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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 the1990s, 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 be 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 (Maijoor, 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.

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