

What Makes Networks Effective: Evidence From The SEC

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Theoreticians have long claimed the importance and centrality of “networks” in the regulation of international economic law. They are indeed critical. But still missing in the analysis is why some networks fail while others succeed. Moreover, even the question of what constitutes “success” is contested, given that baselines between agencies and issues vary, and the metrics of success (power, control, or effectiveness) vary. One way to hold some of these variable constant, albeit qualitatively, is to consider the experiences of one agency. The American Securities and Exchange Commission (SEC) has participated in five networks in an effort to adjust its mission to reflect the increasingly global nature of its regulatory remit. The paper analyzes the SEC’s experiences with its various networks; one agency’s efforts in a variety of similar fora might reveal what networks are good for, and where they can fail.

On the basis of this evidence, the paper suggests that one reason for variously effective networks may turn on the nature of the network itself. On one hand, social networks create soft institutional strictures by which compliance is facilitated through familiarity and positive incentives. This is a cooperative model that uses peer review as encouragement for compliance. On the other hand, other networks create hard rules and incentivize compliance through lock-ins. These networks penalize non-compliance through a range of negative externalities – they look more like the sorts of monopolies that have driven economic network analysis. This is a different sort of peer review; it is like peer review as accreditation as a condition for membership.

I. INTRODUCTION

The first commissioners of the SEC gave their speeches in the United States, concentrated on American stock exchanges, and evaluated the disclosures of American companies. As Commissioner James Landis said of the securities laws in 1933, “the public interest and the protection of investors must be the guiding consideration” for an agency that was needed because “some groups of persons associated with security flotations are not induced to refrain from material nondisclosure by fear either of the very real liability for compensatory damages at common law or fear of prosecution under the criminal law.”¹

Today, the SEC’s mission is the same, but both the investors and the security flotations are as likely to be found overseas as they are in the United States. American gross trading activity in foreign securities is \$7.5 trillion, up from \$53 billion three decades ago.² Approximately two-thirds of American investors own securities of non-U.S. companies – a 30% increase from just five years ago.³ And foreign trading activity in U.S. securities now amounts

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¹ James M. Landis, The Securities Act of 1933, Address before New York State Society of Certified Public Accountants (October 30 1933)

² Christopher Cox, International Business — An SEC Perspective, Address to the American Institute of Certified Public Accountants’ International Issues Conference (January 10 2008)

³ *Id.*

to over \$33 trillion.⁴ Recently, globalization has been blamed for the exposure of a number of European financial institutions to securitized American subprime mortgages, and to an American bank that failed because of them.

The impact of this globalization on the regulators who oversee American markets has been enormous. Instead of exclusively spending their time in the United States, in 2007, the SEC commissioners gave speeches in Sydney (twice), Madrid (twice), Mumbai, London (thrice), Dublin, Berlin, Frankfurt, Paris (twice), Munich, Luxemburg, Cape Town, Vancouver, Brisbane, and Tokyo (thrice).⁵ Former SEC Chair Christopher Cox reports that international work now “comprises over half of my time and responsibilities.”⁶ In his view, “it is no longer possible for the SEC to do its work in the United States without a truly global strategy... what goes on in other markets and jurisdictions is now intimately bound up with what happens here.”⁷

All of this international activity has come in the wake of a recognition by the SEC that the global markets have created unprecedented international challenges. Capital can leave a regulatory jurisdiction, but the regulators trying to attract it or insure that it complies with local laws are less mobile. Moreover, the SEC, long the regulator of the largest capital markets by far, is facing a future with many more competitors, both in formal and informal financial sectors. These competitors do not only offer an alternative to the American regulatory frameworks, they interfere with it, with regulations of increasingly extraterritorial import.⁸

But amidst all these problems, there may be an international solution. American federal regulators have addressed these global developments by interacting with their counterparts abroad, and trying to develop a multilateral regulatory regime of global scope.

They have done so through networks. As Anne-Marie Slaughter has put it, networks of regulators exhibit “pattern[s] of regular and purposive relations among like government units working across the borders that divide countries from one another and that demarcate the ‘domestic’ from the ‘international’ sphere.”⁹ As the network form has developed and spread, the regulatory network has become an important tool in the arsenal of international regulation – perhaps even the primary such tool, and at any rate, a worthy alternative to either unilateralism or more institutionalized, and, occasionally, judicialized forms of international administration.¹⁰ I think of networks as the principle rulemakers in global administrative law, a complement to the tribunals who perform important adjudicative roles in various international administrative schemes.

⁴ *Id.*

⁵ The analysis was concluded by visiting the agency’s website, which admirably keeps track of every speech by SEC Commissioners. See <http://www.sec.gov/news/speech/speecharchive/2007speech.shtml#chair>

⁶ Christopher Cox, International Business — An SEC Perspective, Address to the American Institute of Certified Public Accountants’ International Issues Conference (January 10 2008).

⁷ Christopher Cox, *The SEC Speaks 2008*, available at <http://www.knowledgemosaic.com/Gateway/Rules/SP.spch020808cc.020808.htm>.

⁸ For example, the European Union has imposed substantial fines on Microsoft, an American company, for conduct that American antitrust regulators found consistent with its own antitrust laws and regulations. Various of the opinions and other resources in the lengthy EU litigation may be found at http://ec.europa.eu/comm/competition/antitrust/cases/index/by_nr_75.html#i37_792.

⁹ ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER 14 (2004)

¹⁰ David Zaring, *Choice of Policymaking Form in International Law*, 45 COLUM. J. TRANS. L. ____ (forthcoming 2009).

