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Understanding the disciplinary aspects of neoliberal regulations: The case of credit-risk regulation under the Basel Accords

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ABSTRACT

The risk management explosion has been accompanied by the rise of risk-based regulations. The 2004 reform of the Basel Agreements (Basel II) is usually presented as a typical example of the development of such risk-based regulations. By comparing the discourses accompanying Basel II with an in-depth analysis of its technical provisions for credit risk regulation, our study shows that, if the Basel reform was driven by a neoliberal political agenda, it counter-intuitively resulted in a significant development of intrusive disciplinary processes for banks and their credit-management processes. Drawing on Foucault's analyses of neoliberalism, the paper however suggests that the presence of disciplinary aspects in this risk-based regulation should not necessarily be regarded as a "pathological drift" or as a "subversion" from its initial neoliberal program, but rather as both neoliberalism's other face and its very condition. Methodologically, this study also underlines the value of approaching risk management issues by an in-depth analysis of their technical specifications, since this approach enables us to construct the contrasting image of the changes presented here, and consequently to highlight the strong disciplinary processes embedded in this neoliberal-inspired reform and their structuring effects on management accounting and control processes. Finally, this approach also allows us to better understand the role played by calculative technologies in this disciplinarization process.

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1. Introduction

Historically, risk management was essentially conceived as a calculative practice, most commonly developed in the field of finance and insurance. Since the 1990s, the concept has been tremendously successful at the societal level (Beck, 1992). As far as organizations are concerned, the works of Power (1997, 2004, 2007) have shown how it is through audit that this concept has been introduced and diffused within management processes. With the reinforcement of shareholders' power since the 1980s, audit – reinterpreted through the lens of agency theory – has been pushed forward: new "governance" norms and standards have assigned a central role to audit and its control processes, to the point of fully extending their logic

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within risk management under the form of enterprise-wide risk-management systems (ERM), for example. This dynamic has been analyzed as a “shift” from “risk quantification” towards “risk governance” (Power, 2004, 2007).

The same risk governance-based solutions were used to respond to the financial scandals and crises of the last two decades: examples are the Sarbanes-Oxley Act legislation (2002) which triggered the development of internal control in the US, the Revised Combined Code (2003) for the UK, or the Basel Accords (2004) for risk management in the banking sector. The promise of self-regulation carried out by risk-governance methods appealed very much to the regulators, who then played a significant role in the “explosion” of internal control and risk management (Majoor, 2000; Mikes, 2009; Power, 2004, 2007) through the development of “risk-based” regulations (Black, 2005). Risk-based regulations constitute a “managerial turn” in regulation, reflecting a shift from a “command-and-control” to a neoliberal logic of regulation (Power, 2007). This logic is usually described as “softer”: risk-based regulations are counting on cooperative relationships between regulators and the regulated (Ayres & Braithwaite, 1995; Black, 2001), on the enrolment of some of the regulated resources (Black, 2003), such as their internal control systems, so as to achieve regulation through a control of self-regulation (Power, 2007). Within risk-based frameworks, most regulatory controls have consequently shifted to a meta-level of control: the control of internal controls. Risk-based regulations thus tend to be also “meta-regulations” (Parker, 2002).

However, most risk-based regulations are not formulated by using only “high level” or “meta” principles and this aspect is much less studied. First, even if regulation through high-level principles is seen as the optimal solution in this model, it is rarely implemented in pure form. Second, these principles are usually translated into specific rules, thresholds, and devices which are designed to facilitate the control of self-regulation. Even regulatory frameworks strongly directed towards governance systems, such as the Sarbanes-Oxley legislation, are enforced through a multiplication of tick-boxing and low-level detail documentations. Therein is the neoliberal contradiction: **if risk management were only self-regulation, why are these numerous and precise rules necessary? Why aren't risk-based regulations formulated by using only high-level principles and how do regulators deal with this contradiction?** To answer these questions we analyze the dispositions regarding credit risk in the main transnational regulatory framework for the banking sector: the Basel Agreements, which are usually presented as one of the most typical examples of the development of risk-based regulations.

Established in 1988 by the Basel Committee,¹ the Accord on “International convergence of capital measurement and capital standards” specifies norms of capital requirements for internationally active banks. This first accord, referred to as “Basel I” in this text, was initially focused on credit activities. It has been amended in 1996 to extend capital requirements to market operations, but unlike credit risk requirements, which were precisely defined by the Accord, market risk requirements were based mainly on bank's own estimates of their risks. This reliance on self-regulation was then expanded to credit-risk in the second version of the Accords, referred to as “Basel II”, which was finalized in 2004. The main idea of the reform was to rely more on the internal practices of the banks as a way to take into account their recent progresses in risk modelling and management techniques. The reform led thus to an overhaul of the method used to establish credit risk requirements, but also to an extension of the framework to a new category of risk (operational risk), and to a more general change in the spirit of the regulation: while Basel I only aimed at enforcing minimum capital requirements, Basel II is also concerned with banks' internal control and disclosure processes, which constitute in the new framework the “second” and “third” “pillars” of regulatory supervision (the “first pillar” being the different capital requirements). This three pillars complex architecture of Basel II is a perfect example of the neoliberal contradiction that we want to address in this paper.²

The works of Michel Foucault will help us to understand how such a framework animated by a neoliberal spirit and aiming at exercising control at the meta-level of organizational governance counter-intuitively goes hand in hand with coercive rules, imposing on all banks similar risk-assessment metrics and risk-management processes. Michel Foucault's classes on neoliberalism (2008) are very helpful for understanding the kind of regulation we are interested in. According to him, what neoliberalism requires is not a withdrawal of the State (as in the traditional free market liberalism of Adam Smith), but a transformation of practices by the State which, on the contrary, actively intervenes to produce the right conditions for a market and helps markets to emerge and produce their benefits whenever possible. We will show that the design of the Basel II Accords embodies this view.

Foucault also stresses that among the necessary conditions for construction of these markets, it is important to produce subjects (through the intermediary of biopolitics) able to act in a world made up of markets. We aim to go beyond this analysis and show that when the market agents are enterprises (not only individuals), they too must be subjected to active production and a conformation process. And the form of behavior expected cannot be just the one of any type of enterprise; it must be able to go through a subjectification process that itself also brings a range of power techniques into play. This framework is consequently able to explain the concurrent development of liberty and discipline in the economic field and more specifically, how this development plays out in the case of the credit-risk regulation of the Basel Accords.

¹ The “Basel Committee on Banking Supervision” (BCBS) is hosted by the Bank for International Settlements, in Basel. It was established in 1974, shortly after the failure of the Bankhaus Herstatt, by the countries that created the “Group of Ten” to refund the IMF in 1962. Until 2009, its members were the representatives of the central banks and financial supervisory authorities of Belgium, Canada, France, Italy, Japan, the Netherlands, Luxembourg, the United-Kingdom, the United States of America, Germany, Spain, Sweden, and Switzerland. In 2009, 14 new members have been added and the composition of the Committee is now close to the composition of the G-20 group.

² Following the 2007 financial crisis, the framework has been reformed once more through the so-called Basel III Accord. However, Basel III is built on Basel II: it has changed the definition of the elements recognized as capital and added some new elements, but the global architecture of the framework and most of the methods and instruments introduced under Basel II have been maintained.

1.1. Towards a new understanding of the technical dimension of risk-based regulations

Research on the extension of risk management has already highlighted certain aspects of Basel II framework. For example, Power (2007, Chap 4) looked at the introduction of market and operational risks in addition to the initial requirements for credit risk in the framework. His analysis presents the successive reforms of the Basel Agreements as a shift from a command-and-control approach towards one “with the flavour of enforced self-regulation” (Power, 2007, p. 106). However, the impressive inflation in technical rules and details³ accompanying the reforms of this regulatory framework remains understudied, as does credit risk (the preeminent part of the Basel requirements⁴) in the risk-management explosion literature. Additionally, we argue that the incorporation of market and operational risks in Basel Accords is not the only significant aspect, and that it does not exhaust what this Agreement can teach us about risk-based mode of government. More specifically, our focus on the most classical credit risk authorizes a new understanding of how risk-based regulations are counter-instinctively associated with a multiplication of rules and detailed prescriptions.

First, we will show that Basel II cannot be only understood as a shift from “command-and-control” to a “softer” and more cooperative logic of regulation, because the “command-and-control” logic is also strongly active. Note that, to explain how laws delegating much to self-regulation may end up producing tight normative networks, our point is not that the regulation is articulated with other sources of normativity that alleviate its ambiguities, as presented in the work of Dobbin and Sutton (1998) or Edelman (1990, 1992). In this research, we deal only with the crafting of the hard law. We show that it is made of different bricks and, crucially, that the initial purpose to rely on self-regulation is contradicted by the real technical content of the standards themselves.⁵

Second, we will show with our case study that changes in risk governance and management appear intrinsically linked with changes in risk metrics. This suggests that risk measurement is more than ever at the center of the regulation, and that rather than marking a shift from “risk measurement” to “risk governance,” the rise of risk-governance processes in risk-based regulation is to be seen as a complementary, and not an alternative constraint to risk-quantification rules.

Much research has addressed the development of risk-management thinking, philosophy or discourse, for example through the diffusion of Enterprise Risk Management (ERM) (Mikes, 2009, 2011; Arena, Arnaboldi, & Azzone, 2010; Soin & Collier, 2013), notably in the public sector (Black, 2005; Woods, 2009), or in the financial sector through the new obligations concerning “operational risk” (Mikes, 2011; Power, 2007; Wahlström, 2006). These examples of risk-management expansion concern situations where the operationalization of risk management is only beginning and where the most pressing issues are explaining the principles of risk management, legitimizing its adoption and enrolling the actors. This makes it understandable why research has focused mainly on diffusion of risk-management discourse, but a detailed study of the multiple and precise technical requirements accompanying the risk-management arrival is still needed to understand thoroughly what kind of changes they produce. We argue that it is through a special attention to techniques that it is possible to document the actual constraints that come with risk-management systems.

This technical dimension of risk-based regulation has been addressed in the literature with the vocabulary of bureaucratization. The inflation of tools and technical standards associated with risk management has thus been described as a bureaucratization risk. Power (2007, 2009) explains that risk-management based standards contribute to create a climate favoring the development of defensive strategies in which the search for auditability would prevail over the search for relevance. The development of risk-management systems increases the risk of developing over-formalized, quantified, and easily auditable risk-management routines, which are cognitively comfortable but provide only an illusion of security. This analysis has been partly challenged by works highlighting the hybrid nature of risk-management practices and their contingency to the pre-existing logics in the organizations (Miller, Kurunmäki, & O’Leary, 2008; Wahlström, 2009; Woods, 2009; Mikes, 2009, 2011; Arena et al., 2010; Soin & Collier, 2013). But even Mikes – whose work shows that the development of highly quantified and standardized routines of risk management depends on the prevalent “calculative culture” (Mikes, 2009, 2011) – recognizes that in spite of these differences, and “due to compliance imperative,” all the banks she studied were engaged in similar projects to develop “risk measurements” and “an economic capital approach for the internal allocation of capital” and that, as far as risk quantification is concerned, “the regulatory imperative should not be underestimated as a driver of coercive isomorphism in the banking sector” (Mikes, 2011, p. 240).

