

*Private financial governance at a crossroads*

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The extensive failures revealed by the global financial crisis have brought the reform of the existing financial regulatory architecture near to the top of the public policy agenda in Europe, US, as well as of international bodies such as the G20.

Regulatory agencies in most industrialized economies have frequently been accused of having fallen 'asleep at the wheel' in the years before the crisis and their conduct has received renewed scrutiny. However, most debates concerning the regulatory response to the crisis frequently neglect a key point: the regulation of financial markets is more than what regulators do.

This insight is central to the volume written by Geoffrey P. Miller and Fabrizio Cafaggi, together with Tiago Andreotti, Maciej Borowicz, Agnieszka Janczuk, Eugenia Macchiavello, and Paolo Saguato. The volume is part of a broader collaborative work investigating the mix of public and private regulation and enforcement. Among the different domains and industries, finance stands out for the extent, variety, and relevance of governance arrangements designed and administered by the same financial industry. The volume makes an important contribution to the studies of financial regulation by systematically reviewing and analyzing the diversity of these private regulation and enforcement mechanisms. Indeed, private regulatory mechanisms are to be found at a multitude of levels, starting from inside individual financial firms where internal compliance officers, internal auditors and risk management officers perform functions that are key to the orderly functioning of financial markets. Financial industry associations gathering the key stakeholders active in a given domain also play key regulatory functions in governing some of one of the newest and most rapidly developing areas of financial markets, such as microfinance and derivatives, as well as in one of the most traditional areas, that is the payment system and international accounting standards. Indeed, as the analysis of the International Swaps and Derivatives Associations (a private standard setting body composed by the major participants in the market, in regulating credit derivatives contracts) highlights, the regulatory impact of financial industry associations is often not limited to the national sphere but also fills gaps in international regulatory architecture.

These private governance arrangements however rarely remain complete outside of the sphere of influence of government. For example, the volume emphasizes how banking regulatory authorities that comprise the Basel Committee on Banking Supervision have come to incorporate a greater role for private regulatory mechanisms in international banking standards. The cornerstone of the international banking regulation, the Basel Agreement, relies heavily on internal modeling, processes and risk assessments by the financial institutions that they are designed to regulate. More broadly, the domains analyzed in this book reveal a wide range of variations in the division of responsibilities between public and private actors in the process of standard setting and enforcement.

What is then the proper allocation of regulatory authority between public and private actors? The authors take upon themselves the task of assessing the relative strengths and weaknesses of different private governance arrangements, including their legitimacy and accountability. According to the authors, an extension in the reliance on government intervention is not always the most desirable approach. While acknowledging some of the limitations associated with private regulations, in particular the misalignment between the incentives of private actors and those of the

public, the authors highlights how private actors can be enlisted to carry out some of the tasks traditionally assigned to governments.

This conclusion partially clashes with the direction of most regulatory initiatives introduced in response to the global financial crisis. As a number of financial scandals such as Libor have revealed severe shortcomings in the accountability and effectiveness of private governance arrangements, policymakers have in recent years expanded the perimeter of public regulation to encompass a number of sector previously self-regulated. The authors argue the crisis has not displaced the involvement of private actors in the regulation of finance. On the contrary, new forms of interaction between expanded public regulatory frameworks and private transnational actors are emerging, as private industry associations introduces changes in their internal structures in order to enhance their accountability relationships and increase the legitimacy. However the publication of this volume as the regulatory response to the crisis is still unfolding limits the capacity to assess whether the multitude of private governance arrangements analyzed in this volume will remain structural feature of the governance of finance in the XXIst century or a trend in decline.

Indeed, a longer historical view would reveal how the border between the public and private sphere in the governance of finance has changed significantly over the decades, with the peak of private governance in finance arguably preceding the rise of the involvement of the state in the regulation of markets after the Great Depression. If history is of any lesson, the move away from private governance arrangements in the current phase is a cyclical rather than structural characteristics of the regulation of finance. As the memories of the crisis fade, public authorities are likely to increasingly resort to solutions designed by the financial industry in the future. This volume provides therefore a helpful guide to understand the strengths and limitations of what remained a key component of the regulation of financial markets not only before the crisis, but also in the coming years.