For these and other reasons, the SEC has been remarkably network friendly – it “has pursued [its] goals through a variety of international multilateral and bilateral fora, including the International Organization of Securities Commissions (IOSCO), a bilateral dialogue with the Committee of European Securities Regulators, and with fellow securities regulators” on a number of issues, including the “holy grail” issue of standardization of accounting practices.¹¹

The SEC has also joined the Financial Action Task Force, designed to do something about money laundering. It participates in the Joint Forum, designed to coordinate international supervision of financial conglomerates. It is a member of the new Financial Stability Board, the successor to the Financial Stability Forum, a network of networks designed to coordinate financial oversight across jurisdictions. It has through its other networks encouraged the addition of a new one; the Public Interest Oversight Board, designed to ensure that accountants develop international standards that meet the goals of their regulations. And, perhaps most interestingly, to that end, after the agency failed to develop accounting standards through its international regulatory network, a different network, the International Accounting Standards Board, developed those standards – which the SEC has since appeared to grudgingly adopt.¹²

All of these institutions are networks. They are not formal international organizations, created by treaty and governed by traditional principles of international law. Instead, they are informal, rather than hierarchical, open, or entrusted with carefully limited responsibilities. They work through collaboration and, in theory, mutual agreement.

But which of them are doing the SEC some good? Answering this question is difficult because theorists have not been able to explain why some networks fail and others succeed. I try to do so in this paper by looking at the SEC’s international efforts, which is largely encompassed by each of these networks. What is the record of success for each of these networks? And what is it about them that makes them successful?

It is difficult to draw final conclusions about institutions that are all works in progress. Nonetheless, some broader themes may be identified. I argue that some networks develop legal standards via soft institutional strictures by which compliance is facilitated through familiarity and positive incentives. They offer club goods as benefits, are informal, and offer easy ways in and out. Social scientists call these sorts of networks “social networks.” The SEC has created one such network in IOSCO.¹³

Other networks are more likely to create hard rules through connections that incentivize compliance through lock-ins and penalize non-compliance with a range of negative externalities. They offer similar goods as benefits – the club goods of access to the network, but also real costs for exit. These networks look like telephone or utilities monopolies, and like these monopolies, they are difficult to build, but, once built, hard to leave. I think that networks that offer both the benefits of network membership, and the costs of exit from – or noncompliance with – the network approach to regulation are the most likely to be successful ones. These sorts of

¹¹ James Hewitt & Michael White Testimony before Congress, October 24 2007, available at <http://www.sec.gov/news/testimony/2007/ts102407cwh-jww.htm>.

¹² See *infra* notes ___ and accompanying text.

¹³ I attribute this insight to Chris Brummer.

networks have been described as economic networks. It appears that a network the SEC has eschewed – on accounting standards – has managed this process. The IASB has made the turn from advisory to necessary. In what follows, I consider these networks and the others to which the SEC belongs.

II. GLOBALIZATION AND NETWORK THEORY

Networks allow domestic officials to interact with their foreign counterparts directly, without much supervision by foreign offices or senior executive branch officials, and feature “loosely-structured, peer-to-peer ties developed through frequent interaction rather than formal negotiation.”¹⁴

The evolution of regulatory networks may be charted by tracking the way the scholarship on those networks has changed. In the early years of network analysis, scholars – myself included – were impressed at how widespread and vibrant this tool of international governance appeared to be.¹⁵ But when do they work, and work best? Some network based standards have enjoyed wider compliance than have others. In financial regulation, the Basel Committee has been able to claim a remarkable record of international compliance with its capital adequacy requirements, as I and others have documented,¹⁶ while IOSCO has not yet been able to develop a comparable set of international standards.¹⁷

Some have cautiously suggested that networks are less likely to be *as* effective as formal international cooperation,¹⁸ or that, more generally, international efforts closely controlled by states are more likely to work better than those where powers are delegated to other international institutions, which networks, composed of agencies, not states, exemplify.¹⁹ I suspect determining where a network is effective is likely to turn on the strength of the network itself.

In doing so, I distinguish between social and economic networks. In some ways, all regulatory networks are “social” or “virtual” in that they depend upon intangible ties between the people who staff regulatory agencies and the somewhat evanescent links that a memorandum of understanding, or an agreement on principles of regulation, can provide. But while social network theorists have focused on the implication of these ties, other, more economically minded scholars consider networks through the costs imposed on network membership and departure.

A. Social Networks

Social networks are tied together by intangible links – ties of consanguinity, say, or of affinity. Social networks theorists trace the spread of the evanescent, such as ideas, or

¹⁴ Kal Raustiala, *The Architecture Of International Cooperation: Transgovernmental Networks And The Future Of International Law* 43 VA. J. INT'L L. 1, (2002).; see also Risse-Kappen 1995).

¹⁵ See David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281 (1998).

¹⁶ David Zaring, *Informal Procedure, Hard and Soft*, in *International Administration*, 5 CHI. INT'L L.J. 547 (2005); Walter Mattli & Tim Büthe, *Global Private Governance: Lessons from a National Model of Setting Standards in Accounting*, 68 LAW & CONTEMP. PROBS. 225, 227-28, 250-59 (Summer/Autumn 2005).

¹⁷ David Zaring, *Informal Procedure, Hard and Soft*, in *International Administration*, 5 CHI. INT'L L.J. 547 (2005).

¹⁸ Eric A. Posner, *International Law and the Disaggregated State*, 32 FLA. ST. U. L. REV. 797 (2005) (describing the difference between a traditional unitary state model and a theory that disaggregates the state, concluding that formal international cooperation is likely to do as well as networks).

¹⁹ Eric A. Posner & John C. Yoo, *Judicial Independence in International Tribunals*, 93 CAL. L. REV. 1 (2005).

friendships, in organizations ranging from school playgrounds to graduate school disciplines. Although, today, social networks scholars often rely on complex computer modeling and abstract algebra to model and depict complex and large-n networks, the concept has been with us for some time. No less an authority than Emile Durkheim concluded that in society, “the essential is not the number of persons subject to the same authority but the number bound by some form of relationship.”²⁰

Some international legal scholars have rather explicitly adopted a social networks approach to the new international governance. As Kal Raustiala has said, “networks appear to promote convergence” across jurisdictions not subject to each other's laws “through a decentralized, incremental process of interaction and emulation.”²¹

One of the ways that networks do this is through knowledge exchange – a process that has been characterized as the creation of an epistemic community.²² Under that theory of international relations, some of the stuff that bubbles beneath state action is explainable partly by the fact that the people involved in the action come to think the same way about issues that confront them – in ways that cross borders.²³ Thus regulators who talk to one another, and learn to think like one another may eventually come to see their regulatory projects in the same way. In this way, standards can cross borders not because of the content of the standard, but rather in a way that is developed through intellectual history – that is, by the rise of a common language and thought process of regulation. In this way international governance looks a lot like the dissemination of ideas, rather than rules. It is a squishy concept, and one that owes some allegiance to constructivist theories of international relations – but it surely plays a role in helping the network to coalesce.²⁴