Our paper explores the paradox of how a neoliberal-inspired reform can give birth to its apparent opposite – a strengthening of discipline and controls, instead of a liberalization of practices – but suggests an alternative view to Power’s insights on the possible “pathological drift” towards bureaucratization. Rather than wondering whether the strengthening of discipline and controls undermines the capacity of risk-management processes to actually manage risks (an issue on which we will not take position here), we focus our analysis on what the rise of disciplinary processes in a neoliberal-inspired

³ Setting aside the further additions to the framework gathered under the name of “Basel III,” the initial 28-page text of the first 1988 Basel I Agreement has reached the impressive size of 333 pages in the latest consolidated version of the Basel Agreement issued in 2006.

⁴ From a sample of 50 large international banks, Le Leslé and Amramova (2012) estimate that credit risk accounts for 86% of requirements, compared to 6.5% for market risk and 7.5% for operational risk.

⁵ Basel II has also the particularity of being a state-enforced regulation and not a voluntary standard. In his works, Power (2007) does not particularly distinguish between the kinds of normativity (hard- or soft-law) that support risk-management, while it is a central focus point for us. Incorporation into hard-law is not the destiny of every practice of self-regulation. Many will never enjoy such a success. We consequently suggest that such incorporation should not be analyzed in isolation, but rather as an element embedded within a broader set of rules constituting a specific regulatory program.

reform can teach us about neoliberalism in general, and about the Basel regulatory program for credit-risk management in particular. In this perspective, our analysis suggests that the strengthening of discipline and controls in the regulation should not be seen as a “pathological drift” in the regulation, but rather as both neoliberalism’s other face and its very condition.

1.2. Method and structure of the article

To understand these questions, it is important to pay attention to the detailed process of writing the regulation in order to highlight the questions and problems met by the regulators themselves. This article is rooted in such research, as we follow the changes regarding the requirements for credit risks from the Basel I accords (1988) to the Basel II accords (2004), from one preparation report to another,⁶ until the crafting of the ultimate text.⁷ We try to combine discourse and technical analyses, in order to give attention to rationalities as well as to programs and technologies (Miller & Rose, 1990). Our analysis does not separate the different “pillars” of the regulation: we analyzed the changes made to the calculation methods of the capital requirement (“pillar I” according to the language of the Accords) as well as the arrival in the regulation of the two others “pillars” (“pillar II” on the supervision of internal control and “pillar III” on disclosure). We show that in many respects, the design of pillar I (dedicated to risk metrics) cannot be dissociated from the content of the two other pillars (risk governance and management).

However, our analysis also shows the complexity of this process. On the one hand, the change between Basel I and Basel II on credit risk is driven by a free market agenda built on a critique of the inefficiency and unwelcome side effects of State intervention in financial affairs, and it seeks to assign responsibility for the stability of the financial system to decentralized decisions by the banks. This aspect is highlighted by regarding discourses that have been produced by promoters of the Basel II reform⁸ (mainly from the US Federal Reserve System), who explain very crudely their regulatory vision. However, this does not tell the whole truth about the Accords which end up as being a highly disciplining regulation, in many respects more intrusive than their former version. Specifically, our analysis of the reform of credit-risk requirements from Basel I to Basel II points towards three intertwined processes of disciplinarization: the regulator’s construction of financial incentives, the imposition of working methods, and the implementation of a bureaucracy of control.

The rest of the article is structured as follows. The first section presents our theoretical framework and notably how the work of Foucault can be helpful to understand the present case. The second section presents the system constructed by the Basel II Accords especially the technical options chosen for the calculation of credit risk capital requirement. We study the change in the calculation method between Basel I and Basel II, showing that in practice it effectively delegates management of the security of the financial system to the actors in the system. Study of the discourses accompanying the reform demonstrates that this change was indeed the product of a liberalization political agenda based on a strong critique of State intervention and carried by lobbies representing market actors. The technical form of the minimum capital requirement is thus inseparable from the neoliberal agenda that gives it meaning. The third section of the article shows that it was not possible to implement the original agenda and that despite the underlying aim of liberalizing the financial sphere, it resulted in substantially more discipline, and above all an unprecedented level of rules on banking practices. The regulators in charge of financial system stability and market efficiency (instituted as a common good), found themselves obliged to lay down mandatory practices for banking establishments in order to change them and to ensure that once “liberated,” their systems of action and decision-making would keep them within the defined frame.

This approach enables us to grasp how strong disciplinary processes and intrusive state regulations may be embedded in neoliberal reforms inspired by critics of state intervention. More specifically, it enables us to understand how management accounting and control processes in the field of credit risk are strongly framed by a reform presented as “liberalizing” practices. Finally, this approach allows us to perceive how neoliberal reforms and financialization, broadly understood here as the specific form capitalism is currently taking, are interacting one with the other. In this perspective, our study provides insights on how risk-based regulations may contribute to what we see as a financialization of one of the most traditional forms of financial intermediation: the distribution of credit and loans.

2. Neoliberalism and discipline

Foucault’s (2008) analyses of neoliberalism, taken up more recently by Dardot and Laval (2009), suggest that the neoliberal agenda should not be considered synonymous with less State intervention in economic affairs, in other words a

⁶ The negotiation of the reform took 5 years (1998–2004) and involved the publication of three consultative documents (1999, 65 p.; 2001, 541 p.; and 2003, 244 p.), five quantitative impact surveys and several complementary reports before the publication of the final Agreement (2004, 251 p.) and of its first consolidated version (2006, 347 p.). The corpus studied was consequently composed of 19 documents representing about 2000 pages of text. When explicitly cited, these documents appear in the bibliography.

⁷ Requirements regarding credit risk introduced under Basel II in 2004 have been integrated to the latest consolidated version of the Agreements available, which was published in 2006. These requirements did not significantly change with the introduction of Basel III and all the methods and instruments for calculating credit risk presented in this study have been maintained under Basel III. The rules presented here consequently still are Basel standard regulatory rules for computing credit risk today.

⁸ A corpus of 31 public discourses pronounced between 1998 and 2003 by the main promoters of the reform has been created and analyzed. When they are explicitly cited, the references of these discourses appear in the Appendix A.

policy of liberalization and “laissez-faire”. The neoliberal view does not assume that free markets will naturally emerge and grow harmoniously if the State withdraws. According to Foucault, it is what distinguishes this present-day or neo-liberalism from the classical liberalism of Adam Smith, Jeremy Bentham and the physiocrats. In contrast to their classical view, where the government was called upon to respect the form of the market and laissez-faire, the neoliberal view considers that markets result from a legal order and require public regulation. State intervention in economic affairs thus takes on a new nature, and involves setting formal, shared rules for the “economic game.” The objective is to create a framework in which competition can develop and markets can operate efficiently. The new rules must therefore support development and reinforce the competition mechanisms that guide production and the economic allocation processes.

2.1. Neoliberalism as new programming of liberalism

Note that if Foucault clearly distinguishes the “neo-liberalism” that emerged in the 1930s from the “classical” liberalism of the eighteenth century, it is as two different – but strongly linked – programmings of the same governmental rationality.

Foucault (2008) first refers to liberalism as a specific form of governmental rationality characterised by its reliance on a very specific principle of limitation of governmental action: the principle of the self-limitation of governmental reason.⁹ Liberalism is thus based on “a critique of the irrationality peculiar to excessive government” (Foucault, 2008, p. 322), and, as such it also constitutes “a tool for the criticism of reality: criticism of a previous governmentality from which one is trying to get free; of a present governmentality that one is trying to reform and rationalize by scaling it down; or of a governmentality to which one is opposed and whose abuses one wants to limit” (Foucault, 2008, p. 320).

According to this definition, neoliberalism is then “a liberal type of governmentality” (p. 86) but with a new “programming” (Foucault, 2008, p. 94) which results from the crisis of its previous forms (during the 1930s). This new programming permits the association with new technologies. Neoliberalism or, as Foucault first called it, “today’s liberal [. . .] program,” is “brought into play and analyzes itself” (p. 78) by reactivating liberalism as a tool to criticize the state and to identify its “destructive and harmful effects” (Foucault, 2008, p. 117). However, it also represents “an absolutely important mutation with regard to [the] traditional liberal projects [. . .] born in the eighteenth century” (p. 117) because, to organize the powers of the state on the basis of the market economy, this new liberal program does not assume that free markets will naturally emerge if the State withdraws.

From now on we will consequently use “free market liberalism”, “liberalization” and “liberalized” when we directly refer to the eighteenth century formulations of the liberal project or when we deal with current discourses and programs putting a stress on state withdrawal and “laissez-faire” policies, which is a way to remember the filiation between neoliberalism and its previous formulations. Conversely, we will restrict our use of the terms “neoliberal” and “neoliberalism” to the discourses and programs that specifically affirm the necessity of an active public regulation to achieve the construction of competitive and supposedly efficient markets.

In this perspective, what is interesting about Foucault’s work is that it highlights how liberalism has been historically articulated with several sets of governmental technologies.

2.2. Production of subjects

The neoliberal mode of government requires actors who think and act in competitive mode, i.e. who see themselves as “enterprises” in competition with each other.

“It is a matter (. . .) of constructing a social fabric in which precisely the basic units would have the form of the enterprise (. . .) I think this multiplication of the ‘enterprise’ form within the social body is what is at stake in neo-liberal policy. It is a matter of making the market, competition, and so the enterprise, into what could be called the formative power of society.” (Foucault, 2008, p. 167)

The means used to achieve this, Foucault explains, is to systematically transpose models of entrepreneurial rationality and behavior in describing individual situations. Each individual will be thought of and treated as a *homo oeconomicus* who freely makes his own decisions, who takes risks when investing with the hopes of making a profit, who is working in his own interests, and who is consequently in the best position to make decisions concerning those interests. Such individuals must also be held fully accountable for the consequences of their actions and assume responsibility for their unconstrained choices.

Dardot and Laval (2009) give a detailed description of how the welfare state has been picked apart in the name of discouraging state handout mentalities that are contrary to the spirit of responsibility that should prevail. The final chapter of their book shows how the neoliberal subject is produced, notably through a range of management techniques (such as individual performance assessment). Little by little “each subject has been led to see himself and to behave in all aspects of his existence as a bearer of capital that should be improved: university studies, private pension plans, becoming a homeowner, long-term investments in stock market securities” (Dardot and Laval, 2009, p. 285, authors’ own translation).

⁹ Liberalism “is the idea of society which permits the development of a technology of government based on the principle that it is already in itself ‘too much’, ‘excessive’—or at least that it is added as a supplement whose necessity and usefulness can and must always be questioned” (Foucault, 2008, p. 319).

Individuals thus find themselves subjected to a disciplinarization process that teaches them how to behave as neoliberal subjects and how to keep competition in operation.

