THE DOMESTIC IMPLEMENTATION OF INTERNATIONAL REGULATIONS

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In response to the challenges of globalization, U.S. agencies at times reach agreements on regulations with their foreign counterparts and then subsequently implement those regulations domestically. Some have suggested that this model of rulemaking gives agencies determinative incentives to implement the international regulation as negotiated—and thus to ignore public comments in the domestic rulemaking process. In this Note, I use the Basel Accords as case studies to show that agencies do not necessarily implement international agreements as a fait accompli. Nevertheless, I argue that international agreements may illegitimately influence the domestic rulemaking process and that courts must therefore be more vigilant in reviewing these types of regulations.

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Introduction

In 2007, the federal agencies charged with regulating banks[1] issued new rules dictating the minimum amount of capital certain banks had to hold relative to their total assets.[2] These rules were explicitly based on an agreement that had been reached by an international committee of bank regulators in Switzerland. However, no statute had instructed the U.S. regulators to negotiate such an agreement with their foreign counterparts, nor did Congress and the President ratify the agreement. Indeed, the agreement seems to have been instigated on the initiative of a few influential officials on the Federal Reserve Board.[3] Domestically, the banking agencies implemented the rules through the notice-and-comment procedure pursuant to the Administrative Procedure Act (APA).[4] The process took several years and generated hundreds of public comments, which the APA requires the agencies to consider integrating into the final rule.[5] But one might ask, given the agencies' commitment to the international agreement they had negotiated, is it realistic to think that they sincerely complied with their statutory obligation?

The answer to this question carries important implications well beyond banking regulation. Increased international integration has led to increased international regulation. Federal agencies regulating a wide swath of the American economy now regularly reach agreements with their foreign counterparts, which are then implemented domesti-

1 The agencies were: the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS).

2 *See infra* notes 117–30 and accompanying text (describing the international adoption and domestic implementation of the New Accord reached by the Basel Committee on Banking Supervision).

3 *See infra* Part II.C (discussing the U.S. banking agencies' implementation of rules based on the New Accord).

4 5 U.S.C. § 553 (2006).

5 *See infra* notes 123–30 and accompanying text (describing the domestic rulemaking process related to the New Accord).

cally.[6] Whether or not agencies fulfill their domestic public participation obligations in implementing these regulations substantially impacts the regulations' legitimacy.[7] And with the accelerating pace of international regulation, the legitimacy of these types of regulations is critical to the legitimacy of the administrative state more generally.

Some of the most important emerging literature on the global regulatory structure presumes that once federal regulators reach an international agreement, they will implement it at home as a "fait accompli."[8] Parties that lack the resources, coordination, or competence to participate at the international rulemaking level will consequently find themselves substantively excluded from the domestic rulemaking process. In this Note, however, I examine examples of rulemakings and find contrary results.

My central argument has two parts. First, I investigate agencies' regulatory record and show that they do not simply implement international regulations as a fait accompli. Second, I argue that international agreements nevertheless do influence domestic implementation and that, in some cases, such influence is illegitimate. I argue that courts must therefore be more vigilant in scrutinizing these regulations.

The Note proceeds as follows. In Part I, I elaborate on the problem, explaining why agencies reach international agreements, what incentives these agreements may present, and what effects agency adherence to these agreements has on the legitimacy of the administrative state. In Part II, I turn to the rulemakings themselves, applying a theoretical framework for understanding the legitimacy of agency decisionmaking to two case studies: the Federal Reserve

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6 *See infra* Part I.A (discussing the dual national-international role of American regulators).

7 *See infra* Parts I.B–.C (discussing legitimacy challenges prompted by domestic implementation of international regulations).

