"THE POST-DEREGULATION MEANING OF REGULATION"

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"There is one condition that gives birth to rules, another to which rules give birth".
Nietzsche, *Human, all too human*.

INTRODUCTION

What does "regulation" mean today? This term enjoys a wide array of meanings. For the purpose of this study, we will suggest and rely on one specific definition. We acknowledge that in any event the link between the variety of definitions reflects a constraint or the standardization of a choice before a given order and a set of rules. In other terms, the interactions between the *political arena* and the *economic and financial sphere*, as well as the normative issues deriving from such interactions, must be analyzed. The political arena includes diverse regulatory bodies operating both at national (e.g. the French financial market regulatory authority AMF) and European Union levels through the European Central Bank. The *economic and financial sphere* refers to all activities involving trade in goods and services as well as manufacturing activities.

The State is the starting point of our analysis. Its role is currently evolving and requires to go beyond the existing framework and to set out a new approach of the notion of regulation through the notion of "*mastering financial risks*". This new approach may seem contradictory to the powers initially associated with the notion of regulation. The emergence of such new power involving financial markets oversight, monitoring and control has been intensified over the years by the addition of a political dimension. Ethical questioning and normative concerns with regards State's role and its interaction with the financial sphere have arisen. In light of the above, to what extent are we experiencing the emergence of a new type of regulation?

I. STATE'S ROLE

The State is regularly defined as a producer of goods and services. As a regulator, the State's overarching role is therefore to ensure that economic agents comply with *existing rules*. While income redistribution and stabilization are methods of intervention in the economic sphere, regulation may be considered as a third method of intervention. The protective role assumed by the State is currently enhanced and restored. Public authority encompasses various forms and seems to call for an increased control of the economic and

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financial sphere. Regulation is one of public authority's crucial functions. The notion of public authority (*puissance publique)* refers to the various means at the State's disposal with a view to ensuring safety on its territory for the benefit of its citizens and to enforce laws and regulations. The classical theory of public authority, formulated and discussed at length by Maurice Haurious (1856-1929), highlights the exorbitant nature of public law.

We are currently witnessing a new equilibrium with regards the relation between public interests and financial markets. This new state entails that State's intervention *depends on* a new approach vis-à-vis financial markets. The various financial crises triggered the calling into question of the ethical and political State's role. What would be an agreed definition of the rules and constraints the economic and financial sphere has to comply with? The main State1's power is to enact a given rule and to enforce it, whilst balancing short-term national election prerogatives with long-term legal developments (including at European level).

II. A MULTIDIMENSIONAL REGULATION

THE NOTION OF REGULATION

The notion of equilibrium is at the core of State's prerogatives and the political arena. Regulation refers to all the means implemented with a view to reaching the equilibrium to ensure system sustainability. Regulation may be understood as resulting from the confluence of a constraint or standardization of a choice *x* and of a set of rules *y*.

A "first-class" regulation, that aims to supervise financial markets, can be differentiated from a "second-class" regulation that is instead social and political and aims to fix market fluctuations. The meaning of *regulation* is not universally agreed upon. As a matter of fact, most non-English speaking countries have literally translated the English term "regulation". The notion of regulation, i.e. the enactment of rules, must further be differentiated from the concept of "supervision" that relates to the *ex post* control of such rules. Ultimately, *regulating* and *supervising* are part of the same single system while being poles apart. To this end, the State supervises and regulates through autonomous and/or independent "administrative authorities"[2].

AN EXTERNAL MECHANISM?

Assuming that financial market regulation implies to protect savers, ensure compliance with competition law and prevent systemic risks, the State faces three categories of hurdles while regulating; namely information asymmetry, existing natural monopolies and, lastly, externalities and the provision of public goods. Regulation in the economic and financial sphere is externally carried out based on institutionalized interventionism, both at national and European levels. For example, the French banking and insurance regulatory

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[1] See Christian Arnsperger, Philippe Van Parijs, *Éthique économique et sociale*, Paris, La Découverte, Collection Repères, 2003.

[2] See *Normes et institutions*, sous la direction de Thomas Boccon-Gibod et de Caterina Gabrielli, Paris, Hermann, 2015.

authorities have merged within the French prudential supervisory authority (*Autorité de contrôle prudentiel et de résolution* or ACPR) following the last financial crisis. The French financial market regulatory authority (*Autorité des marchés financiers* or AMF) is responsible for monitoring stock markets as well as protecting investors. At European level, monetary authorities are in charge of addressing systemic risks through national central banks and the European Central Bank (ECB), besides issuing paper money and fixing interest rates.

