominates the Technical Committee, which sets the fundamental standards.\textsuperscript{287} Input

\begin{itemize}
  \item \textsuperscript{278} Esty, supra note 276, at 1521.
  \item \textsuperscript{279} Id. at 1519–20 (discussing systemic legitimacy).
  \item \textsuperscript{281} Keohane & Nye, supra note 190, at 15–16 (discussing output legitimacy in terms of effectiveness).
  \item \textsuperscript{282} Kelly, supra note 35, at 619.
  \item \textsuperscript{283} Hurd, After Anarchy, supra note 66, at 7. See also Ian Hurd, \textit{Legitimacy, Power and the Symbolic Life of the UN Security Council}, 8 GLOBAL GOVERNANCE 35, 38 (2002).
  \item \textsuperscript{284} Hurd, After Anarchy, supra note 66, at 7.
  \item \textsuperscript{285} Kelly, supra note 35, at 608 (identifying input and output criteria for assessing legitimacy).
  \item \textsuperscript{286} See supra note 276 and accompanying text. See also Alvarez, supra note 264, at 630–31 (stating that rules and standards promulgated by international organizations “lack the legitimation of national law produced through democratic processes”).
  \item \textsuperscript{287} The Technical Committee is currently comprised of fifteen member organizations, two of which—the SEC and the CFTC—are U.S. organizations. IOSCO Committee Lists, http://www.ioasco.org/lists/display_committees.cfm?cmtid=3 (last visited Feb. 5, 2009). Cf. Beth A. Simmons, \textit{The International Politics of Harmonization: The Case of Capital Market Regulation}, 55 INT’L ORG. 589, 594–95 (2001) (discussing the dominance of the United States and the United Kingdom in international equity markets and high-
legitimacy in the form of process can likewise be problematic because soft law often gels behind closed doors or in a club organization. Some organizations have responded to this concern. IOSCO has procedures to promote transparency and public participation. Nevertheless, the Executive and Technical Committee Meetings are still closed to the public.

The claim to effectiveness as a basis of output legitimacy seems most appealing, but it is difficult to assess. First, one must assume that the "good" outcome is in fact a good outcome. A second concern is that effectiveness for one set of participants may not be the same for another.

lighting that regulatory standards promulgated to ensure "best practices" generally stem from the practices of one or both of these countries). See also Bradley, supra note 99, at 137 (noting that IOSCO tends "to be dominated by members from northern, economically developed States").

288. Janet Koven Levit, A Bottom-Up Approach to International Lawmaking: The Tale of Three Trade Finance Instruments, 30 YALE J. INT'L L. 125, 131 (2005) (describing club organizations as secretive and stating that their industry-specific rules nonetheless tend to mature into law); Zaring, supra note 79, at 562 & n.64 (noting that IOSCO has been characterized as a club organization).

289. Zaring, supra note 79, at 563–65 (describing IOSCO's efforts to comply with requests for information, to provide information to the public through its website, to allow SROs to contribute to the rulemaking process, and to maintain comment periods). For example, the Technical Committee's report of its work program was made public in 2007 for the purpose of soliciting comments and suggestions from stakeholders. IOSCO, An Overview of the Work of the IOSCO Technical Committee, at 2–4 (July 2008), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD278.pdf. In response, IOSCO received comments from seventeen different organizations. IOSCO, Comments Received in Relation to the Consultation Report on "An Overview of the Work of the IOSCO Technical Committee," at 2 (June 2007), available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD251.pdf.

290. See Conference Programme—IOSCO 2008, http://www.iosco2008.org/spip.php?rubrique26 (last visited Feb. 5, 2009) (detailing the schedule for IOSCO's 2008 Conference and dividing sessions according to those open only to IOSCO members and those open to the general public). Likewise, IASB is an expert-driven standard-setting organization. About the IASB, supra note 85. Amid criticisms that its standards were not fully legitimate because of its dependence on private funding, the organization "focused on increasing the transparency of its standards-making processes." Bradley, supra note 99, at 177–78. Following public consultations in 2004 and 2005, IASB issued a "Due Process Handbook," which describes in detail its procedures for standard setting, transparency, and accountability. IASB, DUE PROCESS HANDBOOK, supra note 95, ¶ 4–17. Nonetheless, the organization remains "an independent group of experts." Id. ¶ 5.

Whether the OECD Anti-Bribery Convention ultimately works well might be a different question for Canada than for Nigeria. A large, wealthy country may find some rules effective, while a weaker country might not. Third, effectiveness can be disputed, and it sometimes takes a great deal of time to determine whether a standard is effective. Some gaps only appear over time. The NRSROs were effective for years before the recent crisis.

Soft law securities regulation thus raises some legitimacy problems. The basis of its legitimacy seems most solidly rooted in its claim to effectiveness, a claim that is sometimes hard to substantiate. Still, it seems worthwhile to consider ways in which the legitimacy of soft law securities regulation can be improved from an input perspective. Good procedures are helpful to promote debate and develop better rules. However, procedures can impede progress and increase costs. Similarly, input legitimacy claims would benefit from greater transparency and participation by those affected by the resulting rules, even if national regulators will exercise a fair degree of discretion implementing those rules. But again, participation slows things down and one would need to consider the possibility of capture and distortion in the rulemaking process.