Foucault's study shows the historical ambiguity of the expansion of liberalism, which has gone hand in hand with a concurrent progression of discipline since its first formulations:

"The second consequence of this liberalism and liberal art of government is the considerable extension of procedures of control, constraint, and coercion which are something like the counterpart and counterweights of different freedoms. I have drawn attention to the fact that the development, dramatic rise, and dissemination throughout society of these famous disciplinary techniques for taking charge of the behavior of individuals day by day and in its fine detail is exactly contemporaneous with the age of freedoms." (Foucault, 2008, p. 67)

"[T]he very formula of liberal government," Foucault continues, "is the Panopticon" where the accent is put on visibility and this discipline described by Foucault seems compatible with the principle of state withdrawal:

"What basically must a government do? It must give way to everything due to natural mechanisms in both behavior and production. It must give way to these mechanisms and make no other intervention, to start with at least, than that of supervision. Government, initially limited to the function of supervision, is only to intervene when it sees that something is not happening according to the general mechanics of behavior, exchange, and economic life." (Foucault, 2008, p. 67)

Current neoliberalism also clearly embodies a disciplinary dynamic. Like classical free-market liberalism, it is a producer of discipline, as a means of subjectification. But the disciplinary means and the standards that have to be incorporated are specific. The new behavioral standard is thinking and acting like an enterprise competing on the markets, with resources and capital that must be cleverly invested to generate profits. The discipline exerted on people as individuals is intended to make them internalize these norms so that they exercise auto-control and thus do not endanger the social order while they are, at the same time, maximizing their profits.

Whereas the literature has focused mainly on the discipline exerted on individuals, we argue that individuals are not the only beings placed under subjectification processes. Legal entities are concerned as well, and we intend to describe the particular forms of discipline at work in their case.

2.3. *Disciplinarization of legal entities*

The first discipline that comes to mind is the "market" discipline widely demanded by the neoliberal vulgate. This discipline results from stronger competition (measures taken against monopolies and dominant positions, opening up former state monopolies to competition, etc.). Competition is supposed to ensure that consumers can choose the best products at the best price and thus produce better economic efficiency because the quality of decisions is improved. This quality is itself presumed to grow along with public information, intended to keep consumers and investors better informed so they can make the best choices. In return, their decentralized decisions based on quality information are supposed to promote the common good.

Improving public information is thus presented as the path to truly efficient markets, i.e. markets whose operation is beneficial for the whole system. The financial markets are a principal setting for application of these ideas, as much of their regulation concerns equitable management of information. More broadly, this idea of greater discipline through better information underlies several practices that affect all kinds of organizations. This explains the rise of rankings and other performance comparison systems, which are known to have the capacity to change practices (Espeland & Sauder, 2007). The growing number of ratings and label systems is another illustration of this aim to discipline organizations by disseminating information that is used by market actors to choose between the offers available to them. To impose discipline, this "regulation by information" (Schneiberg & Bartley, 2008) does not necessarily need to prescribe any particular course of action beyond information disclosure itself: price mechanisms and consumers' choices are supposed to "naturally" sanction deviant behaviors.

But market-discipline is not the only noticeable discipline: at least, some well-documented disciplinary mechanisms have the specificity of exerting their influence on States. They may take the form of market-mediated mechanisms (currently, for example, government borrowings go through the financial markets). But their main feature is that they also include very strict rules on the operating and management methods which States must adopt. The structural adjustment programs imposed on developing countries in exchange for aid from the IMF and the World Bank, for example, have been particularly prescriptive. The form of States, their practices, and their intervention methods had to change in order for market discipline to flourish everywhere. In such cases neoliberalism showed that the discipline it conveyed was not spread by free competition alone. States themselves have had to submit to fundamental morphological transformations that are not pure products of competition, but have made it possible to bring them, too, under the rule of competition and its discipline (to such an extent that certain observers believe even the law is now broadly produced by competition between different countries' laws).

This article seeks to show that for enterprises as well, market discipline is not enough to produce the supposed and desired effects, and this is a less well-documented issue. Enterprises are no more likely than individuals or States to behave spontaneously in a way that allows the market order to generate its "benefits." The stimulus of competition alone may be insufficient. The case examined here shows that at least some enterprises in the banking sector find themselves ordered to

change the ways they do their business. The neoliberal enterprise is thus also the product of conformation that operates through disciplinarization processes that cannot be explained by competition alone and that operate, so to speak, upstream of competition.

How does a neoliberal government go about producing actors (individuals, enterprises, States) that have sufficiently calculable rules of behavior and action and that are disciplined enough for market self-regulation to produce the expected benefits, while also ensuring that each individual freely decides to become disciplined (as delinquency is still a possible option)? The neoliberal solution to this thorny problem involves construction of incentives.

2.4. *Disciplinarization by incentive*

Incentives aim to manipulate the criteria included in calculations by economic agents. It is because subjects are encouraged to act as a *homo oeconomicus* that the incentives have an influence:

“(T)he individual becomes governmentalizable, (. . .) power gets a hold on him to the extent, and only to the extent, that he is a *homo oeconomicus*. That is to say, the surface of contact between the individual and the power exercised on him, and so the principle of the regulation of power over the individual, will be only this kind of grid of *homo oeconomicus*.” (Foucault, 2008, p. 252–253)

Norms of action are now prescribed through conscious organization of an incentive system such as “freedom to choose,” which “is in fact the obligation to obey a maximizing conduct in a legal, institutional, regulatory, architectural, and relational framework, which must in fact be constructed for the individual to choose ‘freely’ what he must obligatorily choose in his own interest” (Dardot & Laval, 2009, p. 300, authors’ own translation). The specificity of the neoliberal program compared to liberalization policies is that the aim is not only to define a space for freedom by prohibiting certain practices and leaving others open to choice. The list of authorized practices is much longer, and the freedom seems greater, but in fact each practice is bound up with an incentive formula carefully designed to make the maximizing individual choose a particular option, and this is all the more true as it is the system that teaches him how to calculate “properly.”

Enterprises themselves are subject to these processes, which actually aim to lay down their organization modes and management modes, in contrast to the discourse claiming that they have never been as free to do as they wish, and that the only sanction they risk is not being chosen by actors (customers, employees, investors, etc.) who, due to free competition, have the option of choosing another enterprise instead. Market discipline is thus complemented by a more pervasive and very prescriptive discipline, as some ways of doing things are indicated as desirable by the incentive system. Some questions raised at this stage are why is market discipline considered to be an insufficient method for markets to self-regulate so that they will produce the expected common good, and why does the neoliberal lawmaker consider then it necessary to dictate rules via incentives (since, unlike the “command and control” style of its predecessors, it cannot ban or control).

If certain management practices and methods are imposed on firms through incentives, meaning they are not entirely free to make their own operational choices, then clearly competition will not enable investors, consumers, and labor providers to pick the most suitable firm for themselves, or at least the choice will be extremely restricted. It is thus important to understand which limitations are imposed in this way, and which forms of organization are surreptitiously disappearing.

2.5. *Selection of acceptable organizations*

This type of selection has always been the prerogative of public policies and the law, but laissez-faire policies would imply to leave this choice up to market selection. In practice however, this is not the case.

Our past work on accounting standards (Chiapello, 2005a, 2005b) showed that hidden behind the choice of accounting standards used for listed companies’ published financial statements is a particular selected view of the firm and its role, such that this choice is more than a simple decision for a certain set of conventions just because one is needed to make the market work. In this regard, the EU (European Union) decision to enforce IFRS standards for EU listed companies has been particularly questioned by the accounting literature. The standpoint from which financial statements are established has shifted from that of a producer of goods and services seeking to construct a durable, profitable economic activity, to that of purchasers of securities on the market seeking to make a profit from trade in those securities. In fact, the accounting standards issued by the IASB define the enterprise by reference to the financing markets and to financial users (Young, 2006; Zhang & Andrew, 2014), and not the other markets in which it operates (the market for the products and services which it buys and sells, or the labor market). This justified the integration of valuation techniques derived from financial economics into accounting, notably through the adoption of the fair value principle (Müller, 2014) which can be analyzed as a form of financialization of accounting (Chiapello, 2015, 2016).

2.6. *Studying neoliberalism technologies*

Yet, technologies’ role in the selection and reproduction of specific forms of organizational behaviors is neither straightforward, nor necessarily claimed, nor even totally deliberate. Discourses and technologies are not perfectly coupled (Miller & Rose, 1990).

Standard-makers have to deal with powerful interests but also with the necessity to justify their choices towards various other stakeholders and audiences. To do so, they rely on their own cognitive and normative schemes, which consequently have an impact on their choices. However, as actors are embedded in these schemes, they may constitute a blind spot both in their reflexivity and in their justification discourses. Moreover, the negotiation of standards implies normative and “technical” schemes, which do not necessarily totally overlap and converge. Indeed, although “technique” has some plasticity, it also brings with it specific requirements that are sometimes difficult to circumvent. Even when justifiable political compromises are reached, their operationalization at the most technical levels may consequently raise new issues, which in turn generate interest from new actors. The design of specific standards emerges from such successive rounds of interactions. Of course, these rounds are interrelated. However, the outcome of each of these socio-technical interactions cannot be totally anticipated. There is always at least a possibility that such processes result in the design of technologies that are both coherent with previously established objectives, but also partly unexpected, even by those who participated in the process. To better understand how discipline is articulated under neoliberalism, we therefore suggest to study not only the standard-makers, their discourses and their social networks, but also, crucially, the standards that emerged from this process themselves.

To do so, we below analyze the Basel Accords on the basis of the instruments they propose by dissecting the way indicators are calculated and by identifying the sources of information and the quantification processes that have produced them. Of course this is a significant undertaking (and often an arduous one when discussing financial regulation), but we feel this starting point is necessary if we are to go further than the discourses. Sometimes, as will be seen, there is a gap between the governance agenda conveyed in the Basel Accords and the associated techniques and their implementation, and this gap can offer a glimpse of phenomena that have not often been described to date. Having broadly established our intended theoretical contributions, we now present the case study.

3. The basel reform on credit risk¹⁰: an agenda of liberalization

Credit risk is the oldest and still one of the main risks for banks. It is the risk of counterparty¹¹ default on credit, in other words the risk that the person who has promised to repay a loan will not be sufficiently solvent to do so within the time and terms agreed, and will thus be in “default.” Requiring banks to keep a minimum level of capital to cover that risk can improve the stability of the financial system by limiting the risks of bank failure, because the capital required by the regulations can be used if necessary to absorb losses caused by non-recovery of credit in default.

This is not the only possible regulatory mean to protect the stability of the financial system in case of a credit crisis. However, following the passing of the Basel I Accord in 1988, the principle of a norm for capital specifically apt for confronting credit risk and the rational of capital requirements as stipulated in the treaty took hold, progressively being adopted by more than 100 countries.

The Basel credit risk ratio has been modified twice: in 2004, through the Basel II Accord, and after the financial crisis, through the Basel III Accord. The Basel II rules now apply to most internationally active banks in the world and many countries – such as the EU countries – apply them to the totality of their banking sector. Moreover, requirements regarding credit risk established by Basel II in 2004 did not significantly change with the additions to the framework introduced by Basel III¹² and all the methods and instruments for calculating credit risk introduced under Basel II have been maintained. They consequently still are the standard regulatory rule for computing credit risk today and represent, as such, a major instrument of financial regulation at global level.

