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# The European Union as hardening agent: soft law and the diffusion of global financial regulation

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## ABSTRACT

Soft law promulgated by transnational networks is one of the hallmarks of governance in global finance. Standard accounts alternatively view such governance as a fast and flexible solution to transnational problems or weakly institutionalized club standards epiphenomenal to great power interests. We argue that dominant perspectives' view of soft law is misguided, as soft law in global finance cannot be understood in isolation from domestic law. Viewing soft law through the prism of multilevel governance highlights the role European integration in particular plays in 'hardening' soft law provisions, thereby shaping the global diffusion of such standards. As soft law becomes embedded in domestic law, its certainty and durability are enhanced while at the same time its flexibility is reduced. Case studies of the diffusion of international accounting

standards and close-out netting rules for over-the-counter derivatives provide empirical support for the importance of domestic law in the global diffusion of soft law.

KEY WORDS:

Accounting standards

financial regulation

global governance

over-the-counter derivatives

soft law.

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## Notes

1 In terms of institutionalization, we follow Ruggie ([1998](#): 2) who focuses on predictability of behavior structured in large part by organizational routines. He identifies international organizations with their bureaucratic capacities as the key mechanism for institutionalization internationally. Given the non-treaty-based nature of soft law, many observers have described them as thinly institutionalized or network-based. See, for example, Zaring ([2004](#)).

2 'The provisions in ... Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (4), form an equivalent to the provisions of the Basel framework agreement.' Directive 2006/48/EC of the European Parliament and the Council of 14th June 2006 relating to the taking up and pursuit of the business of credit institutions. Official Journal of the European Union, 30 July 2006: L 177.

3 We refer to the organization as the IASB. Prior to 1999, the organization was named the International Accounting Standards Committee (IASC).

- 4 Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards. Official Journal of the European Communities, 11 September 2002: L 243.
- 5 <http://www.iasplus.com/en/resources/ifrs-topics/use-of-ifrs> (accessed 12 February 2014).
- 6 Prior to the financial crisis, ESMA was known as the Committee of European Securities Regulators (CESR).
- 7 [http://ec.europa.eu/internal\\_market/accounting/third\\_countries/index\\_en.htm](http://ec.europa.eu/internal_market/accounting/third_countries/index_en.htm)
- 8 See <http://www.esma.europa.eu/page/IFRS-Enforcement-0> (accessed 12 February 2014).
- 9 'About ISDA', available at <http://www2.isda.org/about-isda/> (accessed 26 January 2013)
- 10 Letter dated 30 October 2009 by Peter M. Werner of ISDA to Aleš Zalar, Minister of Justice of Slovenia, available at [http://www.isda.org/speeches/pdf/SVN\\_NettingLtr-Moj\\_v1.pdf](http://www.isda.org/speeches/pdf/SVN_NettingLtr-Moj_v1.pdf) (accessed 9 February 2013).
- 11 Interview with ISDA official.
- 12 See ISDA comment letters to jurisdictions at <http://www.isda.org/speeches/comments.html> (accessed 9 February 2013).
- 13 See Article 7 of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.
- 14 'ISDA proposes harmonization of netting in Europe', Press Release, 17 April 2008.
- 15 The 2006 EU Capital Adequacy Directive and the 2006 Auditing Directive both rely on international standards. The Auditing Directive is still awaiting implementation.

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## Additional information

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