B. Constitutional Queries

International soft law securities regulation poses some constitutional queries, which are in large part academic, but nonetheless prompt questions concerning procedure, accountability, and transparency. First, in the United States, international agreements are constitutionally enacted as Article II treaties, congressional-executive agreements, or executive

292. Kelly, supra note 35, at 621–22 (discussing the shortcomings of effectiveness as a determinant of legitimacy).

293. See Unterman, supra note 69, at 122–25 (stating that the recent “monumental failings are indicative of the poor health of the ratings industry” and that conflicts of interest within the industry further emerge as the rating agencies extend their services without regulation).


296. Id. at 87 (noting the limitations on extensive participation in the international regulatory realm).
agreements. Each of these methods has a constitutional foundation that reflects the role of the executive and legislative branches. The regulation of securities through the development of international soft law arguably operates outside of this framework. Second, we are somewhat concerned about what seems to be the delegation of standard-setting power to international bodies where those standards are then codified into U.S. law. We do not suggest that these arguments be given much merit, as we think it is largely a theoretical exercise, and we believe that international soft law securities regulations, on balance, are a good thing. Moreover, we feel that these delegations may be necessary in order to achieve regulatory cooperation and that they are not inconsistent with the level of delegations currently permitted under U.S. constitutional analysis. Nevertheless, reflecting upon these theoretical constitutional concerns prompts us to consider the principles underlying our constitutional structures, i.e., procedures for checks and balances, transparency, and accountability, and how those principles should be applied to international soft law development.

In the United States, treaties are “agreement[s] between two or more states or international organizations that [are] intended to be legally binding and [are] governed by international law” and may be negotiated in


298. The text of the Constitution grants the president the authority to enter into treaties on behalf of the United States. U.S. Const. art. II, § 2, cl. 2. Although Article II confers authority on the Senate to approve treaties, Article I grants both Houses the ability to regulate foreign commerce; thus, Congress is within its powers in authorizing the president to negotiate and conclude congressional-executive agreements. E.g., Made in the U.S.A. Found. v. United States, 242 F.3d 1300, 1313 (11th Cir. 2001) (referencing this power with specific regards to the North American Free Trade Agreement). Similarly, the Constitution does not grant specific authority to the president to enter into executive agreements. The power to do so, however, is traditionally found in “the presidential responsibility of representing the country in foreign affairs, the authority to receive ambassadors, the role of the commander-in-chief of the military, and the obligation to ‘take care that the laws be faithfully executed.’” Robert J. Spitzer, The President, Congress, and the Fulcrum of Foreign Policy, in The Constitution and the Conduct of American Foreign Policy 95 (David Gray Adler & Larry N. George eds., 1996).

299. See supra Part II.B.

300. See The Federalist No. 9, at 72–73 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (stating that checks and balances and electoral representation are powerful principles by which republican government is enhanced); The Federalist No. 10 (James Madison), id. at 81–83 (noting that finding the optimal ratio of elected representatives to constituents is essential to ensuring that public interest is accurately represented).

a variety of constitutionally acceptable ways. First, Article II of the U.S. Constitution provides that the President shall have the power to negotiate treaties with the "advice and consent" of the Senate.\textsuperscript{302} While this treaty power may be well-known, it is certainly not the most frequently exercised.\textsuperscript{303} Rather, most international agreements are not really treaties as contemplated by Article II of the U.S. Constitution; they are executive agreements or congressional-executive agreements.\textsuperscript{304} These are international agreements where the President acts pursuant to either his inherent or statutory powers.\textsuperscript{305} International soft law, however, evolves, and sometimes hardens, outside of these frameworks.

\begin{itemize}
  \item \textsuperscript{302} U.S. Const. art. II, § 2, cl. 2 ("[The President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur.").
  \item \textsuperscript{303} See Stefan A. Riesenfeld & Frederick M. Abbott, The Scope of U.S. Senate Control over the Conclusion and Operation of Treaties, 67 Chi.-Kent L. Rev. 571, 636–37 (1991) (discussing the rise to prominence of executive and congressional-executive agreements over treaties).
  \item \textsuperscript{305} Jeff Nemerofsky, Livinov Lives?: U.S. Investors May Be Playing Russian Roulette, 8 Mich. St. U.-DCL J. Int’l L. 487, 492–93 (1999). The president may enter into executive agreements pursuant to his or her independent constitutional powers. Restatement (Third) of Foreign Relations Law of the United States § 303(4) & cmt. a. Because they do not require independent approval, executive agreements are quicker and easier to conclude. Congressional-executive agreements, however, are treaty-like in both substance and magnitude and are thus preferred, if not required, over executive agreements in cases concerning "material long-term agreements." Michael D. Ramsey, The Constitution’s Text in Foreign Affairs 197–98 (2007). In congressional-executive agreements, the president has been pre-approved by Congress to commit the United States to subsequently enact legislation. John H. Jackson, The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results, 36 Colum. J. Transnat’l L. 157, 168 (1997) [hereinafter Jackson, Sovereignty Debate]. Thus, for example, both the General Agreement on Tariffs and Trade and the Agreement Establishing the World Trade Organization are congressional-executive agreements. Spiro, supra note 304, at 962, 983 (noting the establishment of WTO specifically, and the Uruguay Round generally). The process involved in these agreements is sometimes referred to as a “fast track” or “statutory” approval for what would otherwise be considered a treaty. Jackson, Sovereignty Debate, supra note 305, at 168 & n.21. Understandably, it would have been impossible for the United States to negotiate complicated tariff and trade liberalization commitments with over 100 nations unless those nations were assured that the agreement would not falter in the typical treaty ratification process under Article II. See John K. Setear, The President’s Rational Choice of a Treaty’s Preratification Pathway: Article II, Congressional-Executive Agreement, or Executive Agreement?, 31 J. Legal Stud. S5, S27 (2002) (discussing that for trade agreements
Initially, even though soft law develops outside of the treaty system, it does not seem troubling because it is not binding. The Case-Zablocki Act requires the Secretary of State to compile and publish "United States Treaties and Other International Agreements" for each year.\textsuperscript{306} The regulations under the Act set forth the criteria for identifying treaties and international agreements, namely that they (1) identify the parties as States, agencies, or IGOs, and their intent to be bound by international law;\textsuperscript{307} (2) be of political or financial significance, or pertain to technical cooperation or assistance;\textsuperscript{308} (3) be specific and contain "objective criteria for determining enforceability";\textsuperscript{309} and (4) must at least be bilateral.\textsuperscript{310} Soft law is not "treaty law" because it does not purport to bind either by intent or by its terms, nor does it contain explicit provisions for enforceability.\textsuperscript{311}