The 2004 reform of the requirements regarding credit risk is generally presented simply as a modernizing reform sharpening the rigor and detail of the original accord. However, on the technical level, this reform clearly marks a change of direction: analysis of the mechanisms introduced shows that the conventions used to measure risks and set the level of regulatory requirements were almost entirely overhauled in Basel II.

After presenting the changes, in terms of content, between Basel I and Basel II, we trace them back to the political agenda that underlies this situation.

¹⁰ All the data presented below were collected for Céline Baud’s doctoral thesis. A wide variety of data was collected (studies and documents issued throughout the regulatory process, speeches by Basel committee chairmen, parliamentary debates on the incorporation of the Basel Accords into US and European law, study of application of the reform in a French bank specializing in small and medium-sized businesses, finance research articles, and research on the risk modelling that inspired the conventions selected).

¹¹ The counterparty in a credit is generally the borrower, but may be a different party in some cases, for instance if the borrowing is fully guaranteed by a third party.

¹² The Basel III Agreements have changed capital requirements for market risks and the definition of the elements included in the capital. They also plan a global increase in the capital adequacy ratio and the implementation of liquidity ratios. However the implementation of these two last elements only began in 2015 and should not be totally effective until 2019. Basel III full implementation will consequently modify the structure and the level of the capital required for credit risks, but our object of study in this text – the methods used to quantify credit risks – is left unchanged under Basel III.

3.1. A new solvency ratio

The solvency ratio (called the Cooke ratio) put in place by Basel I required banks to hold capital equal to at least 8% of their total risk-weighted assets. The minimum amount of capital a bank must hold in reserve to be allowed to operate, *MinimumCapital*, is calculated as follows:

$$\text{MinimumCapital} = 8\% \sum r_i C_i$$

where: C_i represents the amount of credit due to the bank as presented in the balance sheet; r_i is the risk weighting to apply to the asset, as determined by the regulation.

The default weighting is 100%, but lower weightings (0%, 20% or 50%) applied for certain counterparties and, in specific circumstances, for certain types of loans. Thus, under Basel I, the weighting assigned to sovereign debtors (States and their central banks) was 0% if the sovereign debtor was an OECD member. There were no capital requirements for this type of credit. The weighting for borrowings by banks from OECD countries, multilateral development banks and borrowings guaranteed by such banks was set at 20%. The capital requirement for this type of credit was 1.6% of the bank's commitments (20% of 8%). Finally, borrowings by the private sector (businesses, individuals) and non-OECD countries¹³ were weighted at the default rate, 100%. The basic capital requirement of 8% thus applied in such cases.

When the Basel Accord was reformed in 2004 (Basel II), the new ratio (called the McDonough ratio) for credit risk retained a similar form. The definition of the items included in the capital base was broadly unchanged and only the weightings for assets (r_i) were substantially modified. Basel II brought in two authorized asset weighting methods: the standard method (based on external ratings) and the IRB method (based on internal ratings).

The standard method operates under the same principle as the initial Accord. Risk-weight coefficients defined by the regulator are applied to different transactions according to the type of counterparty. As previously, the higher the weighting, the higher the capital requirements: this has a cost for the bank, and potentially for the client.¹⁴

The major difference between Basel I and Basel II Standard Method was that the " r_i " values were no longer based on institutional criteria (OECD or non-OECD country) for States and banks, and on a relatively indifferent attitude to enterprises (standard weighting of 100%). Risk weightings were now based on the counterparty's credit ratings (AAA, AA-, B, etc.) assigned by specialist agencies. Three private rating agencies, which make up the dominant oligopoly worldwide, received official accreditation for this purpose: Moody's, Standard & Poor's, and Fitch Ratings. Other agencies were also accredited locally by national banking authorities.¹⁵ The better the credit rating, the lower the weighting, which means a lower capital requirement (0% for a State rated AAA, 20% for a bank rated AAA but up to 150% for an enterprise rated lower than B-).

This was a ground-breaking shift: the reform radically altered the nature and source of the information on which the legitimacy of regulatory "judgment" is founded. In practice, by adopting the "OECD Group" system, the states of the Basel Committee had previously opted to assign more favorable weightings to certain States and their banks. By subsequently adopting weighting principles based on financial ratings and equally applicable to all, they delegated part of their assessment role to the rating agencies and abandoned their prerogative. Financial market expertise thus partly supplanted State expertise, and this is all the more remarkable given that this shift was organized by the very States that gained the most from the earlier system. The new standard method marked the move to a model in which State conventions recognize financial evaluations as legitimate grounds for regulatory "judgment." However, this method is still strongly marked by State presence and authority, since it is the States who define the risk weighting to apply to each of the possible scores in the agencies' rating systems. This leads to a hybrid situation in which the market's assessment is reinterpreted by the regulatory authorities, who put their stamp on the process.

The IRB (internal rating-based)¹⁶ method marked another change, basing risk assessment on an internal scoring system (i.e. carried out by the banks themselves, although they may use external ratings in their internal process) applied to each counterparties. When they assign ratings to borrowers, banks put them into particular risk classes. They then estimate the statistical probability of default for each risk class, usually based on historical data. Calculation of prudential requirements in this method is based on estimated probabilities of default that are processed through a special financial model chosen by the regulator (the ASRF¹⁷ model). This time, it is not financial market actors (such as ratings agencies) that are influencing calculation of capital requirements, but models derived from financial theory.

¹³ Excepted if debt was denominated in its national currency. In this case, the weighting applied is 0%.

¹⁴ The cost of holding capital can be passed on the clients through the interest rates offered by banks. But it is also in the banks' interests to preserve their market share, especially for the lowest-risk clients, by offering low rates. This is particularly true for large borrowers who are often considered "low risk" and can obtain financing directly from the financial markets.

¹⁵ In France, for example, the COFACE and the Banque de France (Fiben Cote 3) rating systems were certified.

¹⁶ As opposed to "external ratings" by agencies.

¹⁷ Asymptotic Single Risk Factor.

Table 1

Greater responsibility of financial actors in calculating the capital necessary to cover credit risk.

| | Assignment of the counterparty to a risk class | Choice of weighting coefficient applicable to the risk class |
|--|---|--|
| Basel I (1988) | Convention set by signatories to the Basel Accord based on counterparty nature (bank, nation State, enterprise, individual, etc.) and location (OECD or non-OECD) | Convention set by the Basel signatories (0%, 20% 50%, 100%) |
| Basel II (2004) – Standard method – (External ratings) | Use of ratings established by accredited agencies | Convention set by the Basel signatories (0%, 20%, 35%, 50%, 75%, 100%, 150%) |
| Basel II (2004) – IRB method – (Internal ratings) | Use of internal ratings established by banks | Based on estimated probability of default calculated internally by the bank (Foundation IRB method) and where relevant, the estimated rate of loss in case of default (Advanced IRB method). ¹⁸ The complete weighting also requires the use of the ASRF model chosen by the regulator. |

The transition to Basel II was thus marked by the introduction of a new system of measurement conventions based on the conventions and tools of finance—which can be seen as a type of cognitive financialization—, and the relinquishment by the States of their power to decide on weighting levels, which was delegated either to rating agencies (external ratings) or to the banks themselves (cf. Table 1).

Note that the use of financial estimates is presented in the regulations as a guarantee of impartiality, since these estimates are supposed to offer an “objective” alternative to the “arbitrary” compromises previously established by States. The arbitrary nature of Basel I, which imposed a rule because a rule was needed to harmonize capital requirements and avoid unfair competition between banks, was thus said to be giving way to a realistic estimate of the “true” amount of capital required. The IRB method embodied the State’s conversion to the idea that theories and techniques drawn from the financial markets can reflect the true level of risks, in a “metrological realism” approach (Baud, 2013a; Chiapello & Desrosières, 2006).

Technical analysis of the minimum capital requirement and how it changed between Basel I and Basel II clearly shows a trend of handing over regulatory power to market actors, and a decline in States’ decision-making power. We shall now show that this was indeed the Basel reformers’ political agenda.

3.2. A political agenda of market liberalization

In June 1998, the President of the Federal Reserve Bank of New York (FRB of NY), William McDonough, was appointed Chairman of the Basel Committee. He decided to conduct a “thorough review” of the Accords as soon as he arrived, and this decision was publicly announced at the London conference on *Credit Risk Modelling and the Regulatory Implications* organized by the Bank of England and the Financial Services Authority (FSA) on September 21 and 22, 1998 with the support of the Federal Reserve Board of Governors, the FRB of NY, and the Bank of Japan. Considering the time period, it’s evident that this launch is not connected to any regulatory crisis (such as after financial crisis or scandals), which suggests ideological roots for this reform plan. McDonough’s initiative was preceded by other research conducted in the Federal Reserve System (FRS¹⁹) and by various lobbying groups, whose role in the reform’s process is discussed at the end of this section.

The discussion below draws on the speeches of the following people who repeatedly emphasized the need for and spirit of reform, particularly in the early months of the process:

- Alan Greenspan, Chairman of the Board of Governors of the FRS for almost 20 years (from August 1987 to January 2006), keeping the office under successive American presidents;
- William J. McDonough, President of the FRB of NY (1993–2003) and of the Basel Committee (1998–2003). The FRS’ capital is held by the twelve regional Federal Reserve Banks (FRBs). As New York is America’s principal banking market, the FRB of NY is the largest of these twelve reserve banks.
- Laurence H. Meyer, Governor of the FRS (1996–2002);

¹⁸ Two methods exist, the Foundation and the Advanced IRB methods. In the Foundation method, banks estimate the probabilities of default internally. The other parameters used by the ASRF method are set by the regulator. In the Advanced method, the number of parameters estimated by the banks is larger. For example, the banks also estimate rates of Loss Given Default (LGD) internally.

¹⁹ The FRS or Federal Reserve System (FRS) (known as “the Fed”) is the United States’ central bank. It has three main components: the Board of Governors, the regional Federal Reserve Banks (FRB) and the Federal Open Market Committee (FOMC). The Board of Governors has 7 members and is headquartered at Washington, D.C.

- Roger W. Ferguson, Jr., Governor of the FRS (1997–2006) and Vice-Chairman from 1999 to 2006;
- John J. Mingo, technical advisor to the Division of Research and Statistics of the FRS' Board of Governors (1992–1999). Particular reference will notably be made to his very detailed address at the London conference of September 22, 1998.

Precise references of each of the speeches cited as well as details about the context in which they have been delivered are provided in the [Appendix A](#).