This is not to say that a single standard will always occur when a network gathers and exchanges information. As Raustiala has noted: “the more a network is virtual..., the more likely there are to be multiple standards. But network effects do imply that convergence on one or more standards is likely and this convergence is likely to be relatively sticky.”²⁵

The implication of these virtual relations is that they can eventually enmesh the network nodes in a variety of ties, standards, and obligations, that eventually, as David Mitrany predicted decades ago, prove to be hard to break. “Internationally,...while a body of law grew slowly and insecurely through rules and convention, many common activities were developed effectively by means of functional organs,” he wrote.²⁶ The idea here, as with other networks is that once the

²⁰ EMILE DURKHEIM,, DURKHEIM, MONTESQUIEU AND ROSSEAU: FORERUNNERS OF SOCIOLOGY, (tr. A Cuvillier 1965) (1892).

²¹ Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 VA. J. INT'L L. 1, 52 (2002).

²² See Peter M. Haas, *Introduction: Epistemic Communities and International Policy Coordination*, 46 INT'L ORG. 1, 3 (1992) for the principal statement on this thesis. For more legally related work in the area, see Thomas, Ashley. "International Legal Epistemic Communities" *Paper presented at the annual meeting of the International Studies Association, Town & Country Resort and Convention Center, San Diego, California, USA, Mar 22, 2006*, available at http://www.allacademic.com/meta/p99745_index.html.

²³ See *id.* (describing how similarly situated experts – or, presumably, diplomats, could eventually arrive at a common set of beliefs and policy suggestions).

²⁴ See, e.g., ALEXANDER WENDT, *SOCIAL THEORY OF INTERNATIONAL POLITICS* (1999); JOHN GERARD RUGGIE, *CONSTRUCTING THE WORLD POLITY* (1998); Ted Hopf, *The Promise of Constructivism in International Relations Theory*, 23 INT'L SECURITY 171 (1998).

²⁵ Raustiala, *supra* note ??, at 67.

²⁶ DAVID MITRANY, *THE FUNCTIONAL THEORY OF POLITICS* 113 (1975).

actors in a network setting adopt a standard, switching to a new standard requires extensive and costly, and hence rarely achieved, collective action.²⁷

Sociologists have found social networks to be very interesting, and one has bragged that “network analysis is booming and the tendency of social scientists to ignore structure is diminishing. Today, all kinds of social scientists, along with mathematicians and physicists, have embraced the structural perspective.”²⁸ Although describing the breadth of research in these sorts of networks must be done cautiously – sociologists have begun to develop their own sort of statistical processes to describe the way that networks develop, political scientists such as Andrea Jung and David Lake, are doing agent-based modeling to understand how social networks work, while others are researching the phenomenon in less quantitative ways, the import of this research is promising.²⁹

There is no question that the social variant of a network can be powerful. But it is worth noting that it is fragile. For one thing, some believe that social networks, at least in the international setting, atrophy as they grow. Regulatory networks of jawboners, mutual understandings, and common approaches may not expand widely across the regulatory firmament – or, at least, it is not obvious that they would do so. Some political scientists think that traditional networks like these come with expiration dates.³⁰

For now, it is perhaps enough to note the ties between the ties between regulatory networks of friendship, epistemic community, and common perspective. These networks are limited in the branches between their nodes, limited to suasion and common perspectives, and, accordingly, may be limited in the compliance that they can expect in the anarchic world order.

B. *Economic Networks*

The significant difference between “social” and “economic” networks may lie in the intellectual history of the economic variant. Economic network theorists considered networks to be so potentially powerful (and, at times, inefficient), because the costs of membership were worth it simply because the benefits of similarity with other members of the network were so high.

Economists think that network effects can affect a market when the utility of a product to one consumer increases the more other consumers use the product. More economically tied networks exist when goods provide value to a consumer that “increases with the number of additional users of identical and/or interoperable goods.”³¹ To be sure, economic networks “need not be linked to a common system as are the constituents of a communications network.”³² As two law and economics scholars have put it, less is required: “a network effect exists where

²⁷ Raustiala, *supra* note ??, at 67.

²⁸ LINTON C. FREEMAN, *THE DEVELOPMENT OF SOCIAL NETWORK ANALYSIS* 167 (2004).

²⁹ Andrea Jung & David Lake, *Markets, Hierarchies, and Networks: An Agent-Based Organizational Ecology* (working paper).

³⁰ *Id.*

³¹ Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 491 (1998);. Telephones are examples of “actual network goods.” *Id.* at 488. The more people who purchase telephones connect to a network, the more valuable the telephones already on that network become, as the calling options available to those already on the network increase. *Id.* at 488-89.

³² *Id.*

purchasers find a good more valuable as additional purchasers buy the same good.”³³ For example, users of a particular word-processing program benefit when other users use the same program, making it easy to exchange files.³⁴ This does not, of course, mean that the word-processing system will be the best on the market, just that it is the one that more people selected, which in turn makes it attractive to new entrants, because it offers a feature – interoperability – that other, even other better designed, word processing programs may not.

Economists have approached social networks a bit grudgingly. There is an “inherent difficulty of drawing inference from the data that economists commonly bring to bear to study social interactions,” as one economist has admitted.³⁵ Nonetheless, if social networks offer the promises of club goods, economic networks, roughly, do the same *and* impose costs on defectors from the network.

Economic networks, in short, are difficult to start, and difficult to exit. Although the mechanisms of cooperation for international regulators look more social than economic – that is, it looks more like friendship than it does like a water utility – the fact is that the imposition of costs of exit marks the distinction between the international regulatory efforts like those of the SEC’s which have largely failed, and those of other regulators, which increasingly cannot contemplate a world where their efforts would transgress from the international norm.