Soft law sometimes hardens into binding treaty law. That hardening may occur, as in the OECD Anti-Bribery Convention, after soft law moves normative positions far enough that States are willing to make a hard law commitment in a form of agreement already recognized as constitutionally acceptable. But other times, soft law hardens through regulatory codification. One recent example of regulatory codification involves CRAs. Since the collapse of Enron there has been increased focus on the appropriate regulations of CRAs.\textsuperscript{312} While national regulators have stu-
died the problem, so have international bodies such as IOSCO and the Financial Stability Forum. IOSCO’s Consultation Report of 2008 and new Code of Professional Conduct represent soft law.\textsuperscript{313} However, the SEC’s current regulatory initiatives for CRAs that incorporate some IOSCO and Financial Stability Forum input are solidifying international soft law into hard law. Another example concerns IFRS. The SEC currently has out for comment proposed rules and a roadmap that would require U.S. companies to state their financials in accordance with IFRS, again transforming international soft law into domestic hard law. Also, the SEC amended its foreign issuer disclosure forms to replace the non-financial disclosure forms with ones substantively endorsed by IOSCO.\textsuperscript{314}

Where soft law hardens via regulatory action, the practical effect seems indistinguishable from hard law codified after the conclusion of a treaty. In the United States, agency regulations, if enacted pursuant to delegated authority and not arbitrary and capricious, are the law,\textsuperscript{315} just as a statute implementing a treaty is the law. In the case where the SEC uses substantive norms developed by IOSCO, assuming that the SEC acted within its regulatory mandate (and pursuant to proper procedure), the only remaining question would be whether the substantive standard was arbitrary and capricious.\textsuperscript{316} One could envision a situation where the SEC’s case for nonarbitrariness was bolstered by the fact that the standard had been developed by an international organization.\textsuperscript{317} The result is hard law.

Admittedly, one can argue that soft law is of no constitutional concern until a constitutionally acceptable codification occurs. Thus, for example, despite the soft law evolution of the OECD Anti-Bribery Convention, the

\begin{footnotesize}
\begin{enumerate}
\item[313.] See \textit{supra} note 255 and accompanying text.
\item[315.] Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843-44 (1984) (stating that where Congress had delegated authority to an agency to fill gaps in legislation, that agency’s “regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute”) (citations omitted).
\item[316.] Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42-45 (1983) (accepting petitioner’s construction of the arbitrary and capricious standard and agreeing that if an agency is within its mandate, the Court may not set the agency’s rules and standards aside unless they are not rationally linked to relevant data).
\item[317.] Bradley, \textit{supra} note 99, at 138 (noting that international standards may receive the benefit of the doubt when domestic regulators consider implementing them).
\end{enumerate}
\end{footnotesize}
final binding instrument was an Article II treaty that was signed by the President and ratified by the Senate.\(^{318}\) Up to that point, the negotiations at the OECD did not have any constitutional significance. Even codification through the regulatory process seems unobjectionable as long as the agency has the authority to enact the regulations and the choice of the internationally set standard is not arbitrary and capricious.

But sometimes soft law operates like hard law prior to any codification. For example, as discussed above, MOUs are not legally binding instruments.\(^{319}\) They are negotiated between the SEC and foreign regulators.\(^{320}\) Despite their nonbinding status, however, these agreements are followed.\(^{321}\) As previously noted, in 2007, the SEC made 556 requests to foreign regulators for assistance and information under MOUs and responded to 454 requests.\(^{322}\) Likewise, in 2005, IOSCO required that all of its members sign or commit to signing its MMOU by 2010.\(^{323}\) This "nonbinding" agreement is now virtually mandatory.