The core of the argument for reform relies on the idea that recent advances in risk modelling techniques enable the banks to calculate, for each loan, the precise amount of “economic capital” that perfectly covers the risk borne. In view of the precision required, the calculation method recommended by Basel I is unsophisticated and inaccurate. Given the divergence between the “economic capital” and “regulatory capital” (the amount required by the regulations), it is impossible to be sure that the risk is actually covered by a bank that meets the requirements of Basel I:

“The inconsistencies between internally required economic capital and the regulatory capital standard create another type of problem—nominally high regulatory capital ratios can be used to mask the true level of insolvency probability.” (Greenspan, 1998)

Banks with sophisticated models practice “regulatory capital arbitrage”(RCA), which consists of 1) securitizing low-risk assets that require regulatory capital higher than economic capital, and 2) keeping assets requiring regulatory capital lower than economic capital in the portfolio. These arbitrage techniques, which can be seen as a way for banks to align their “economic capital” with the “regulatory capital,” are also considered costly for banks, which lose competitiveness compared to other actors not subject to the same constraints:

“Maximization of shareholder value, for example, presumably would not occur if the bank had to incur additional capital costs, because of a regulatory requirement, over and above those called for by the internal risk measurement process.” (Mingo,1998)

“It is clear that our major banks have become quite efficient at engaging in such desirable forms of regulatory capital arbitrage, through securitization and other devices. However, such arbitrage is not costless and therefore not without implications for resource allocation.” (Greenspan, 1998)

Furthermore, these techniques tend to obscure the signal sent out by banks when they publish their regulatory ratios: “For these and other reasons, the 1988 Accord has become increasingly undermined and the risk-weighted capital ratios have become more difficult to interpret.” (Meyer, 1999a)

“The problem as perceived by regulators is that, through RCA, a bank may achieve an overall regulatory capital ratio (a “risk-based” capital ratio, or “RBC” ratio) that is nominally high yet may mask capital weakness; that is, despite a high RBC ratio the bank may have an unacceptably high probability of insolvency.” (Mingo,1998)

“The possibility that regulatory capital ratios may mask true insolvency probability becomes more acute as banks arbitrage away inappropriately high capital requirements on their safest assets, by removing these assets from the balance sheet via securitization.” (Greenspan, 1998)

In response to these difficulties, the reformers outright reject the idea of banning and/or restricting arbitrage practices, arguing that it is important to keep an innovative financial system with the ability to adapt rapidly:

“(P)olicymakers must be sensitive to the trade-offs between more detailed supervision and regulation, on the one hand, and moral hazard and the smothering of innovation and competitive response, on the other.” (Greenspan, 1998, 1999)

Also, introducing bans would mean regulating a number of practices, and this would create significant inflexibilities. It would be extremely restrictive and intrusive for the banks:

“[The] scale and complexity [of arbitraging techniques] imply that the supervisor cannot alone accomplish the job, or at least cannot do so without a degree of intrusion and network of rules and regulations that would be simply inconsistent with the need for flexibility and rapid response by financial businesses operating in an increasingly complex market environment.” (Meyer, 1999b)

“The alternatives to strengthening risk management are limited and not very attractive: prohibitions on activities or very intrusive supervision and regulation. Bank managers and stakeholders, as well as those who believe in the market process, have an important stake in making Basel II work because the alternatives to it are so unappetizing.” (Ferguson, 2003)

This possibility is ruled out and our commentators see only one remaining option: relying on the good practices of the banks, who know their own risks better than anyone and are supposed to be able to perfectly calculate the “economic capital” needed to cover their risks. It follows that calculation of the “regulatory capital” should be based on the banks' internal computations, and that the new regulations must ensure security at a lower cost for the banks, i.e. must not require more than what the market would require if there were no regulation:

“a reasonable principle for setting regulatory soundness standards is to act much as the market would if there were no safety net and all market participants were fully informed./ . . . / [The markets are suggesting] that regulated financial intermediaries cannot maximize their value to the overall economy if they are forced to operate at unreasonably high soundness levels.” (Greenspan, 1998)

So the banks should be left to get on with their work, which is assumed to be of good quality since they are deemed capable of calculating the “economic capital” that should cover each credit risk. Regulatory requirements will thus be below what a well-managed bank would impose on itself:

“The common interest is to keep the Basel standards at a level sufficient to ensure financial soundness, a minimum above which banks will choose to operate. To achieve this, we must fashion a set of standards that does not greatly distort incentives.” (McDonough, 1999)

In these initial discourses, the only discipline talked about is market discipline. It is seen as being able to sanction poor management by increasing the interest rates demanded by the market to lend to the bank concerned: “We have no choice, therefore, but to rely increasingly on market discipline as both a supplement to supervision and regulation, and as a source of information to the supervisors” (Meyer, 1999b). And: “the supervisors have little choice but to rely more – not less – on market discipline” (Greenspan, 1998, 1999).

The relevance of market discipline is discussed in the Basel Committee’s report “Enhancing Bank Transparency” (BCBS, 1998) which seeks to show that a bank the market considers healthy and well-managed can expect more favorable terms in relations with investors, creditors, depositors and other counterparties than a bank considered less reliable. Counterparties tend to apply higher risk premiums and require additional security from riskier establishments. These market pressures are supposed to encourage banks to allocate funds more efficiently and help limit systemic risks. Following this rationale, to get a self-regulating banking system, there should be no need to prescribe any particular course of action beyond disclosure of the information investors want to make their decisions.

Examination of the discourses of Basel II reform promoters clearly demonstrates that their agenda is one of market liberalization. Regulation of any kind is considered to distort market operation and prevent actors from maximizing shareholder value, which the regulator sees as the primary objective of the banking sector, or the only objective to be pursued by enterprises – of all types – in order to maximize general well-being, as Friedman (1962) would put it. Consequently, actors should be left free to operate as they wish and organize the market in such a way that market sanctions alone will oblige them to be efficient. This agenda broadly explains the new calculation methods proposed by the Committee for the solvency ratio which, as seen earlier, trust the ratings issued by banks and financial markets and the risk estimations (probabilities of default) banks associate with those ratings.

Underhill and Zhang (2008), Claessens and Underhill (2010), Tsingou (2012) and Lall (2015) highlight the role of several lobbies and groups to explain how the reform was conducted. Indeed, if the FRS members cited here set the initial agenda, it was not independently from the demands and programs previously established by some of them. Three of these groups are important here due to their links with FRS reformers and the Basel Committee: the Group of Thirty (G30) and two lobbies, the Institute of International Finance (IIF) and the International Swaps and Derivatives Association (ISDA). The G30 – which is a group of personalities who directly manage, supervise or study banks and financial establishments – launched a call to reform the regulation and to re-organize it around norms to be established by the industry itself in December 1997 (G-30, 1997). Tsingou (2012) demonstrated that, at that time, the G-30 had a reputation for objectivity and many informal links with Basel Committee members. The G-30 was consequently both credible and able to make its claims heard by the Basel Committee. This idea is confirmed by the chronology of events: the G-30 call is rapidly followed by the first official discussions on the regulatory use of modelling techniques.²⁰ These discussions were then immediately followed by the publication of two reports, by the IIF and the ISDA, arguing for a reform and, more especially, for the recognition of banks’ internal models for credit risk in the calculation of their capital requirements (IIF, 1998; ISDA, 1998). The critiques developed by the FRS reformers and their interest for internal modelling techniques strongly resonate with the arguments of these groups and lobbies (Baud, 2013b). This convergence of views may also explain why the FRS discourses presented are so strikingly similar despite the variety of the contexts and audiences before which they were delivered (see the Appendix A): the same discourse which had been developed in between regulators could be directly presented to the industry since the reformers’ arguments were already in line with what part of the industry was advocating. Part of this process can consequently certainly be interpreted as the result of a regulatory capture. However, as also recently stressed by Goldbach (2015), the capture hypothesis cannot explain all of the process.

More specifically, we will show through a detailed technical study of this episode that the Basel committee was unable to follow through on its goal to achieve total reliance on banks’ practices, that is, to authorize them to use their own model to estimate the requirements. Even in the version drawing most extensively on items estimated internally by the banks (the advanced IRB method), estimation of the necessary regulatory capital uses a very precise prescribed formula for risk calculation. The regulator chose a very specific statistical model to estimate the amount of losses, the ASRF (Asymptotic Single Risk Factor) model, which the Basel committee elaborated from “time-honoured” financial models. It may be said that the regulators chose to rely on internal banks practices but this statement hides that at the same time they provide a very precise prescription of what these internal practices should be.

²⁰ The first conference on this subject, the “Conference on Capital Regulation in the 21st Century” was held at the Federal Reserve Bank of New York on February 1998 (See the Appendix A for more details).

This imposition of a specific model contrasts with the situation observed in accounting regulation, for example,²¹ which leaves firms free to choose the valuation models they use when they measure their assets on a “mark to model” basis. In the accounting world, allowing use of internal models was not accompanied by instructions specifying which models to use, although the chosen models must be subjected to various audits and assessments. Ultimately, as we shall see, there was an obstacle to the Basel Committee’s aim to liberalize banks’ practices: the fact that the actors it sought to liberate were not in fact ready for freedom, and would have to be taught how to behave properly before being set free.

4. The impossibility of liberalization and the development of new forms of discipline

When the reformers were launching the reform, a survey was conducted of 20 international banks’ practices for estimating “economic capital.” The report of the findings, published in June 1999 (BCBS, 1999), observed that “Very few (if any) banks have developed a fully integrated company-wide model to measure credit risk,” (p. 57), and that “only a small proportion of the banks surveyed by the Task Force is currently using outputs from credit-risk models in active portfolio management” (p. 6). It also found that there was no consensus over which models should be used to prepare such estimates.

The task force was thus forced to conclude that it was not possible to rely on bank practices as they were:

“The Task Force recognizes that credit-risk modelling may indeed prove to result in better internal risk management, and may have the potential to be used in the supervisory oversight of banking organizations. However, before a portfolio-modelling approach could be used in the formal process of setting regulatory capital requirements for credit risk, regulators would have to be confident not only that models are being used to actively manage risk, but also that they are conceptually sound, empirically validated, and produce capital requirements that are comparable across institutions. At this time, significant hurdles, principally concerning data availability and model validation, still need to be cleared before these objectives can be met, and the Committee sees difficulties in overcoming these hurdles in the timescale envisaged for amending the Capital Accord.” (BCBS, 1999, p. 1)

So almost as soon as they were launched, the plans for reform came up against the “immaturity” of banking practices and the need to educate the banks and bring them to use these “good practices.” There is some irony in the fact that the existence of regulatory arbitration was presented as the main reason for the declining relevance of Basel I, while even the experts mandated by the committee believed few banks were properly equipped to use it, at least at the level of sophistication presented in the discourse. And so the transition from Basel I to Basel II looks like a large-scale operation to forcibly incorporate into banking practices forms of financial modelling that were far from widespread or generally accepted:

“The approach is to incorporate within the regulatory and supervisory processes some of the quantitative risk-management tools that large complex banking organizations (LCBOs) now use, or will be using by the time the enhanced Accord is implemented, to evaluate and manage their own risk positions. This requires – and it is essential to our vision – that both supervisors and banks focus on the same positions, controls, and objectives. In the process, not only would other LCBOs be required to improve their risk management, but, in addition, a system would be established that can evolve naturally as risk-management practices themselves evolve.” (Meyer, 2001)

Active conformation of banking practices took three forms. First, banks were given active incentives to adopt the most advanced practices, i.e. to practice in-house financial estimation of potential losses. This was the “incentive” aspect of the accord. But to enjoy the benefits of adopting the most advanced method, banks had to demonstrate that they fulfilled a whole series of conditions, and were making in-depth changes to their management practices extending well beyond the methods for calculating regulatory capital. Lastly, to ensure that the freely adopted standards were actually applied, an impressive system of monitoring was introduced.