III. NETWORKS IN ACTION

The SEC used to deal with international problems, if at all, through unilateral and extraterritorial efforts to bring foreign investors and listers to heel. It insisted on the adoption of American accounting standards for companies that sought to make use of American markets. It has imposed American insider trading rules on financial institutions doing business in foreign jurisdictions, and generally policed overseas fraud that it concluded affected American securities markets.³⁶ It required foreign listers to comply with Sarbanes-Oxley.³⁷

But this traditional model has resulted in what many think is a flight of capital from the United States to other jurisdictions. It has made it difficult for the SEC to deal with activities that no longer occur within the United States. Accordingly, the SEC has developed outreach efforts, some bilateral, some multilateral, and perhaps most interestingly, some through firmly established networks. In this part of the paper, I survey these networks.

1. IOSCO

³³ Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 483 (1998); see also Robert B. Ahdieh, *Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets*, 76 S. CAL. L. REV. 277, 296 n.73 (2003) (“The relatively high network value and low inherent value of such goods implies that, once consumers perceive that a de facto standard has been established, tipping will occur very quickly.”).

³⁴ Lemley & McGowan, *supra* note ??, at 491 (identifying computer software as the “paradigm example” of virtual networks).

³⁵ Charles Manski, *Economic Analysis of Social Interaction*, 14 J. ECON. PERSPECTIVES 115, 117 (2000).

³⁶ SEC v. Wang, 699 F.Supp. 44 (S.D.N.Y.1988); for a discussion, see Susan R. Essex, Comment, *SEC v. Standard Chartered Bank: Maintaining the Integrity of U.S. Capital Markets or Extraterritoriality Run Rampant?*, 22 LAW & POL’Y INT’L BUS. 159 (1991); for a discussion of the SEC’s traditional practice with respect to overseas fraud, see Note, *Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction*, 98 HARV. L.REV. 1310, 1315-16 (1985).

³⁷ For a discussion, see John C. Coffee, *Leading Issues Under Sarbanes-Oxley*, Part I, N.Y. L. J., Sept. 19, 2002, at 5.

IOSCO is a regulatory organization that developed out of the Interamerican Association of Securities Commissions and Similar Agencies in 1984, when the members of that body passed bylaws transforming it from a regional group founded a decade earlier into a global collection of securities regulators.³⁸ IOSCO's members have 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; to provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses."³⁹

As a regulatory network, IOSCO is informally constituted, it has few rules, regulations, or limitations on its regulatory agenda, and is comprised of most of the securities regulators in the world. The organization has, over the quarter century of its existence, developed some core principles of securities market supervision – largely as a means of advising developing countries what the organization thinks is required of a good securities regulator – created a process for international cooperation on enforcement issues, and, perhaps most interestingly, but least successfully, tried rather unsuccessfully to agree on core regulatory approaches to market supervision.

The problems for IOSCO have lain in the fact that it has not managed to create the kind of costly ties that mark economic networks. Instead it remains a largely social network of regulators, one that the SEC has often abandoned when it has seen fit, and one which has been unable to create an international securities regime that meets the promise of a global market. Instead, the SEC's globalization dilemma remains unsolved by this network, which offers limited accomplishment.

A review of the organization's efforts of late is illustrative. I focus first on its success: law enforcement cooperation, and then turn to its semi-failure to play an important role in devising a government response to the 2008 financial crisis. As for policy harmonization – the holy grail of international regulatory efforts – IOSCO has little to say, and so we turn to the story of the development of international accounting standards to help us understand this process.

IOSCO's principal achievement has been law enforcement cooperation memoranda – slippery documents that require, in gauzy language, securities regulators to cooperate with their foreign counterparts on law enforcement matters. Because these memoranda permit a wide variety of regulators to maintain a wide variety of enforcement priorities, do not punish defection or reward compliance (it is quite difficult to quantify cooperation), and have been concluded with scores of participating entities, the initiative has failed to be the sort of onerous and exclusive commitment that marks a successful regulatory enterprise.

³⁸ See Paul Guy, *Regulatory Harmonization to Achieve Effective International Competition*, in FRANKLIN R. EDWARDS AND HUGH T. PATRICK, EDS, *REGULATING INTERNATIONAL FINANCIAL MARKETS: ISSUES AND POLICIES* 291, 291 (1992). The bylaws of IOSCO declare that "[t]he securities commissions or similar agencies of the countries of the American Continent, as well as the Commission des valeurs mobilières du Québec and the Ontario Securities Commission, are charter members of the Organization." Bylaws of the International Organization of Securities Commissions pt 2, P 2.

³⁹ IOSCO, *2002 Annual Report* 22 (2002), available online at < [http:// dev.iosco.org/annual_report/PDF/IOSCO_2002.pdf](http://dev.iosco.org/annual_report/PDF/IOSCO_2002.pdf)> (visited Nov 7, 2004).

Over the past three years, IOSCO has “endorsed the requirement that all securities regulators applying for...membership...become signatories” to the *Multilateral Memorandum of Understanding concerning Consultation and Cooperation, and the Exchange of Information*,⁴⁰ “contribut[ed] actively to the work of” an accounting standards board as it “remains convinced that the adoption of IFRS...should help to achieve convergence towards high quality global accounting standards,”⁴¹ and taken steps to establish “a more structured arrangement for...dialogue” with the financial industry and “rationalise [its] decision making process.”⁴²

IOSCO’s main concern during the this period has been the IOSCO MOU, described as “the first global multilateral information-sharing arrangement among securities regulators,” that “sets a new international benchmark for cooperation critical to combating violations of securities and derivatives laws.”⁴³ In 2005, IOSCO “resolved...to require all members to become signatories to the IOSCO MOU, or to commit to doing so, by 1 January 2010,”⁴⁴ and has continually worked towards this goal.⁴⁵ IOSCO states that its mandatory participation requirements “reflect[...][the] belief that the IOSCO MOU is critically important.”⁴⁶

This sort of cooperation is worthy, but it has remained voluntary. And even though, from the SEC’s perspective, the IOSCO MOU has fit well with what it has hoped to do, it is by no means clear that it will be enough.