Theoretically, if MOUs were considered treaties, they would fail to satisfy our constitutional framework. They are negotiated and agreed to by an independent agency, the SEC.\(^{324}\) They cannot be characterized as executive agreements, as it would be very difficult to argue that the matters they concern fall under inherent presidential powers;\(^{325}\) nor are they congressional-executive agreements.\(^{326}\) Assuming arguendo that one could view the SEC as negotiating on behalf of the executive, there is no ex ante congressional authorization to do so. Subsequent congressional au-

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319. JOHNSTON, supra note 154, at 37 (discussing that MOUs are accorded "less-than-treaty status" because of their informality and nonbinding form).

320. STEINBERG, supra note 155, at 205.

321. See supra notes 157–58, 164 and accompanying text (discussing SEC requests to foreign regulators under MOUs).


324. See text accompanying supra notes 154–56, 158 (discussing the first MOU signed by the SEC and Switzerland in 1982, and the Office of International Affairs).

325. See supra note 302 (discussing the derivation of authority by the executive to enter into international agreements).

326. See supra note 298, 304–05 and accompanying text (citing the ability of Congress to delegate its powers to the executive for the purposes of concluding international agreements).
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...ination that speaks to only one class of MOUs does not validate the process in all instances.

Nevertheless, we believe that these instruments are not binding and a treaty powers analysis does not foreclose international soft law securities regulation. It may be formalistic to say that these agreements are not binding until they are binding, but given the myriad of ways in which soft law forms and hardens over time, a line must be drawn at some point. That point, in our view, should be where States formally commit to bind themselves, even if in practice States may routinely comply with obligations prior to such time.

A more challenging constitutional concern, in our view, is the nondelegation question. The nondelegation doctrine prevents the abdication of lawmaking power by Congress. Congress must give an agency an intelligible principle in order to fulfill its legislative mandate. The SEC's negotiation of MOUs seems dangerously close to agency lawmaking without an intelligible principle and without sufficient safeguards.

327. In 1989, Congress amended the Exchange Act by adding § 21(a)(2), which gave the SEC the authority to cooperate with requests for information from foreign regulators and allowed the SEC discretion in deciding whether to supply the information. The SEC is to consider two factors when deciding to provide assistance: reciprocity and the U.S. public interest. Specifically, the first consideration is "whether . . . the requesting authority has agreed to provide reciprocal assistance." Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, sec. 6(b), § 21(a), 102 Stat. 4677, 4681-82 (codified as amended at 15 U.S.C.A. § 78u(a)(2) (2008)). Then in 1990, Congress amended the Exchange Act again to include a section stating that the SEC "shall not be compelled to disclose records obtained from a foreign securities authority if . . . the Commission obtains such records pursuant to . . . a memorandum of understanding." International Securities Enforcement Cooperation Act of 1990, Pub. L. No. 101-550, sec. 201-02, § 24(d), 104 Stat. 2713, 2714-15 (codified as amended at 15 U.S.C.A. § 78x(d) (2008)). These amendments, however, merely recognized the SEC's information-sharing MOUs—they did not grant the agency further authority to conclude future MOUs.

328. Cass Sunstein, Nondelegation Canons, 67 U. CHI. L. REv. 315, 315 (2000) (stating that traditionally the purpose of the nondelegation doctrine was "to ensure that law is made by the national legislature rather than by the executive").

329. Whitman v. Am. Trucking Ass'ns, Inc., 531 U.S. 457, 472 (2001) (stating that since the Constitution vests lawmaking powers in Congress, the delegation of congressional authority must be specific and provide an "intelligible principle" (quoting J. W. Hampton, Jr., & Co. v. United States, 276 U.S. 394, 409 (1928)). See also Sunstein, supra note 328, at 318 (identifying the "intelligible principle" requirement).

330. While the SEC's mandate is "to enforce . . . securities laws, to promote stability in the markets and, most importantly, to protect investors," Congress did not specifically authorize the SEC to enter into information-sharing MOUs with foreign regulators. The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, http://www.sec.gov/about/whatwedo.shtml (last visited Feb. 14, 2009) (noting the purpose behind the SEC's formation). See also supra note 161-62 and accompanying text (discussing congressional amendments to the Exchange
While the nondelegation doctrine gives us pause, ultimately we feel that the practical benefits of international soft law instruments weigh in favor of a generous view of delegation, consistent with that of the Supreme Court with respect to domestic lawmaking.\(^{331}\)

The constitutional status of MOUs and other international soft law instruments that may harden at some later date is (and in our opinion should remain) a theoretical question. These soft law instruments are expedient, flexible, and very useful. The time and burdens of negotiating either an Article II treaty or a congressional-executive agreement would impede effective and timely standard setting.\(^{332}\) The delegation question, although somewhat troubling, occurs in the domestic setting as well. But the constitutional inquiry should cause us to at least consider the values that support our constitutional system: procedures for checks and balances, accountability, and transparency. While soft law may escape constitutional objections, it should be supported by the foundational values akin to those underlying our constitutional system, i.e., division of powers, accountability, and transparency.\(^{333}\)

The division of powers provides checks and balances against the abuse of power.\(^{334}\) The process by which the United States enters into binding

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332. See *supra* notes 301, 305, 307–10 and accompanying text (discussing the processes of concluding Article II treaties and congressional-executive agreements).