These three sources of bank disciplinization are discussed below.

4.1. The incentive-based structure of the accord

As seen earlier, Basel II allows two methods to calculate capital requirements: the standard method and the IRB method, which exists in Foundation and Advanced versions. The Advanced IRB method makes the greatest use of financial modelling and internal estimates (see Table 1 above).

Far from leaving banks a real choice as to which method to adopt, the Basel Committee consciously organized the structure of incentives in such a way that the strongest incentive was to estimate capital requirements under the most advanced method.

Several quantitative studies were conducted prior to the choice of the final model, to gauge it so that it was in the banks’ interest to use the most advanced method. The initial impact studies gave an incentive structure that was totally contrary to the desired result, and so the Committee went back to the drawing board. Table 2 below shows the “gain” in capital requirements under the method used by the bank, compared to Basel I, as estimated for the final version of the Accord. In

²¹ This also contrasts with the Committee’s decision regarding the capital requirements for market risk (1996 Amendment to the Basel I Accord, which was retained in Basel II and III). For market risk, banks can also be left free to use their own model.

Table 2

Total change in capital requirements between Basel I and Basel II.

| | Standard Method | Internal Rating-Based Method | |
|--|-----------------|------------------------------|----------|
| | | Foundation | Advanced |
| Large international banks^a | –0.9% | –3.2% | –8.3% |
| Small national banks^a | –3.0% | –16.6% | –26.6% |

^a Results for the “CEBS” Group comprising all the European countries of the G-10 group plus the following countries: Bulgaria, Cyprus, the Czech Republic, Finland, Greece, Hungary, Ireland, Malta, Norway, Poland, and Portugal. Source: [BCBS, 2006a](#), Results of the fifth quantitative impact study (QIS 5), Table 5.

other words, the advanced IRB method reduces the capital requirement for large international banks by 8.3% compared to Basel I, while the standard method only reduces it by 0.9%.

It is strange to see that despite its aim to improve financial security and despite the announcement that the overall requirement would remain unchanged,²² Basel II resulted in an overall reduction in the amount of regulatory capital.²³ But this is not at all surprising if we remember the reformers’ arguments that quantitative capital standards should no longer constrain the action of “well-managed” banks. This reduction of capital requirements is clearly an outcome welcome by the financial industry, which may support again the thesis of the regulator capture. Nevertheless, the special shape of the incentive structure should also be noticed as it encourages all banks (and especially the small ones that were not using these “advanced” methods) to develop these “good practices” by compensating for the cost of the new system through the allocation of significantly lower requirements. Even the biggest banks that were already more advanced were channelled to implement the model prescribed by the regulators, and to go far beyond their actual practices. Indeed, once the banks were brought to realize that it was in their immediate economic interest to adopt the IRB method, they were then obliged to change their management practices to take advantage of the method.

4.2. *The hidden mandatory management practices involved in opting for the best method*

Access to the IRB method was controlled by a whole series of constraints on internal management that restricted freedom of management and organization in several ways, in order to ensure that the banks would act as suggested by their risk assessment instruments. For example, it was specified that banks wishing to use the IRB method must have approval to do so, and to be approved they must pass what is known as the “use test.” The aim was to ensure that internal ratings systems were not established for regulatory purposes only, to take advantage of the financial benefits offered by the IRB method, but that they genuinely guided the banks’ management decisions every day:

“The Committee does not wish banks to develop risk rating systems simply for IRB purposes. To be in a position to demonstrate to supervisors that an internal rating system should be used for the purpose of determining minimum regulatory capital requirements, a bank must first demonstrate that the rating system is an integral part of its current business and risk management culture.” ([BCBS, 2001](#), section ‘The Internal Ratings-Based Approach,’ §228, p. 48)

There was no way the IRB method could be adopted without subscribing to the entire risk management process associated with the rise of rating and risk modelling systems. Indeed, the final document stresses that ratings and loss estimates “must play an essential role in the credit approval, risk management, internal capital allocations, and corporate governance functions of banks using the IRB approach,” as well as for establishing pricing models²⁴ ([BCBS, 2006b](#), §444, p. 98–99). These recommendations had implications for management of individual loans ([Baud & Chiapello, 2015](#)). The new risk management promoted by Basel II also involved basing decisions to grant credit and determining decision-makers’ delegations of powers on credit ratings (for example, for counterparties identified as the riskiest, the credit decision had to be taken at a more senior level of the organization). There were also implications for allocation of the cost of risk between stakeholders in the credit. The IRB method assumed that the capital was used to cover changes in the level of losses observed around average loss levels (not the average loss itself). This meant it was up to the borrowers to cover the average cost of risk (average loss). As a result, it is impossible, for example, to apply low interest rates for poor customers, because the probability of default was high and high rates automatically apply to compensate for the high average estimated risk. Moreover, as the regulation imposes to link the calculation of capital requirements with the use of pricing models and capital allocation systems, it means that each operation had to be sufficiently profitable to pay the required rate of return on the capital held to cover risks. Interestingly, the interest paid on capital was consequently guaranteed by the method of constructing rates. The

²² See [BCBS, 2006b](#), §14, p.4.

²³ The same impact study ([BCBS, 2006a](#)) finds that the requirements are only rising significantly (+19.5%) for small banks in southern countries.

²⁴ The use of pricing models is regarded as so obvious in this perspective that it is only indicated in the final text of the Agreement that, if banks do not use “exactly the same estimates” for both regulatory and pricing purposes, for example, it “must document [the differences] and demonstrate their reasonableness to the supervisor” ([BCBS, 2006b](#), §444, p. 98–99).

return on risk is somewhat institutionalized, although the very justification for paying interest to capital providers is the fact that there is a risk and that they are supposed to bear it. These arrangements contain the same expectations as highlighted by *Lordon (2000)* in his dissection of the EVA, the indicator of the measure of shareholder value.²⁵

The minimum requirements laid down by the Committee thus imposed specific risk-management and credit-management practices. Each operation with each borrower is supposed to generate the rate of profit that would theoretically be required by investors on the markets for the same operation, namely a risk-adjusted return on capital.

The level of prescription for banking practices was high under Basel II, which progressively reduced diversity in practices and the range of possible conceptions of what a bank is, in favor of a single definition. Banks were primarily considered as actors competing on the financial markets, where the aim was to attract investors by guaranteeing them equivalent or higher returns (compared to the risks) than the levels offered by competitors. Consequently, borrowers and their operations are also regarded as anonymous securities to be traded depending on what is regarded as “their” risks. So, borrowers are also implicitly held fully responsible for what the bank estimates to be its potential losses on any given operation.

The fact that banks’ policies of risk selection and management are also determining banks risks and the fact that banks may have other economic functions than satisfying their investors, such as providing funding for long-term investment to the economy, for example, were points that were overlooked in the cognitive universe of Basel II. This can be seen as a form of financialization of the distribution of credit and loans.

Moreover, the growing scarcity of alternative conceptions and practices, organized through regulation, was not the direct product of competition that selects the “best” model, but the result of a decision made prior to introduction of competition. Through the decisions made, the regulator created an “upstream” disadvantage for alternative models of banking, which were made more costly by regulatory capital requirements. The very fact that the earliest simulation of their impact gave higher requirements under Basel II than under Basel I is enough indication that the adoption of financialized models (that is financial economics based models) allowing more detailed risk management does not automatically lead to a lower cost of capital. In fact, it was because the authorities wanted all banks to adopt these models and the associated “marketized” conception of the bank that a regulatory premium was granted to banks that followed the recommendation, thus allowing them to save capital.

To complete the disciplinary edifice, banks had to submit to a labyrinthine supervisory system of which they were part-organizers.

4.3. Proliferation of supervisory bodies

In concrete terms, the risk control system at a bank that wished to be approved for the IRB method as described in the final Accord must have four strictly independent levels. The first-level control is direct control by the operators of credit relations themselves.

Real control begins with the second-level control (or “internal control”). This principally aims to ensure that first-level operators comply with the norms and procedures, and to control and ratify the decisions they made. It is also the “internal control” that reports on risks to the bank’s management, and it establishes and regularly reviews the tools and procedures used by the bank’s personnel. To make sure that control is effective, the Basel Committee requires second-level control teams to be “functionally independent from the personnel and management functions responsible for originating exposures” (*BCBS, 2006b*, §441, p. 98).

However, having controllers who are independent of the people/practices controlled is not enough to guarantee integrity in controls. Second-level controllers are part of the banks’ organizational structure and may come under pressure from certain managers, for example to minimize, hide, or delay reports of weaknesses existing in the control system or the estimated risk levels. The controllers must therefore be controlled. This is the role of third-level control, which must be carried out by what the Committee calls “internal audit” teams. The Basel Committee once again stresses the necessary “independence” of internal audit, which is generally organized such that internal audit depends directly on an audit committee formed by the Board of Directors.

It is thus the bank’s management which, under the supervision of the Board of Directors, occupies the fourth and final level of internal supervision.

Internal monitoring must be organized on a pyramid model, which is the internal adaptation of the control approach recommended by Basel II for external monitoring by the banking authorities.

As well as this four-level control, a further control is added by the regulators, who must themselves monitor that internal control. With Basel II, monitoring by the supervisory authorities concerned more than banks’ compliance with the minimum capital requirements imposed by the regulation. The prudential authorities also had to ensure that internal procedures and

²⁵ *Lordon (2000)* goes to the heart of the calculation of EVA (Economic Value Added) and shows all political and economic assumptions embedded in the calculation. One of them is the right of every shareholder to receive minimum interest (at the average market rate) for their capital contribution (and yet this is contrary to the status of a shareholder, who is supposed to bear the company’s risks). The second postulate is that having received interest at the average level of the risk he takes, he also has an automatic right to a share of any surplus then generated by the firm. Finally, calculations of EVA are blind to changes in the risk-return ratio, which in recent years has shifted to the benefit of shareholders. The norm for the rate of return on shares is considered to be given by the market, as a factor exogenous to EVA calculation, not as a political construction deriving from economic power struggles. Calculation of EVA thus tends to reinforce the apparently factual, non-negotiable nature of this rate, and thus the favourable position of shareholders in the distribution of value added.