The SEC likes criminal and law enforcement cooperation because its international efforts have, traditionally, focused on that area – an area with a whiff of extraterritoriality about it. The goal for the agency, in law enforcement matters, at least, is to enforce its prohibitions against market participants located abroad. It is thought that regulatory networks can help agencies conduct their law enforcement responsibilities by providing for cooperation with foreign law enforcement officials; the principal idea is that the networks help agencies like the SEC by providing a path for the exchange of information; indeed, IOSCO template MOU was designed to do exactly this.⁴⁷

The number of specific initiatives mounted by the SEC to do more international enforcement work are many – insider trading, for example, has long been a priority for the SEC, and there is nothing about the practice that limits it to the confines of the United States; the agency has been pursuing insider trading claims against foreign investors for decades now.⁴⁸ The SEC chair has often said that the agency would be essentially unable to continue its work on

⁴⁰ IOSCO, 2005 Annual Report at 3, available at <http://www.iosco.org/annual_reports/annual_report_2005/pdf/Annual_Report_05.pdf.

⁴¹ *Id.* at 5.

⁴² IOSCO, 2006 Annual Report at 9, available at <http://www.iosco.org/annual_reports/annual_report_2006/pdf/annual_report_2006.pdf>

⁴³ U.S. Securities and Exchange Commission, *SEC Announces IOSCO Unveiling of Multilateral Agreement on Enforcement Cooperation*, available at <<http://www.sec.gov/news/press/2003-145.htm>>

⁴⁴ IOSCO, 2005 Annual Report, *supra* note 1, at 2.

⁴⁵ “The organisation considered recent developments among the membership in taking up the MOU including the progress being made as IOSCO seeks to meet the 2010 deadline by which members are required to become signatories.” *IOSCO Update: Issue 6*, May 2007 at 1, available at <http://www.iosco.org/library/newsletters/pdf/IOSCO_Update_May_2007.pdf>

⁴⁶ IOSCO, 2005 Annual Report, *supra* note 1, at 3.

⁴⁷ <http://www.sec.gov/news/press/2003-145.htm> has the so-called multilateral MOU available on its website.

⁴⁸ E.g., Hong Kong case

the area without international cooperation.⁴⁹ The claim is a plausible one, as the agency's efforts against foreign corruption suggest, indicating a new global enforcement priority that requires foreign cooperation to work.

In 2008, the SEC developed more cases than ever against corporate executives who bribe foreign officials under the Foreign Corrupt Practices Act. The SEC filed 15 FCPA cases during that fiscal year; since January 2006, the SEC has brought 38 FCPA enforcement actions—which, it has said, amounts to more than were brought in all prior years combined since FCPA became law in 1977.⁵⁰

Through the IOSCO MOU, however, it is not clear that the SEC has been able to leverage the network's international cooperation to amount to much. On the one hand, to be sure, it has cajoled the network into committing to information exchanges and law enforcement assistance. But although the SEC will soon be able to point to a large number of signatories to the IOSCO MOU, it is unclear, in the end, whether those signatures will amount to a binding international regime that will have a real effect on global problems of cross-exchange criminality. The MOU, after all, recourses to the gauzy promises of enhanced cooperation – often “to the extent possible,” and without the sort of mandates that make for an international standard.

The insight can be generalized. Like any network, much of the work IOSCO does not appear to amount to much of anything. Highlighting anecdotal initiatives is not dispositive, of course, but consider the 2008 financial crisis. During that crisis, the SEC has implemented a short-lived ban on the shorting of financial stocks; it coordinated that ban with the securities regimes of other countries, including Great Britain, Australia, Taiwan, and Pakistan.⁵¹ But IOSCO was not the vehicle for the short ban, and, indeed, the organization has had little to say about the financial crisis in any respect, other than a May, 2008, suggestion that its members peruse some recommendations about the subprime mortgage crisis, the precursor to the market crashes.⁵² IOSCO thus is not a network that oversees global market regulation – rather, it facilitates the abilities of members to enforce their own standards.

2. IASB

Despite taking on member participation in the IOSCO MOU as its main focus, IOSCO is also concentrating on “maintain[ing its] role as the international standard setter for securities regulation.”⁵³ But it has largely ceded a role, albeit with consultation, in developing accounting standards – a critical part of any securities enterprise (disclosure, after all, turns on the requirements of what publicly listed companies are required to disclose to potential investors) to another network. I view this as an example of the failure of the nonexclusive, nonbinding, securities network.

⁴⁹ Christopher Cox, *The SEC Speaks 2008*, available at <http://www.knowledgemosaic.com/Gateway/Rules/SP.spch020808cc.020808.htm>

⁵⁰ <http://sec.gov/news/press/2008/2008-254.htm>

⁵¹ See, e.g., *Canadian Regulators Implement Short-Selling Ban*, REUTERS, Sep. 21, 2008, at <http://www.reuters.com/article/governmentFilingsNews/idUSN1925996220080919>.

⁵² IOSCO Technical Committee Task Force on the Subprime Crisis, *Final Report on the Subprime Crisis* (May 29, 2008), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf>

⁵³ IOSCO, *2006 Annual Report*, *supra* note 3, at 4.

The attractiveness of common accounting standards in a world where investors and firms have multijurisdictional presences is not hard to fathom. Common standards would allow investors to evaluate companies based in the United States, Europe, or the developing world on the basis of the same kinds of financial statements. By the same token, the ability of companies to use the returns that their local accountants prepared to list stocks in New York, London, and anywhere else is clear. As one former SEC commissioner has stated, “one cannot overlook the potential expansion of investment opportunities if all issuers could use one set of accounting standards that would be accepted world-wide for securities offerings.”⁵⁴

Despite these incentives, the SEC recently opted out of the informal effort to create common standards that would work for any company and any exchange. It presumably assumed that it had no need for foreign standards. It announced “concerns with respect to the IASB governance structure,” among other things.⁵⁵ These sorts of strategies capsized IOSCO’s 1980s efforts to develop such a standard; the SEC has also failed to seriously participate in the informal network that succeeded IOSCO in trying – the International Accounting Standards Board, though it did participate in the arm’s-length IOSCO committee that monitored IASB’s progress.⁵⁶ But while during the 20th century, American regulators could insist on unique American standards, in the 21st century, the preeminent place of those standards has become much more tenuous, because of the global acceptance of a European rooted principles-based system.⁵⁷