333. See *The Federalist* No. 9 (Alexander Hamilton), *supra* note 300, at 72–73 (discussing that although they were “wholly new discoveries” at the time, republican principles of power distribution, checks and balances, and representation would help to perfect the Framers’ choice of government); *The Federalist* No. 10 (James Madison), *id.* at 81–83 (noting that the proper ratio of representatives to constituents results in greater accountability and transparency).

334. See *The Federalist* No. 47 (James Madison), *id.* at 301 (responding to charges that the Constitution violated the “political maxim” that the three governmental branches must be entirely “separate and distinct”). Madison discussed the necessity of the separation of powers amongst governmental branches, but noted that the branches must be somewhat intermingled if they are to prevent the usurpation and abuse of power. *Id.* at 302–04 (citing the New Hampshire constitution in declaring that the branches should be entirely independent of each other only to the extent that it “is consistent with the chain of connection that binds the whole fabric of the constitution in one indissoluble bond of unity and amity”). See also *The Federalist* No. 48 (James Madison), *id.* at 308 (discussing that this “blending” of the branches affords each a check on the other two, and thus
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international agreements envisions a role for both the legislative and the executive branches (save for those issues solely within the executive's power). Some soft law instruments, such as MOUs or IASB accounting standards, may endanger this balance. When soft law hardens into international obligations, it would seem fair to question whether the manner in which it evolved had sufficient protections against the abuse of power.

The lack of input from both the executive and legislative branches raises problems of accountability. Where internationally set standards fall short or fail, a question arises as to who can be held accountable. Arguably, if the IASB standards or MOUs fail, then blame can lay with the SEC the same way it would if any standard or rule set by the SEC failed. However, the SEC may not be called to task for such failures; blame may be levied at the international system instead. There may be a backlash against international cooperation, and that backlash may occur in multiple jurisdictions. Additionally, the SEC could seek greater au-

maintains the maxim of free government in a way that complete separation could never achieve).

335. U.S. CONST. art. II, § 2, cl. 2 (granting power to the president to make treaties with the Senate's advice and consent); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 303 (1987) (listing four ways by which the United States may enter into binding international agreements, the first three of which require Senate or congressional approval on some level, and the final being pursuant to the executive's sole authority).

336. See Chris Kentouris, Harmonizing Accounting Standards No Easy Task—Uniformity Could Promote Cross-Border Investment, But When?, SEC. INDUS. NEWS, June 30, 2008 (discussing support for an overseeing body to monitor the IASB and facilitate cooperation among regulators and standard setters); Floyd Norris, S.E.C. Says Foreign Companies Do Not Have to Adjust to U.S. Accounting, N.Y. TIMES, Nov. 16, 2007, at C8 (discussing concerns that there is no international equivalent of the SEC to ensure consistent enforcement of international standards and also noting that European officials are skeptical of the IASB because it is not currently politically accountable). Cf. David Reilly & Kara Scannell, Global Accounting Efforts Gain a Step—SEC Drops Requirement on Foreign Companies, but Other Challenges Loom, WALL ST. J., Nov. 16, 2007, at A4 (noting that the IASB could be “buffered from political interference”).


thority from Congress, claiming that the failure stemmed from the lack of authority to regulate as it would like. 339

Perhaps the most difficult problem is the lack of transparency that is endemic to international standard setting. The development of international soft law and its hardening are particularly susceptible to nontransparency. 340 Experts that develop standards, rules, or guidelines that become soft law sometimes do so without the participation or even knowledge of the wider public. 341 The OECD is a club organization that has a limited number of members from the wealthiest nations. 342 Yet its anti-bribery work targeted activities that occurred throughout the developing world. IOSCO is a club of securities regulators. 343 But it is dominated by Amer-
ican regulators.\textsuperscript{344} Even when soft law emerges from the international agreement process that surrounds MOUs, it can be the result of compromise that is hidden from the public view.\textsuperscript{345} In fact, MOUs are often used because of the parties’ concerns regarding confidentiality.\textsuperscript{346} Sometimes, private actors who are unaccustomed to acting in the public view are involved. The FASB and the IASB standards are established by an industry, not a legislator or regulator. The rating agencies established criteria that were, in effect, adopted by the SEC by virtue of its recognition of NRSROs.\textsuperscript{347} Private actors are not necessarily accustomed to acting in a transparent manner and may need to adopt specific procedures to become transparent.\textsuperscript{348} Admittedly, private actors influence the national legislative process as well. Legislation evolves through the efforts of private parties, industry, or even regulators who lobby the legislative branch to adopt laws.\textsuperscript{349}

International soft law is also less transparent because it usually takes the form of standards rather than rules. International standards usually

\textsuperscript{344} See supra note 287 and accompanying text.

\textsuperscript{345} Chinkin, \textit{Challenge of Soft Law}, supra note 272, at 861 (stating that “[t]he use of a soft law form is often a compromise”); Kal Raustiala, \textit{Form and Substance in International Agreements}, 99 AM. J. INT’L L. 581, 597 (2005) (discussing soft law agreements as “pacts” and noting that they are more confidential than other international agreements and that use of them “lessens the likelihood that Congress—and domestic interest groups—will be aware of an agreement or able to capitalize politically on criticism of it”).