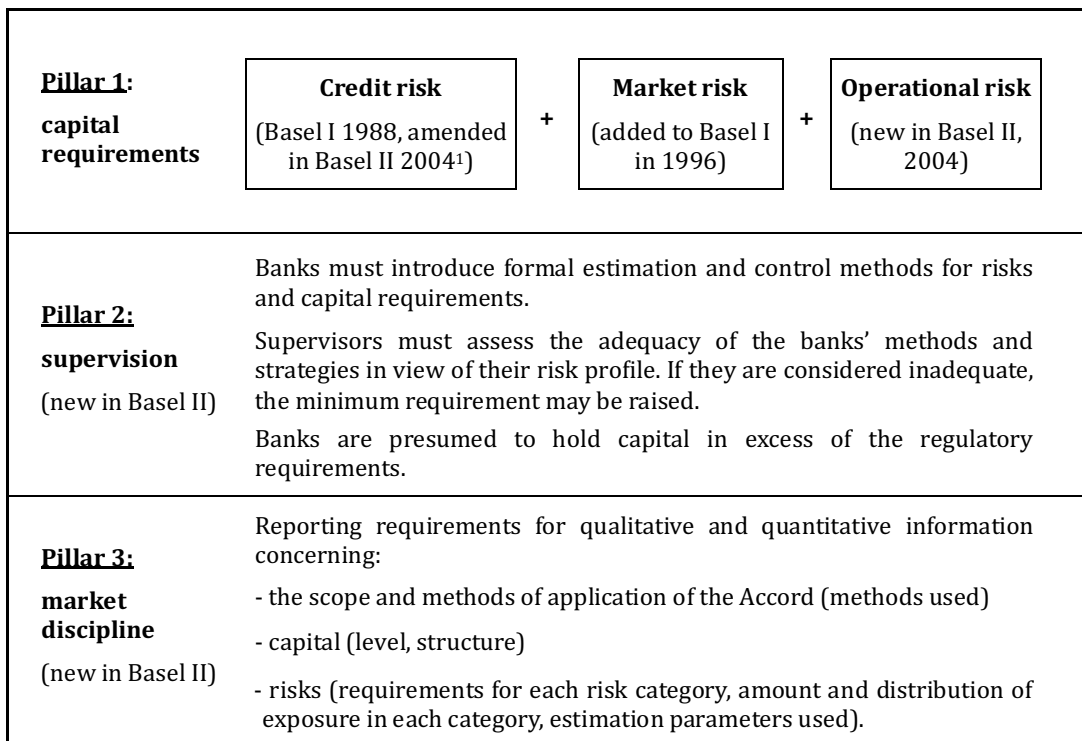


Fig. 1. Structure of the Basel II Accord.²⁶

tools for risk management were appropriate and that – especially for banks adopting the IRB method – all instructions were correctly applied. Basel II also stipulated that the supervisors could call in external auditors (considered as “independent” by definition) for a further assessment of internal audit reports.

The infinite development of control is the only way neoliberal thinking can organize monitoring, since in a world where the expected behavior is that of a calculating, maximizing individual concerned only with his own interests, the efficiency of the structural efforts made to align interests should be checked continuously at all levels because the resulting alignment is a fragile and incomplete construction which is continuously threatened by individual’s opportunism and by the attractiveness of free-riding strategies on short-term. As long as all actors have not been properly educated and disciplined, it is impossible to be sure that, by serving its own interest, the monitoring entity will also serve the common good. The generalized *homo oeconomicus* model consequently leads to generalized mistrust that can only be overcome by multi-layered levels of monitoring and control. This is the price to pay to ensure that reporting will indeed be really “transparent.”

In the end, “market discipline” – the only type of discipline formally mentioned in the Basel regulation – is by no means the only source of disciplinarization applicable to organizations. They are in the end subject to very strict instructions combined with a stratified control system. And so the transition from Basel I to Basel II was accompanied by a very significant change in the way control was conceived. The best way to demonstrate this is to analyze an aspect of the Basel II agreement not yet discussed in this article: the three-pillar structure.

4.4. The 3-Pillar structure and the change in the spirit of regulation: beyond the opposition between “command-and-control” and “soft” law

Basel I only had one aim: enforcing minimum capital requirements. The requirements were precisely defined by the regulators, they were prescriptive, and the function of supervision was to check compliance with these regulatory standards. It was a compliance control with a direct system “rationale:” the objectives were fixed and imposed as minimum requirements, and the authorities had to check that the results complied with those objectives. Otherwise, standards could

²⁶ The only ratio studied in this article only concerns the box “Credit risk” of Pillar 1. The other two risks (the two other boxes of the same pillar) give rise to capital requirements that are substantially lower in terms of absolute value.

be enforced via administrative sanctions. However, this classical command-and-control style of regulation left the banks free to organize themselves and their credit activities as they wished, provided that the requirements were met.

In Basel II, the regulation still set minimum capital requirements (with changes in calculation methods) but two other “pillars” were added (see Fig. 1): a pillar on “supervision” (pillar II) and another on “market discipline” (pillar III). Pillar II explains what the bank supervisors in each country must verify and authorized them to raise the minimum capital requirements applicable to a bank if they were not satisfied with its responses or practices. The very idea of compliance consequently becomes much more qualitative and flexible than it was under Basel I. Moreover, Pillar III lists the information that banks must disclose to enable the “market” to make informed decisions, particularly about the price charged to provide banks with the capital they need to meet their minimum capital requirements. This shows that the new regulation is not only organized to ensure that regulators will be able to assess and control banks' compliance. It is also organized in order to facilitate market control, sanctions, and rewards. The move from one to three pillars consequently appears to signal a shift in thinking on regulation.

The conception of control in the Basel regulation changed and evolved towards a control of resources from the second half of the 1990s, in the 1996 amendment to Basel I concerning market risks. In 1997, the committee also published *Core Principles for Effective Banking Supervision* (BCBS, 1997) which clearly marks a shift. Minimum capital requirements and compliance control make up the first of these “principles,” but the nine other principles presented concern quality control for internal control processes.²⁷ In this document the Basel Committee formally expressed its subscription to what Power (2007) argues can be considered a new “philosophy.” Its purpose was to organize the regulation of self-regulation by internal systems for risk estimation and management.

As stressed by Power in his short study of market risks requirements, in this process, Pillar 1 represents “an ideal of regulatory and managerial control based on capital as a common language for internal and supervisory management” (2007, p. 120) and convergence between regulators and banks' interests was to be created through “the promise of graduated forms of inspections” (2007, p. 106) within the second Pillar. Power concludes that this development “perfectly illustrates Meyer and Rowan's (1977) thesis about how powerful organizations come to externalize their own rules as governing institutions for a field” (2007, p. 106). Moreover, in this perspective the addition of the second Pillar, dedicated to the control of internal controls, confirms the idea that this liberalizing agenda is implemented through a shift, in risk-based regulations, from risk quantification towards risk governance.

However, our study shows that, for credit risk at least, this agenda of liberalization could not be implemented in such a straightforward way because most banks were not actually using economic capital systems to estimate and manage their risks and had first to be taught how to do so. Consequently, the aim of changing the rules on regulatory capital requirements so that the “regulatory capital” was lower than the “economic capital” of a well-governed bank, therefore ensuring that regulation would not “hamper” these well-governed banks (which can be interpreted as an aim to emancipate the banks), could not be implemented without first teaching banks how to construct their risk estimates and to compute their economic capital (by using Pillar 1 prescriptions for the IRB method), and then strictly guiding them so as to teach them how to use and control this system (thanks to the recommendations included in Pillar 2). We show that this implied very significant reinforcement of the forms of discipline finally imposed on banks and the development of mechanisms that are doubtless just as intrusive as those the reformers claimed they wish to avoid.

This suggests that Basel II cannot be only understood as a shift from “command-and-control” to a “softer” and more cooperative logic of regulation because it also relies on several kinds of disciplinary processes that include very intrusive prescriptions. In this perspective, our study illustrates Foucault's idea that the extension of procedures of control, constraint, and coercion are the counterpart and counterweights of liberal freedoms. This also confirms the idea, already developed in governance studies and in the sociology of law, that current forms of regulations “would be overlooked through simple classifications of state versus non-state, market-based versus standards-based, or even markets versus states versus self-regulation” (Schneiberg & Bartley, 2008, p. 42) and that they deserve close examination to better understand how they hybridize and combine apparently contradictory normative rationales such as, in our case, the “soft” and “hard” ones.

To understand the emergence of coercive and intrusive mechanisms in Basel II, our study stresses the fact that Basel II does not aim only at incorporating risk-management practices but also crucially at producing specific practices of risk quantification and management. Pillar 1 does not merely indicate the State's conversion to the idea that theories and techniques drawn from the financial markets reflect the true level of a bank's risk. It should also be regarded as the expression of regulators' will to see the banks representing themselves as pure financial market actors, only competing to attract investors by offering them higher risk/return ratios than their competitors. In this perspective, Basel II also embodies a very specific project: the social transformation of banking practices on the global scale. Crucially, this project is based on the metrological utopia of risk measurement developed in mainstream financial theories. It is regulators' faith in the capacity of these quantification systems to provide the basis for the self-regulation of banking activities that explains and justifies the

²⁷ Bank supervisors are now required to evaluate banks' policies, practices and procedures on questions as vast and wide-ranging as (1) granting loans, and everyday portfolio management, (2) evaluation of asset quality and the adequacy of provisions and reserves, (3) management information systems, (4) compliance with standards on loans to borrowers related to the establishment, (5) monitoring and control of the country risk and the transfer risk, (6) monitoring and control of market risks, (7) general risk management, (8) delegations of powers and responsibilities, (9) knowledge of customers, ethics and professionalism.

development of intrusive disciplinary processes within the Pillar 2 of the regulation. This suggests that Basel II is also fundamentally a “risk-measurement” project and that the rise of risk governance processes in this regulation is intrinsically linked with this project. It should consequently be seen as a complementary, and not as an alternative, constraint to the new risk-quantification rules.

5. Conclusion and discussion

The move from Basel I to Basel II was originally conceived as a plan to free banks from State interventions that were criticized for being intrusive and prescriptive. The reformers’ discourses studied in this article are consistent with this aim of leaving actors with freedom to act, controlled only by “market discipline.” This result is also consistent with previous studies suggesting that the Basel reform project was strongly influenced by lobbies and groups, such as the G-30, the IIF and the ISDA and that it has been constructed under conditions suggesting regulatory capture. However, if this phenomenon was the only factor in play, the final standard would not include any particular prescription on course of action and would rely mainly on market discipline to ensure the self-regulation of actors.

Yet, an in-depth analysis of the regulation has shown that the Basel Committee was unable to achieve this aim: the regulation relies on mechanisms that are doubtless just as intrusive as those the reformers claimed they wish to avoid. The banks’ actual practices turned out to be disappointing and the Basel Committee decided to educate them.²⁸ In this regard, our examination of the Basel regulation particularly points towards three intertwined processes: the regulator’s construction of financial incentives, the imposition of working methods, and the implementation of a bureaucracy of control. Such a turn of events demonstrates the relevance of an in-depth analysis of calculation-mechanisms and systems.