8 *See* Richard B. Stewart, *U.S. Administrative Law: A Model for Global Administrative Law?*, 68 LAW & CONTEMP. PROBS. 63, 78–79 (2005) (arguing that domestic regulators will likely be so committed to international agreements that they will implement them "as is" domestically); David Zaring, *Best Practices*, 81 N.Y.U. L. REV. 294, 305 (2006) ("After international agreement, the domestic rulemaking that follows is the train that follows the engine: Although it may look like any other form of administrative action, its outcome is preordained by what has already happened abroad."). *But see* Pierre-Hugues Verdier, *U.S. Implementation of Basel II: Lessons for Informal International Lawmaking*, *in* INFORMAL INTERNATIONAL LAWMAKING 437, 438 (Joost Pauwelyn et al. eds., 2012) ("Basel II poses significant challenges for critics who see the domestic implementation process as perfunctory."). Professor Verdier draws his conclusion about the nature of domestic implementation—that it is not a fait accompli—from the implementation of Basel II. There are, therefore, important similarities between his paper and this one. However, I focus more closely on the notice-and-comment procedure, the role of commenters in implementation, and the implications for American courts.

Board's implementation of the Basel Accord and the U.S. banking agencies' implementation of the New Accord. In Part III, I explore the legal implications of Part II's rulemaking analysis. In particular, I examine whether and when the APA permits an agency to use adherence to an international agreement as a basis for action.

I
The Potential Problems with the Domestic Implementation of International Regulations

In this section, I begin by explaining the pressure that globalization has put on U.S. agencies to form regulatory agreements with their foreign counterparts. I then argue that U.S. agencies have strong incentives to comply with these agreements. Finally, I argue that to the extent these incentives drive agencies, the legitimacy of the American regulatory system—including the court-developed doctrine built around it—is undermined.

A. The World Is Globalizing, and So Are Agencies

We live in a rapidly globalizing world.[9] Our domestic economy is increasingly interdependent with the economies of other nations.[10] This interdependence has provided profound benefits to the world.[11] At the same time, it has furnished new challenges, including a severe strain on the capacity of U.S. agencies to regulate.[12]

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[9] Between 1986 and 2007, trade between the United States and other industrialized nations more than doubled, and trade between industrialized nations and emerging market nations grew even more. Donald L. Kohn, Vice Chairman, Fed. Reserve Bd., Speech at the International Research Forum on Monetary Policy: Global Economic Integration and Decoupling (June 26, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/kohn20080626a.htm#f2.

[10] For example, international securities transactions among the G-7 nations grew from less than 10% of gross domestic product (GDP) in 1980 to more than 140% in 1995. Beth A. Simmons, *The International Politics of Harmonization: The Case of Capital Market Regulation*, 55 Int'l Org. 589, 589 (2001). In each of the last seven years, food imports into the United States have grown, on average, by 10%. U.S. Food & Drug Admin., Pathway to Global Product Safety and Quality 2 (2011), *available at* http://www.fda.gov/downloads/AboutFDA/CentersOffices/OfficeofGlobalRegulatoryOpeOfficeofGlobalRe/GlobalProductPathway/UCM262528.pdf. Americans import approximately two-thirds of the fruits and vegetables they consume and eighty percent of the active ingredients in pharmaceuticals sold in the U.S. *Id.*

[11] *See* Paul Masson, *Globalization: Facts and Figures* 2 (Int'l Monetary Fund, Policy Discussion Paper No. 01/4, 2001), *available at* www.imf.org/external/pubs/ft/pdp/2001/pdp04.pdf (noting that increased trade as a result of globalization has caused an "unprecedented rise in living standards").