\textsuperscript{346} JOHNSTON, supra note 154, at 37–38 (noting the desirability of MOUs where confidentiality is a concern). MOUs are ideal for this purpose because so few are published. ANTHONY AUST, \textit{MODERN TREATY LAW AND PRACTICE} 43 (2007). Additionally, in the United States, all binding international agreements must be reported to Congress, regardless of their secretive subject matter. Case-Zablocki Act, 1 U.S.C.A. § 112b(a) (2008). But if MOUs are carefully constructed so as not to create binding rights and obligations, they do not have to be reported to Congress or the State Department. See 22 C.F.R. § 181.2(a) (1981) (stating that all criteria must be met for a document to be construed as an international agreement within the purview of the Case-Zablocki Act).

\textsuperscript{347} SARBANES-OXLEY REPORT, supra note 231, at 6–9 (describing the function and recognition process for NRSROs).

\textsuperscript{348} Mattli & Buthe, supra note 86, at 261 (discussing that while private bodies are advantageous to international regulation, they provide less transparency and accountability than public regulatory bodies). See also id. at 258 (noting that following the Enron collapse, institutions including the IASB were pressured to adopt more transparent procedures and provide greater public access to their rulemaking processes); IASB, DUE PROCESS HANDBOOK, supra note 95 (detailing IASB’s new due process standards in response to criticisms concerning accountability and transparency).

\textsuperscript{349} International standard setting may involve foreign parties or regulators whose presence may raise additional sovereignty concerns. However, international regulatory cooperation will necessarily involve some diminution of sovereignty.
grant a fair amount of discretion to national regulators. Discretion is, by definition, nontransparent. In IOSCO, national regulators develop standards that grant those same national regulators a great deal of discretion in implementation.\textsuperscript{350} The fact that discretion is endorsed by an international organization (made up of those same regulators) seems troubling.

A lack of transparency is particularly worrisome because transparency guards against two problems that are of particular concern internationally: capture and conflicts of interest.\textsuperscript{351} Both capture and conflicts of interests are problems in the domestic arena, however, as regulatory cooperation proliferates, the incentives for capture, the danger of conflicts, and the harm that can come from either are magnified.\textsuperscript{352} The incentives for capture and conflicts are not increased in the international sphere, but the dangers posed by them are magnified in this globalized world. The systemic and global effects of a regulatory failure are palpable. The recent credit rating crisis serves as an example.\textsuperscript{353} Moreover, the collateral damage from securities law failures now reaches the public even if it did not before. Pensioners, municipalities, and entities that invest in the market, from universities to charitable funds, all rely upon a well-functioning securities system.\textsuperscript{354} Thus, although the international soft law deficiencies may mirror those found domestically, their potential impact seems greater, and care should be taken to address them.

\textbf{C. Regulatory Competition v. Regulatory Cooperation}

Soft law may offer an alternative to regulatory competition by facilitating regulatory cooperation. The absence of a single international securities law regulator creates the potential for a classic regulatory race to the

\textsuperscript{350} IOSCO, Objectives and Principles of Securities Regulation, supra note 73, at 3 (stating that IOSCO members are to “use their best endeavors within their jurisdiction to ensure adherence to [the] principles” and noting that however each regulator implements the principles, they should take “the entire domestic context” into account).

\textsuperscript{351} Stewart, supra note 295, at 83 (stating that transparency allows the public to see the facts underlying decision making, which opens the process to scrutiny and can “alleviate information asymmetries, and check the influence of narrow interest groups”).

\textsuperscript{352} See supra notes 294–96.

\textsuperscript{353} Unterman, supra note 69, at 122–24 (discussing the failures and conflicts of interest of the rating agencies and noting that these failures resonate globally because of the tremendous power CRAs have in both domestic and international markets).

\textsuperscript{354} See, e.g., Arthur Levitt, Jr., Opinion, Standards Deviation, WALL ST. J., Mar. 9, 2007, at A15, ¶ 1 (stating that “[t]he potential for crisis in municipal finance arguably is worse than that in corporate America”); Reilly & Scannell, supra note 336, at A4 (noting that large institutional investors such as Calpers are concerned about the possibility of international accounting standards because inconsistent application of such standards would affect the credibility of financial disclosures).
bottom. Race to the bottom theorists assume that regulatory competition and the lack of a single mandatory framework will encourage managers to incorporate in jurisdictions that have the least demanding regulatory structure.\textsuperscript{355} Others propose that regulatory competition can be beneficial.\textsuperscript{356} The authors believe that without the leadership of an economic hegemon to insist upon some fundamental minimum standards, it is likely that international securities regulation will remain weak and reactive.

The availability of multiple regulatory jurisdictions leads to harmful regulatory competition. Without binding standards, States are free to adopt whatever standards they feel are best. States wishing to make themselves more attractive business centers will opt for standards that are more favorable to those businesses.\textsuperscript{357}

Others disagree. Race to the top theorists contend that regulatory competition will promote efficiency and that efficiency ultimately benefits investors.\textsuperscript{358} A variety of regulatory frameworks provides managers with options to respond to investor preferences.\textsuperscript{359} As preferences are revealed and management responds in order to produce efficiencies, jurisdictions will then realign their laws.\textsuperscript{360} Thus, a level of harmonization will emerge, but not as a result of a paternalistic single regulator.\textsuperscript{361} Race to

\textsuperscript{355} See Lucian Arye Bebchuk & Allen Ferrell, On Takeover Law and Regulatory Competition, 57 BUS. LAW. 1047, 1047 (2002) (discussing state competition in takeover law in particular and noting that this competition tends to favor and even entrench management while harming shareholder interests).