This approach enables us to construct a contrasting image of the changes involved by Basel II, and it shows that, for this kind of research, examination of general policy discourses alone can be deceptive. Moreover, this approach allows us to better understand technologies’ role in neoliberal regulations. Instruments contribute to the production of subjects (in this case, enterprises) that are compatible with the chosen forms of government. This production requires strong incentives to adopt highly specific behaviors and practices. The business enterprise must be remodelled to enable the market to achieve so-called self-regulation. This remodelling involves the adoption of new calculation techniques and the introduction of a stratified supervision system designed to ensure that the norms are properly applied. The autonomy won through this move towards self-regulation is in reality based on stringent discipline that is willingly accepted because it brings down the cost of capital. The disciplinary effect of this regulation operates upstream of the “market discipline” which is the only kind officially promoted. Actors only have room for maneuvering insofar as they can prove that they have espoused the norms promoted by the regulation. In the end, if the level of intrusion remains extremely high, it is in part because the banking sector is not a typical sector. It is where the level of money creation and an economy’s investment capacity is determined. But also – in this age of large financial conglomerates – it is the home of systemic risks at the world level, and it is where default by one large actor can lead to default by all the other actors and even national economies. These risks that banks impose on other actors (not only on themselves) are in fact what prevent the liberalization agenda from seeing its logic through to the end.

This analysis allows us to interpret the rise of the risk-management rhetoric and systems that are accompanying the increase in neoliberal reforms as what Foucault (2008, p. 65) calls “strategies of security,” which are “liberalism’s other face and its very condition” and correspond to “the need to ensure that the mechanism of interests does not give rise to individual or collective dangers.” We suggest that two of the characteristics of risk management make it a particularly suitable candidate for the implementation of such neoliberal strategies of security. The first is the fact that the bifold vocabulary of risk, (related to both the vocabulary of opportunities²⁹ (O’Malley, 2004) and the vocabulary of control), is ideologically compatible with neoliberalism because the logic carried by risk management defines two things in the same movement: how to benefit from the given autonomy and how to collectively preserve it. The second characteristic is that risk-management is imbued with the metrological utopia of risk measurement developed in mainstream financial theories, which provides an apparently “objective” alternative to the “arbitrary” compromises previously established by States that both ideologically and technically suited regulators’ needs. Consequently, relying on risk-management rhetoric and quantification systems provided a technically and ideologically viable possibility for the regulators, who were confronted with the impossibility of simply liberalizing practices.

Our study therefore suggests that the rise of risk-management tools and rhetoric in the regulatory field may not be only interpreted as a “turning inside out” of organizations (Power, 2007), but also as the product of political action to shape internal practices through diverse disciplinary processes. In other words, our study contributes to a better understanding of the nature of the disciplinarization that goes hand in hand with neoliberalism and of the forms of independence it generates.

Ultimately, only field studies at the banks’ level would show how the normative, cognitive, and coercive effects of this regulation articulate themselves when it comes to implementing the new rules. However, these effects certainly reinforce one another and it can be demonstrated that, at least for some banks, the coercive effects are non-negligible (Baud & Chiapello, 2015). Anyway, our study shows that the outcome, in terms of freedom of business at least, is not certain and that it would be more accurate to say that implementation of a new type of freedom brings with it new constraints and

²⁸ Note that it could be seen as an implicit disavowal of the market mechanism regulators claim to promote.

²⁹ Or “risk management is good business,” as Power (2007, p. 23) puts it.

considerable costs. Moreover, we show that this change in the distribution of freedoms and constraints has also been accompanied by a much less ambiguous move towards an imposed and highly specific definition of the bank as an enterprise “like any other,” with a duty to maximize shareholder value. The Basel II framework is intended solely for the bank as an actor on the financial markets, not the bank as an actor in commercial relations with its clients, or the bank as an actor in the local economy, for example. It also tends to prescribe a highly specific mode of relations with the bank’s clients (i.e. the people it lends to), who are only seen as vectors of risk and sources of revenue (Baud & Chiapello, 2015).

Basel II encourages banks to develop information systems in which they can see themselves and operate as actors competing on the financial markets, where the aim is to attract investors by offering them equivalent or higher remuneration for the risks borne by their capital than the rates offered by competitors. What has been organized is therefore more like a forced-march financialization of banks’ practices than a real liberalization of practices, and of course, this change gives certain stakeholders an advantage over others.

Here too, field studies at the banks’ level are necessary to better understand how the regulation has an impact on existing practices. However, our study already provides information on how, in practice, responsibility for the financial system and the stability of that system is transferred to decentralized actors, and how this transfer was made possible in the banking field by modelling and financial theories. This consequently contributes to a better understanding of how theories and techniques drawn from the financial markets are introduced in new social settings, markets, organizations, and cultures (Vollmer, Mennicken, & Preda, 2009), notably by highlighting the active role regulations play in this process.

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Appendix A.

| Speeches (chronological order) Full title and source | Complementary details |
|---|---|
| <p>Greenspan, A. (1998). The Role of Capital in Optimal Banking Supervision and Regulation, Remarks by Chairman Alan Greenspan before the Conference on Capital Regulation in the 21st Century, Federal Reserve Bank of New York, New York, NY, February 26, 1998. Source: http://www.federalreserve.gov</p> | <p>The conference “Financial Services at the Crossroads: Capital Regulation in the Twenty-First Century” was organised by the Federal Reserve Bank of New York in partnership with the Bank of England, the Bank of Japan, and the Board of Governors of the Federal Reserve System just a few months before McDonough’s appointment at the chair of the Basel Committee. Chester B. Feldberg, an executive vice president at the Federal Reserve Bank of New York, provides details about the conference in the “Opening remarks” of the Conference, which have been published by the Federal Reserve Bank of New York in its <i>Economic Policy Review</i> in October 1998. In this introductory speech he explains that the Conference had “more than 250 registered participants as well as many observers from throughout the Federal Reserve System. Among those attending today are fifteen members of the Basle Committee on Banking Supervision, virtually all members of the Capital Subgroup of the Basle Committee, several senior U.S. financial supervisors, and representatives of financial institutions from more than fifteen countries. The academic community is also well represented” (Feldberg, C.B, 1998, p.9). It is also worth noting that Greenspan published part of this speech in <i>Secondary Mortgage Markets</i>, a professional review, under a very evocative title: “Wanted: Bank regulators who act more like the market” (Greenspan, 1998).</p> |
| <p>Mingo, J. J. (1998). Policy implications of the Federal Reserve study of credit risk models at major US banking institutions. Source: Mingo, J.J. (2000). <i>Journal of Banking & Finance</i>, 24(1–2), 15–33</p> | <p>This speech was delivered by John J. Mingo, technical advisor to the Division of Research and Statistics of the FRS’ Board of Governors, at the London conference of September 21–22, 1998 where McDonough, newly appointed Chairman of the Basel Committee, announced his decisions to conduct a “thorough review” of the Accords. The Conference “Credit Risk Modelling and the Regulatory Implications” was organized by the Bank of England and the Financial Services Authority (FSA) with the support of the Federal Reserve Board of Governors, the FRB of NY, and the Bank of Japan. As it has been organised by the same actors, it can be seen as a follow-up to the Conference previously held in New York. Mingo’s speech has been published as part of the proceedings of the conference in a special issue of the <i>Journal of Banking & Finance</i> issued in 2000 (Mingo, 2000).</p> |
| <p>McDonough, W. J. (1999). Mr McDonough discusses the changing nature of banking, risk, and capital regulation, Speech by the President of the Federal Reserve Bank of New York, Mr William J. McDonough, at the 29th Annual Banking Symposium, Bank and</p> | <p>William J. McDonough delivered this speech after he had already announced the main principles of the reform in a Conference held in November 1998 at the Bundesbank and shortly before the publication of the BCBS first report on credit-risk modelling practices (BCBS, 1999). This presentation of the reform project was made before the members of the</p> |

(Continued)

| Speeches (chronological order) Full title and source | Complementary details |
|--|--|
| Financial Analysts Association, New York City, on 17 March 1999. Source: BIS Review, 32/1999,1–6. | Bank and Financial Analysts Association and it has been entirely transcribed shortly after in the BIS review. |
| Meyer, H.L. (1999a). Moving forward into the 21st century , Remarks by Governor Laurence H. Meyer at the Conference of State Bank Supervisors, Williamsburg, Virginia, June 3, 1999. Source: http://www.federalreserve.gov | This speech was delivered in front of the officials of the regional Federal Reserve Banks of the Federal Reserve System when the BCBS had just published its first report on credit-risk modelling practices (BCBS, 1999). |
| Meyer (1999b). Implications of recent global financial crises for bank supervision and regulation , Remarks by Governor Laurence H. Meyer before the International Finance Conference, Federal Reserve Bank of Chicago, Chicago, Illinois, October 1, 1999. Source: http://www.federalreserve.gov | Following the publication by the BCBS of its first consultative paper on the new capital framework, in June 1999, this speech was delivered during the third annual "International Finance Conference" organised by the Federal Reserve Bank of Chicago. According to their website, this annual conference "is designed to focus on important current international issues in banking and finance that are best analyzed by bringing together researchers and policymakers from different countries and different perspectives. [...] The topics are selected because they have important public policy implications across countries and the papers and presentations emphasize the public policy aspects. Both the program speakers and audience are targeted with this objective in mind. Thus, participants are selected from both a broad cross-section of countries and a broad cross-section of affiliations, including government officials, regulators, industry practitioners and academics. The number of participants is limited to encourage active participation by all." The conference is generally cosponsored with a major international organization "in order to enhance both the transnational visibility and credibility." For its third edition, in 1999, the Conference was co-sponsored by the Bank for International Settlements, which is hosting the BCBS in Basel. |
| Greenspan, A. (1999). The evolution of bank supervision , Remarks by Chairman Alan Greenspan before the American Bankers Association, Phoenix, Arizona, October 11, 1999. Source: http://www.federalreserve.gov | Alan Greenspan delivered this speech before the members of the American Bankers Association shortly after the publication by the BCBS of its first consultative paper on the new capital framework, in June 1999. |
| Meyer (2001). Basel II: Moving from Concept toward Implementation , Remarks by Governor Laurence H. Meyer at the Bank Administration Institute's Conference on Treasury, Investment, ALM, and Risk Management, New York, October 15, 2001. Source: http://www.federalreserve.gov | This speech was the keynote address of a conference organised by the Bank Administration Institute (BAI). According to its website, the BAI is a "financial services association and leading industry resource [. . .] that serves a wide segment of the industry." The conference, whose subtitle was "conquering the latest strategies and developments in financial market risks," was aimed at practitioners. Alongside Meyer, other public officials, and several high-level executives from banks, consulting groups presented during the conference. |
| Ferguson (2003). Basel II: A case study in risk management , Remarks by Vice Chairman Roger W. Ferguson, Jr. at the Risk Management Workshop for Regulators, The World Bank, Washington, D.C., April 28, 2003. Source: http://www.federalreserve.gov | Organised by the World Bank Institute when the final agreement was almost reached, the objective of the Risk Management Workshop for Regulators was to "to help senior officials from developed and developing countries learn about the latest methodologies and common policy issues on how to measure and manage risk across the financial sector regarding risk management, in order to enable them to effectively supervise banks and NBFIs in the context of the future new Accord." It was clearly intended for "senior regulators from Central Banks, Ministries of Finance, Bank Regulatory Agencies and Securities Exchange Commissions." |

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