Like IOSCO, IASB began as an informally constituted committee; it was formed in 1973 by the standard-setters--mostly private--of Australia, Canada, France, Germany, Ireland, Japan, Mexico, the Netherlands, the United Kingdom, and, indeed, it included the United States.⁵⁸ Like IOSCO, IASB looks like a network – it is informal as well, only partially public, and not subject to the ordinary requirements and limitations of international law. These are differences the SEC has noted: “IOSCO is a committee of securities regulatory agencies, the IASB is an independent, private sector organization,”⁵⁹ but the organization has moved increasingly to publicize its deliberations, in an effort, some commentators believe, to win acceptance of IFRS by the United States.⁶⁰

The organization tried to develop the sort of accounting standards that could stand in for the diverse standards available around the world. It did so one painful standard at a time, with regular meetings around the world, and the ready cycling in of representatives from various

⁵⁴ See Hunt, 51 Admin. L. Rev. at 1114

⁵⁵ John W. White address at Annual Securities Regulation Institute in San Diego, California (January 23, 2007) at <<http://www.knowledgemosaic.com/Gateway/Rules/SP.spch012308jwww.012308.htm>>

⁵⁶ James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1208 (1999) (describing this event in some detail, and noting that the stature of IASB during the mid-1990s presented the SEC with a difficult decision concerning whether to recognize its accounting standards for SEC filings and how the SEC therefore engaged with IASB, directly and through the International Organization of Securities Commissions (IOSCO), laying out basic criteria it would have to meet and providing a “stream of comment letters” on IASB proposals).

⁵⁷ Roberta S. Karmel, *The EU Challenge To The SEC*, 31 Fordham Int’l L.J. 1692 (2008).

⁵⁸ George Mundstock, *The Trouble With FASB* 28 N.C. J. Int’l L. & Com. Reg. 813 (2005).

⁵⁹ SEC, *Report on Promoting Global Preeminence of American Securities Markets*, available online at <<http://www.sec.gov/news/studies/acctgsp.htm>>

⁶⁰ The restructuring “include[s] changes in the IASB’s objectives and strategy, due process, standards implementation and enforcement, and funding mechanisms.” Maureen Peyton King, Note, *The SEC’s (Changing?) Stance on IAS*, 27 BROOK. J. INTL L. 315, 332 (2001).

jurisdictions in the standard development process.⁶¹ In this neither the SEC nor American accountants played a particularly important role.

During the late 1980s, the United States abandoned accounting standardization, and killed IOSCO's initial efforts along these lines. The result drove IOSCO's headquarters from North America to Europe and recentered the global effort on accounting in the competing network represented by IASB. As former SEC commissioner Roberta Karmel has said, "At this time, the SEC also determined not to adopt a process-oriented approach to IASB standards Rather, it intended to assess each IASB standard after its completion, and then recognize acceptable standards ...[it only] decided instead to consider all IASB standards after the IASB completed its core standards work program."⁶²

None of this stopped IFRS, however. The adoption of the standard throughout the European Union in 2005, and similar decisions by Australia, Hong Kong, and South Africa, tipped over a process that means that over 100 countries are now requiring or permitting IFRS.⁶³ As John White, the current director of the agency's division of corporate finance, has noted, the European accounting system that IASB adopted is the one that seems to have caught on better with the world markets than has the arguably more rigorous US GAAP.⁶⁴

Accordingly, even without the support of the United States, international convergence on accounting standards happened anyway. A December 2002 survey of fifty-nine countries' accounting standard-setters revealed that 90% of the standard-setters intend to converge to IFRS.⁶⁵ "Most countries are moving towards IFRSs," one observer has said, as these countries found the standards to be congenial and reputable.⁶⁶

The SEC in the end, was left with little choice on accounting standards – it decided that it had to defer to the successful global network, though it has been slow to embrace it. In 2006, it established a "database on application of IFRS," where "[IOSCO] members can exchange information about problems and non-compliance with [the standard]."⁶⁷ IOSCO "assesses the data[,] and where it reveals varying interpretations[,] refers them to the [IASB]," the organization responsible for developing IFRS standards⁶⁸ IOSCO has a long-standing relationship with the IASB,⁶⁹ and it claims continues to "contribut[e] actively to the work of the IASB, through

⁶¹ In this it benefited from the support of IFAC, the International Federation of Accountants, another network, though one entirely private, and not one with its own designs on accounting standardization – it was happy to delegate that process to IASB.

⁶² Roberta S. Karmel, *The EU Challenge To The SEC*, 31 Fordham Int'l L.J. 1692 (2008).

⁶³ Christopher Cox, "International Business--An SEC Perspective" *Address To The American Institute Of Certified Public Accountants' International Issues Conference, Washington, D.C., January 10, 2008*, 1669 PLI/Corp 205.

⁶⁴ John W. White *Director, Division of Corporation Finance U.S. Securities and Exchange Commission*, 35th Annual Securities Regulation Institute, San Diego, California, January 23, 2007, available at <<http://www.knowledgemosaic.com/Gateway/Rules/SP.spch012308jww.012308.htm>>

⁶⁵ Donna L. Street, GAAP Convergence 2002: A Survey of National Efforts to Promote and Achieve Convergence with International Financial Reporting Standards 2, http://www.ifad.net/content/ie/ie_f_gaap_frameset.htm

⁶⁶ 40 Int'l Law. 363, 366 (.2006)

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ In 1996, "IOSCO join[ed] the IASB] as observer," and in 1999, IASB formed an "agreement with IOSCO to complete core standards by 1999," where "on successful completion IOSCO [would] consider endorsing IASs for cross-border offerings." "IOSCO review[ed] the]...IASC core standards," and in 2000, "IOSCO recommend[ed] that its members allow multinational issuers to use 30 IASC standards in cross-border offerings and listings." International Accounting Standards Board, <<http://www.iasb.org/About+Us/About+the+Foundation/History.htm>> (last visited October 24, 2007).