\textsuperscript{356} E.g., Robert A. Prentice, Regulatory Competition in Securities Law: A Dream (That Should Be) Deferred, 66 OHIO ST. L.J. 1155, 1156 (2005) (discussing the race to the top and efficiency); Romano, Need for Competition, supra note 262, at 393–96 (discussing that competition aids management in choosing the jurisdiction with optimal regulations and can compensate for policy differences).

\textsuperscript{357} Shelley Thompson, The Globalization of Securities Markets: Effects on Investor Protection, 41 INT’L LAW. 1121, 1123 (2007) ("Permitting companies to list on global exchanges, while simultaneously allowing them to choose the most favorable and least onerous national regulatory scheme, will result in global competition among regulators. And where the very purpose of regulation is to protect the public where competition does not, competition between regulators will likely lead to less protection for the public.").

\textsuperscript{358} Prentice, supra note 356, at 1156 (noting that race to the top proponents argue that state competition creates maximally efficient corporate law).

\textsuperscript{359} Romano, Need for Competition, supra note 262, at 393–96 (discussing that competition tends to reveal investors’ preferences and allows for different jurisdictions to both find the “optimal mix” of management and shareholder benefits).

\textsuperscript{360} Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 YALE L.J. 2359, 2385, 2394 [hereinafter Romano, Empowering Investors] (stating that if investors prefer the mandatory disclosure rules promulgated by the SEC, then those same rules would still emerge as a result of “competitive federalism”).

\textsuperscript{361} Id. at 2378–79 (discussing the SEC’s hesitance to allow projections because of its fear that investors would not know the difference between a forecast and hard financial
the top supporters have extended this analysis to the international regulation of securities.\textsuperscript{362} They view efficiency as the ultimate goal and have faith in investors to push management to maximize efficiency.\textsuperscript{363}

On balance, we would agree with the race to the bottom view, especially in the international realm. We believe the regulatory vacuum is more pronounced internationally because other differences among States and their populations make consensus unlikely. Nations approach securities regulation from different cultural perspectives, from different economic standpoints, and with different governmental structures and resources. In a national race to the bottom, where there may be several jurisdictions under a federal umbrella, some of these differences are less severe.

For example, the United States and the European countries have different views of the role of government versus the market as a regulator. As seen in the recent debate over credit rating agencies, the United States prefers preserving the role of market forces, while the European Union leans towards a greater government role or substantive regulation of the ratings process.\textsuperscript{364} Standards may also differ because of governmental roles or structures. The Chinese government has a majority interest in most public companies.\textsuperscript{365} Public accountants are unlikely to find serious

\begin{itemize}
\item \textsuperscript{363} Winter, supra note 262, at 883. \textit{See also id. at} 901–02 (stating that “[l]osses are an inevitable aspect of competitive markets” and further regulation will not rid the market of losses, it will only make the market less efficient); Romano, \textit{Empowering Investors, supra note 360}, at 2366; Romano, \textit{Need for Competition, supra note 262}, at 389–90 (both noting that institutional investors drive the U.S. market and that their sophistication will offset less sophisticated investors).
\item \textsuperscript{364} \textit{See supra} notes 236–38 and accompanying text (discussing that government regulation of CRAs in the United States is controversial). \textit{See also} Barber, \textit{supra} note 256, at 3 (discussing the inadequacy of the European Union’s self-regulatory framework and the legislative push for CESR to oversee CRA registrations, but also noting the fear that stricter regulation in the European Union than in the United States would result in inconsistent regulation); Unterman, \textit{supra} note 69, at 124–25 (discussing that in the wake of recent failures within the CRA industry, Congress has responded not by reducing the market power exerted by CRAs, but rather by encouraging competition and requiring greater transparency and accountability).
\item \textsuperscript{365} Chi-Wei Huang, \textit{Worldwide Corporate Convergence Within a Pluralistic Business Legal Order: Company Law and the Independent Director System in Contemporary
fault with the accounting statements of a government-owned entity. Also, there is more incentive for the international race to the bottom. National jurisdictions see a big payoff in becoming the regulatory forum of choice. That payoff in the international realm is global.

It is also very difficult to exert sufficient leverage internationally in order to impose high standards. For example, even though the United States was able to overcome some cultural and normative differences surrounding the Swiss bank secrecy laws and views on insider trading, it cannot impose its norms concerning obtaining evidence of fraud worldwide. There are other jurisdictions that are willing to replicate the Swiss laws and remain oblivious to U.S. concerns.

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366. For example, those arguing that state competition in corporate law is a race to the bottom note that competition is driven by States' desires to maximize tax revenue from businesses incorporating within their borders, but that this competition leads to problematic deregulation in favor of management. Cary, supra note 262, at 668–69 ("For revenue reasons, 'creating a favorable climate' is declared to be the public policy of the state."). See also Greenwood, supra note 262, at 385 (noting that the competition for corporate charters is one that produces more sources of tax revenue for the state of incorporation).