At European level, the ECB has been given an additional responsibility since March 1, 2014 for the direct supervision of significant banks in the Eurozone whose assets value exceeds €30 billion. This responsibility is assumed through the enhancement of supervisory tools such as capital ratios, liquidity ratios, leverage ratios, etc. It is therefore added to the already-existing traditional ECB's powers of micro-prudential supervision and macro-prudential policy in the area of monetary policy in the Eurozone. The ECB launched a quantitative-easing program on March 9, 2015 and massively bought public debt (i.e. monthly expenditure amounting to €60 billion per month) to stimulate the economy and foster economic recovery in the Eurozone. Such « non-standard » policy endeavors to issue money by purchasing bonds directly on the financial market rather than financing commercial bank lending. This policy is designed at a time when ECB's standard measures are no longer efficient given that its interest rates are close to 0%. Regulation therefore relies on market mechanisms combined with traditional or exceptional powers that highlight public authority's interventionism.

III. MASTERING FINANCIAL RISKS

A NEW METHOD OF REGULATION

Within the framework of the strengthening of the law, for example by the implementation of the Basel III standards in the banking sector, a new method to master financial risks has been emerging in the last few years. Mastering financial risks does constitute a new sort of regulation. Public authorities (i.e. the State and the successive governments) must effectively prevent any systemic risks on financial markets that would adversely affect the real economy. Consequently, we can hold that mastering financial risks is *de facto* a method of regulation.

The notion of master financial risks requires the implementation of a long-term *procedural mechanism* that intends to counteract any disruption. In this respect, this notion can be divided into *subjective* mastering and *objective* mastering. The former refers to an approach whereby the regulator anticipates the risk (so-called "bottom-up" approach) while the latter endeavors to address financial markets on a systemic basis (so-called "top-to-bottom" approach). It is crucial to go beyond the usual distinction between interventionist approaches and neoliberal approaches. Analyzing the functioning of the f method is instead essential. This is referred to by Christian de Boissieu as "the weak equilibrium of the three following factors: regulation - market discipline - internal control"[3]. Basel III (pertaining to the McDonough ratio introduced in 2008) is based on the two following factors: regulation – internal control, it being specified

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[3] See Christian de Boissieu, Jézabel Couppey – Soubeyran, *Les Systèmes financiers : Mutations, crises, régulations*, Paris, Economica, 2013, p.164.

that market discipline has to meet requirements relating to financial communication as well as expectations of stakeholders such as rating agencies and investors. The Basel Committee has set up and implemented internal market risk-assessment models such as the value-at-risk model (VaR) with the purpose of controlling capital requirements depending on the key value of exposure to financial risk. The VaR model is a benchmark that enables to assess market risk for a given portfolio or for an asset value, i.e. the maximum amount of potential losses with respect to a given likelihood of an event occurring within a certain timeframe.

Similarly, the notion of mastering financial risks can be further divided into a passive mastering and an active mastering. The former intends to anticipate uncertainty while the latter focuses on the protection from systemic risks in financial markets. We can compare the notion of internal mastering *via* financial instruments, such as management tools, with the notion of external mastering *via* the implementation of an institutional and normative internal system. The connection between the notions of financial market *regulation* and *mastering of financial risks* through public authorities is also part of the broader conflict between the purpose of *protection* and the purpose of *production*. The purpose of protection is to ensure safety while the purpose of production is capital growth. These two purposes are part of different normative processes that result from various players and institutions.

AN INTERNAL MECHANISM?

The regulator rules through a set of tools built on risk assessments. Governance is shaping up thanks to the intervention of these risk assessments. Concretely, the regulator first establishes a regulatory tool to assess risk. The model resulting from such tool is then in turn legitimized in the financial sphere. In this respect, we can hold that such model confers a certain status to uncertainty. Uncertainty is both the underlying reason that justified the implementation of regulation in the first place and the driving force behind the emergence of rules.

It is crucial to notice that the mastering of financial risks mechanism relies on a strengthened internal control and an upright market discipline. In other terms, the regulator sets up an internal mastering mechanism whereby agents need to anticipate the irreducible uncertainty as Christian de Boissieu emphasized.

CONCLUSION

Although following a pragmatic approach, we can hold that there is a convergence between a regulatory process focused on internal performance and control, regulation proves to grasp the financial sphere through a political outlook while the ins and outs are closely intertwined with the countless configurations of risk and governance models.

Additional issues must still be addressed, such as information asymmetry between the regulator and regulated agents. The question pertaining to the identity of the agent that should be in charge of regulating the regulator must also be directly addressed. The notion of *regulation* is bound to evolve. The recent evolution towards the "*mastering of financial risks*" phenomenon is already a prime example of a significant change.