participation in various expert committees and responses to consultation,”⁷⁰ and “continue[s] to monitor the work of the IASB[.]”⁷¹ But the SEC has been unwilling to join IFRS, at least until recently, and is only now making its presence felt, after those standards were devised, and after the SEC has declared its intention to adopt them.⁷²

In the end, the SEC had to bow to the power of this network. As former SEC Chair Cox would admit, “our recent decision to accept IFRS financial statements in SEC filings was crafted in such a way as to support the efforts of the IASB, and many other nations, to establish IFRS as a single, global set of standards, and not so many national flavors.”⁷³

In my view, the story of this network is a story of a move from enforcement cooperation, which permits countries to opt in and opt out as they wish, and to retain their regulatory standards, to something in which the costs of exit – and, in the SEC’s case, nonparticipation – are too high to bear, because the advantages of standardization – a major advantage of network effects – were realized by IASB, but not by IOSCO. This was because IASB created a standard that tipped, making it impossible to resist. It is a network that moved from club goods to high exit costs.

3. FATF

IOSCO and IASB are not the only networks in which the SEC participates. The Financial Action Task Force on Money Laundering, created by the G-7 in Paris in 1989, is comprised largely of developed world enforcement agencies, again, the SEC is one of a number of agencies in the American delegation; the American delegation is led by Treasury’s Financial Crimes Enforcement Network and Office of Foreign Assets Control.⁷⁴ As for the rest of the world, the organization is comprised of delegations from, as of 2007, 34 member countries “representing the major financial centers of the Americas, Europe, and Asia.”⁷⁵ It is composed of “Members of the ministries of Finance, Justice, the Interior, and External Affairs, financial regulatory authorities and law enforcement agencies.”⁷⁶

The FATF is concerned with enforcement, but like most networks, it has begun with some principles regulation. In purpose, it resembles IOSCO, and in paradigm too. It does enforcement cooperation, rather than standardization, and the scene is one of a social network. These recommendations were first developed in 1990, revised in 1996 and in 2003, and are designed to, as the FATF puts it “set out the basic framework for anti-money laundering efforts and are intended to be of universal application.”⁷⁷ It calls these its “40 Recommendations” to combat money laundering, and has, in the wake of 9/11, added nine others designed to combat

⁷⁰ IOSCO, *2005 Annual Report*, *supra* note 1, at 6.

⁷¹ IOSCO, *2006 Annual Report*, *supra* note 3, at 6.

⁷² 72 Fed. Reg. 37962-01, 2007 WL 1985828

⁷³ *See supra* notes [] [1669 PLI/Corp 205].

⁷⁴ FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, ANNUAL REPORT 2001–2002, at 3 (June 21, 2002), *available at* <http://www.fatf-gafi.org/dataoecd/13/1/34328160.pdf>.

⁷⁵ FATF, Annual Report 2001-02 at 2, *available online at* <http://www1.oecd.org/fatf/pdf/AR2002_en.pdf> (visited Nov 1, 2004). The international organization members are the Gulf Coordination Council and the European Union. *See* FATF, Members and Observers, *available online at* http://www.fatf-gafi.org/document/52/0,3343,en_32250379_32237295_34027188_1_1_1_1,00.html.

⁷⁶ *Id.*

⁷⁷ http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236836_1_1_1_1,00.html

terrorism financing.⁷⁸ Not every commentator has concluded that the task force has effectively led to policy change.⁷⁹ But the FATF has tried to ensure that its 40 + 9 recommendations are observed through peer review, or “on-site visit conducted by a small team of experts in the legal, financial and law enforcement fields from other member governments,” who report on the progress of members.⁸⁰ This compliance mechanism is carefully delineated, but it is of a piece with the sorts of jawboning familiar to networks.

4. The Financial Stability Forum/Board and the Joint Forum

The SEC is also member of two networks of networks, the Joint Forum and the Financial Stability Forum. These two networks are run out of the Basel Committee for Banking Supervision’s home base, the Basel-based Bank for International Settlements, and the Basel Committee played an important role in founding both. Both are designed to address problems of systemic risk from financial institutions more generally, but while the FSF is aimed at coordinating very grand questions of systemic risk, the Joint Forum, which used to be known as the Joint Forum on Financial Conglomerates, has the somewhat more mundane job of coordinating supervision of large multinational entities across supervisors who might ordinarily only look at parts of those conglomerates – insurance, say, or securities issues. How do these two networks compare to the others in which the SEC is a part?

It is hard to know what, exactly to make of the FSF, other than that it has bright potential, because it coordinates everything that the SEC has hoped for from IOSCO with the international work of other financial regulators. The FSF brings together senior representatives of national financial authorities (e.g. central banks, supervisory authorities and treasury departments), international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank.⁸¹ The Forum was originally designed “to ensure that national and international authorities and relevant international supervisory bodies and expert groupings can more effectively foster and coordinate their respective responsibilities to promote international financial stability, improve the functioning of the markets and reduce systemic risk.”⁸² It has met biannually and currently consists of 26 national regulatory agencies, including the principal members of the networks of banking supervisors and securities regulators.⁸³ The FSF has in the past been run by the General Manager of the Bank for International Settlements, who “was appointed Chairman of the FSF in a personal capacity,” and for that reason, it has seemed like a rather quiet effort by Basel to broaden its supervisory ambit to include systemically significant multinational institutions that engage in banking but that also provide other financial services.⁸⁴ The FSF is a work in progress, with a mandate from the G20 to take a coordinative role in global financial oversight.

⁷⁸ The recommendations are available online at <http://www1.oecd.org/fatf/40Recs_en.htm> (visited Nov 1, 2004). See generally Beth Simmons, *International Efforts against Money Laundering*, in Dinah Shelton, ed, *Commitment and Compliance* 244-63 (Oxford 2003).

⁷⁹ Shaffer and Pollack, Beth Simmons, *International Efforts Against Money Laundering*, in *COMMITMENT AND COMPLIANCE* 244-63 (Dinah Shelton ed., 2000).