367. Different countries may compete for issuers by specializing in investor protections, for example. Others may cater to the interests of management. But once a country becomes a favorite regulatory regime, it can charge foreign issuers a higher fee for use of its regulatory and enforcement services, which may not otherwise be available in the issuer's home country. Choi, supra note 362, at 820–23 (discussing that issuer choice would lead to competition among various countries for increased securities transactions within their borders because of the fees generated by those transactions and the benefits from a general increase in the regulating country's market capital).

368. Macey, supra note 157, at 1367–68 (discussing that the SEC was able to negotiate an information-sharing MOU with Switzerland even though Swiss law traditionally did not criminalize insider trading).

369. For example, Dennis Levine was an investment banker for Lehman Brothers Kuhn Loeb, Inc., and received inside information from another Lehman employee regarding the acquisition of Itek Corporation by Litton Industries, Inc. Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb, Inc., 967 F.2d 742, 744 (2d Cir. 1992). In order to profit from this inside information, Levine made several purchases of Itek stock during the 1980s, but did so through a Bahamian bank. Id. at 745–46. Today, bank and tax secrecy are still prevalent in other countries, and the issue has even spurred support for the "Tax Haven Abuse Act," now in the Senate. Europe, U.S. Battle Swiss Bank Secrecy, supra note 48. The bill identifies thirty-four "offshore secrecy jurisdictions," including the Bahamas, the Cayman Islands, Lichtenstein, Panama, and Singapore. Stop Tax Haven Abuse Act, S. 681, 110th Cong. § 101(b)(50)(E), available at http://www.govtrack.us/congress/billtext.xpd?bill=s110-681 (last visited Jan. 25, 2009).
Stopping the race has traditionally required a leader that can insist upon some mandatory standards. Thus, supporters of increased market regulation feel that the SEC has successfully protected U.S. investors with mandatory disclosure rules, for example, and should continue to do so by imposing stricter regulations on management.\textsuperscript{370} The problem is that in the international realm, a single regulator does not exist, and no one State currently has the muscle to insist upon mandatory standards.

Soft law offers regulatory cooperation as an alternative to competition. By using soft law, States can commit to standards developed by experts without necessarily binding themselves to an international obligation. As a result, States have time to allow normative preferences to shift domestically before committing themselves to hard law. It also gives States a politically viable means of compromise. While the United States for years resisted any public departure from U.S. GAAP, soft law paved the way for IFRS. Despite the fact that soft law can evolve over time, it is more useful that hard law alternatives because its initial development occurs swiftly in response to changing conditions.

CONCLUSION

Ultimately, we believe that globalization and integration of markets will leave States with two regulatory choices: competition or cooperation. In our view regulatory competition will lead to a race to the bottom and the absence of meaningful standards. Stopping a race to the bottom requires a hegemon that can insist on its standards. Although the U.S. continues to be a "hub of the international economy" it lacks the power it once had.\textsuperscript{371} Thus, in order to have meaningful standards States must cooperate and compromise. Soft law makes cooperation and compromise possible. Soft law provides for flexibility and expertise, and can evolve without the political pressures that hinder cooperation among States. Soft law norms allow States to work towards convergence and harmonization without binding obligations. And soft law may ultimately harden once normative positions and rationalistic preferences have moved sufficiently.

\textsuperscript{370} See Cary, supra note 262, at 667–68 (noting that state competition in corporate governance law is the result of a "failure to recognize the difference between the goals of industrial capitalism and the abuses of finance capitalism"). Contra Romano, Empowering Investors, supra note 360, at 2367–68 (stating that the need to prevent a market failure does not equate to the necessity of "a monopolist regulator"); Ralph K. Winter, Economic Regulation vs. Competition: Ralph Nader and Creeping Capitalism, 82 Yale L.J. 890, 891 (1973) (noting "theoretically defective" government justifications for regulation).

to make a binding commitment politically acceptable. Or, soft law may remain soft, but still guide conduct in a stabilizing and helpful way. Thus, in our view international soft law securities regulation is a good product.

But it is not without its problems. Soft law faces a legitimacy challenge. If soft law regulation is to take hold, those affected by it must perceive it as legitimate, either because it works or because they believe that the manner in which it evolved took account of their interests and input. Effectiveness is difficult to judge. It is not clear that there is one universal standard of “effective” securities regulation. And even if there were, a scandal or crisis can cast doubt upon regulatory effectiveness very quickly causing distrust, backlash, and overregulation. Input legitimacy claims are also problematic. Private organizations that develop soft law norms have not typically worried about transparency or participation for nonmembers. Procedures to strengthen soft law’s input credentials are already being adopted by bodies such as IOSCO and IASB, i.e., measures to increase participation and transparency. But more can be done.

International soft law also faces problems similar to those faced in its domestic analog, that is, capture, accountability, the potential for abuses, and conflicts of interest. While these are the same problems faced nationally in many jurisdictions, the global environment cautions for extra care to combat them. These problems, although of the same kind, are of a different degree simply because the stakes are bigger. The payoff for capture and abuse is greater. And the consequences are magnified as well. The systemic risks for failure are tremendous. More needs to be done about these concerns. We believe, though, that the systemic risks of rejecting soft law regulation are far greater. Without soft law regulation, we see little alternative to the race to the bottom and the absence of meaningful standards.