[12] *See, e.g.*, U.S. Food & Drug Admin., *supra* note 10, at 3 (stating that the Food and Drug Administration lacks the resources to "keep pace with the pressures of globalization"). Regulators face several types of pressure as a result of increased interdependence. First, regulators face pressure to avoid spillover effects from lax regulations in other coun-

In response to these pressures, regulators have turned their attention outward.[13] Regulators frequently engage with their foreign counterparts to harmonize regulatory standards.[14] The procedures used to harmonize national standards and to formulate global standards are the subject of the emerging field of Global Administrative Law.[15] Some scholars of this field have raised concerns about the extraordinary difficulties interested groups may face in attempting to participate in the international negotiation of rules.[16] Part of ameliorating this public participation problem may involve developing formal administrative processes at the international level. But absent highly-developed international administrative processes, one potential fail-safe against disregard of disfavored groups in this context is the existing domestic administrative law.[17]

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tries. Capital adequacy standards, which I explore in depth in sections II.B and II.C *infra*, are a prime example. Banks in jurisdictions with inadequate capital standards can cause financial crises in the U.S., so U.S. regulators have an incentive to tighten international standards. *See generally* Ethan B. Kapstein, *Resolving the Regulator's Dilemma: International Coordination of Banking Regulations*, 43 INT'L ORG. 323 (1989) (describing the development and implementation of the Basel Accord). Second, regulators are under pressure from multinational firms to reform regulations that diverge from foreign standards and thereby raise the cost of doing business in multiple markets. For example, drug manufacturers that want to sell in different markets have to subject their drugs to different drug-testing regimes, which is costly. Stéphanie Dagron, *Global Harmonization Through Public-Private Partnership: The Case of Pharmaceuticals* 6 (Istituto di Ricerche Sulla Pubblica Amministrazione, GAL Working Paper No. 2012/2). Third, regulators face narrower sets of options due to international trade obligations. The World Trade Organization (WTO), for example, discourages member states from erecting regulatory tariffs. *See generally* David Livshiz, *Updating American Administrative Law: WTO, International Standards, Domestic Implementation and Public Participation*, 24 WIS. INT'L L.J. 961 (2007) (discussing the Agreement on Technical Barriers to Trade and the Sanitary and Phytosanitary Measures Agreement in the context of the U.S. international harmonization agenda). Finally, regulators are under pressure from the dramatic increase in the volume of cross-border interactions. For example, the number of shipments of goods the FDA regulates has increased from six million to twenty-four million over the last decade. U.S. FOOD & DRUG ADMIN., *supra* note 10, at 2.

13 *See* Stewart, *supra* note 8, at 78 (noting that U.S. regulators "have both an 'external' and an 'internal' role").

14 *See id.* (noting regulators' involvement in treaty-based regimes, transnational regulatory networks, and mutual recognition arrangements).

15 For a foundational discussion of Global Administrative Law, see Benedict Kingsbury, Nico Krisch & Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 LAW & CONTEMP. PROBS. 15 (2005).

16 *See, e.g.*, Livshiz, *supra* note 12, at 966 ("The . . . inability of public interest stakeholders to effectively participate in the new regulatory process has undermined the legitimacy of harmonization as many feel that the entire enterprise has become captured by industry and corporate interests.").

17 *See* Ayelet Berman, *The Role of Domestic Administrative Law in the Accountability of Transnational Regulatory Networks* 24 (Ctr. for Trade and Econ. Integration, Working Paper No. 2011-08, 2011) (concluding that "domestic notice and comment procedures provide the wide public in member states access to global processes").

B. Global-Facing Agencies May Shirk Their Domestic Legal Responsibilities

The APA generally governs U.S. agency rulemaking.[18] When formulating a regulation using the informal, notice-and-comment rulemaking procedure that is the focus of this paper, an agency is required to publish a draft of the rule in the Federal Register; give interested parties an opportunity to participate in the rulemaking through the submission of written comments; and consider the submitted comments before publishing a final version of the rule.[19] Initially, the APA was understood to protect individuals from abusive intrusions by the government.[20] Over time, however, it has come to be understood as a guarantee of public participation in the rulemaking process.[21]

Courts play a crucial role in maintaining the legitimacy of the administrative process by protecting the right of the public to participate.[22] In particular, courts have developed the "hard-look" doctrine.[23] Courts require an agency to give a reasoned explanation for its decisions, employ procedures that facilitate public participation, and explain why it rejected reasonable regulatory alternatives.[24] Agencies must either incorporate revisions submitted by commenters into the final rule or explain why they are not incorporating the proposed revisions.[25]

Although the precise scope of the APA's application to international regulations is an open question, courts have applied the statute to such regulations. In general, international regulations are not self-

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18 5 U.S.C. §§ 551–559, 701–706 (2006).