⁸⁰ http://www.fatf-gafi.org/document/60/0,3343,en_32250379_32236920_34039228_1_1_1_1,00.html

⁸¹ <http://www.fsforum.org/about/overview.htm>

⁸² See G20 (GROUP OF TWENTY), *DECLARATION ON DELIVERING RESOURCES THROUGH THE INTERNATIONAL FINANCIAL INSTITUTIONS – LONDON*, (APRIL 2 2009), <http://www.g20.org/Documents/final-communique.pdf>.

⁸³ FINANCIAL STABILITY FORUM, *supra* note ____.

⁸⁴ G20 (GROUP OF TWENTY), *DECLARATION ON DELIVERING RESOURCES THROUGH THE INTERNATIONAL FINANCIAL INSTITUTIONS – LONDON*, (APRIL 2 2009), <http://www.g20.org/Documents/final-communique.pdf>. The so-called “Joint Forum on Financial Conglomerates” has also served this purpose.

It has begun with principles; time will tell if it can move from consanguinity to the sorts of high costs of exit that organizations like IASB have managed to achieve.

The SEC, through IOSCO, has also joined the Joint Forum, designed to deal with the regulatory issues raised by multinationals that offer banking, investment banking, securities brokering, and insurance services to clients. That forum was established in 1996 to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates. It is comprised of an equal number of senior bank, insurance and securities supervisors representing each supervisory constituency.⁸⁵ The Forum has taken as its charge the need for coordination in oversight – an enforcement goal – and common standards for risk management, auditing, testing, and so on, with an eye to developing common standards for these kinds of large financial institutions.⁸⁶ The Forum has a particular interest in developing adequate disclosure standards for these sorts of institutions, and has threatened to “study financial conglomerate structures that may impair effective supervision or otherwise be problematic, and to periodically assess the supervision by the various regulators to which these institutions report, and “if appropriate, develop guidance and principles and/or identify best practices.”⁸⁷

In keeping with the network paradigm, the Joint Forum began with principles-based regulation. In November 2001, that forum issued its own set of Core Principles.⁸⁸ The principles of the Joint Forum, although broad, do matter for developing markets. As the Forum acknowledged, the IMF and the World Bank suggested that principles be developed, in part to “help assessors improve their understanding of the principles and thereby make the implementation and assessment process more effective.”⁸⁹

5. The Public Interest Oversight Board

Finally, and most recently, there is the Public Interest Oversight Board. That board was created by a variety of other networks, including IOSCO, and will oversee international standard setting activities in the areas of audit performance standards, independence and other ethical standards for auditors, audit quality control and assurance standards, and education standards. The goal is to ensure that the auditing standards set by IFAC and its committees are set in the public interest. Michel Prada, Chairman of the French Financial Markets Authority and Deputy Chairman of the IOSCO Technical Committee, who led the coordination of work amongst financial regulators and related international organizations, has said: “The creation of the PIOB is the fruit of a convergence of views between the official community and IFAC and expresses a sense of responsibility among audit practitioners and the international institutions and regulatory organisations involved in promoting financial stability in a globalised economy.”⁹⁰ The PIOB is also a work in progress, of course; indeed it was founded in 2008. In some ways, from the SEC’s perspective, it represents a commitment to the network form. A nascent network, though, we may expect that it will also begin with principles, and proceed from there.

⁸⁵ <http://www.bis.org/bcbs/jointforum.htm>

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⁸⁷ <http://www.bis.org/bcbs/jfmandate.htm>

⁸⁸ See generally BIS, Capital Adequacy Principles (Feb 1999), available online at <<http://www.bis.org/publ/joint02.pdf>> (visited ____).

⁸⁹ Basel Committee, Joint Forum, Core Principles: Cross-Sectoral Comparison P 12, available online at <<http://www.bis.org/publ/joint03.pdf>> (visited ____).

⁹⁰ All from initial press release <http://www.ipiob.org/>

IV. CONCLUSION

The SEC is not obligated to cooperate, through a network or any other international institution other than a treaty ratified by the Senate, of course. But if it were to embrace the network form, what is the best way to go about doing it? In this paper, I have argued that one critical way that networks differ is through the exit costs that they use to ensure compliance. I have also suggested that networks start slowly and socially, with principles, and may proceed, but do not always do so, with the difficult standardization that creates costs of exit. In this brief conclusion, I suggest some other factors that may matter to explaining why some networks succeed more than do others.

Formality -- One thing that created a network that lasts is the achievement of something difficult in its regulatory arena. This could be characterized as the move from principles to rule, and somewhat surprisingly, it implies that the networks that work best when they push for accomplishment, rather than by letting evolving ties of consanguinity grow into something important. Less counterintuitively, it suggests that an effective network is difficult to create. Accordingly, the lesson here is that some formalization, and particularly harmonization, can help. Currently most networks enforce compliance with standards through self-reporting and some evaluation by outside working groups – at least, that is how it works with IOSCO. This sort of policing is no guarantee of harmonization. Networks may instead benefit from deep degrees of regulation. Technical specification can make interoperability more important, smoother – and more difficult to depart from. Accordingly, the move from principles to rules may be critical to ensure network effectiveness.

Exclusivity -- Exclusivity may also be crucial – and that is not particularly consistent with the economic network model, but consistent with the insights of scholars like Lake and Jung. Small n networks have a better chance of achieving the crucial move to binding rules than do large n ones, it appears. IOSCO is a network open to all; accounting standards were devised by a more obscure and elite outfit. It may not accord with our intuitions about democracy, but it is possible that narrowly focused – and membered – networks do better at devising technical, difficult rules than do large ones.

Voice? -- Because the goal of many of these networks is to make exit costly, offering members “voice,” the other side of Albert Hirschman’s dichotomy may help them stay within the process.⁹¹ We have seen that both IOSCO and the IASC have moved towards more and longer comment periods and transparency. The IASC in particular has not surprised any of its members with its agenda or with the particulars of accounting standards,

There is more to be said for each of these conclusions. And there is more to be done for research in this area. The larger project is to create a metric of success for networks. One way to do that would be to assess the degree of harmonization to their standards through analysis of the text of network member promulgations. The method would be a quantitative word content analysis. It is susceptible to problems of data collection and language differences, but it is a promising avenue for future work. I look forward to hearing the views of the participants in the conference on other ways to make networks work better.

⁹¹ ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).