19 *Id.* § 553(b)–(d).

20 *See* Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1669–70 (1975) (arguing that the "traditional model of administrative law" required intrusions into private liberty to be authorized by the legislature).

21 *See* Cass R. Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 SUP. CT. REV. 177, 181–84 (noting that "agencies must show that they responded to the arguments raised by all parties").

22 *See* Stewart, *supra* note 20, at 1712 (arguing that the primary purpose of judicial review has become "the assurance of fair representation" for all interested parties in the administrative process).

23 *See* Sunstein, *supra* note 21, at 181–84 (describing the hard-look doctrine as an opportunity for courts to review the "factual and policy issues" involved in a regulation "primarily to facilitate review of the reasonableness of the exercise of discretion" by an agency).

24 *See id.* at 181–82 (noting that failure to consider reasonable alternatives is a ground for refusal under the hard-look doctrine).

25 *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) ("Normally, an agency rule would be arbitrary and capricious if the agency has . . . entirely failed to consider an important aspect of the problem.").

executing.[26] That is, once a regulation has been agreed to internationally, an agency must still implement it domestically for it to be binding—and domestic rulemaking is subject to the APA. However, the APA exempts "foreign affairs function[s]" from its rulemaking provisions.[27] Some courts have applied this exemption to internationally negotiated rules, while others have not.[28] For the purposes of this Note, I put the scope of the exemption to the side and assume that at least some courts will refuse to regularly exempt regulations from APA requirements simply because they have an international aspect to them.

Assuming that the legal requirements are generally the same in both the international and purely domestic contexts, it is clear that the political incentives for agencies to comply with those requirements are different in each context. The transaction costs of international negotiation are high,[29] and the range of policy outcomes that will satisfy both domestic constituencies and foreign regulators is relatively narrow.[30] Agencies that fail to implement regulations agreed upon internationally may lose credibility with their foreign counterparts,

[26] *See* Natural Res. Def. Council v. Envtl. Prot. Agency, 464 F.3d 1, 8 (D.C. Cir. 2006) (holding that post-ratification decisions made by parties pursuant to the Montreal Protocol were not judicially enforceable as law in the United States).

[27] 5 U.S.C. § 553(a)(1) (2006).

[28] For examples of both types of decisions, see Stewart, *supra* note 8, at 79, 81–82 (citing Dept. of Transp. v. Pub. Citizen, 541 U.S. 752 (2004) (holding that the Department of Transportation (DOT) was not required to issue an Environmental Impact Statement on the President's rescission under NAFTA of a previous moratorium on Mexican auto carriers operating in the United States), *rev'g* 316 F.3d 1002 (9th Cir. 2003) (requiring the DOT to prepare an Environmental Impact Statement); Int'l Bhd. of Teamsters v. Peña, 17 F.3d 1478 (D.C. Cir. 1994) (holding that a DOT rule change fell under the foreign affairs exception and was not subject to notice-and-comment procedure); Pub. Citizen v. Office of the U.S. Trade Reps., 970 F.2d 916 (D.C. Cir. 1992) (holding that the Office's ongoing participation in the GATT Uruguay Round negotiations was not "final agency action" that was judicially reviewable under the APA); United States v. Decker, 600 F.2d 733 (9th Cir. 1979) (holding that the promulgation of regulations pursuant to the International Pacific Salmon Fisheries Commission was judicially reviewable); Jensen v. Nat'l Marine Fisheries Serv., 512 F.2d 1189 (9th Cir. 1975) (holding that regulations issued by the International Pacific Halibut Commission and subsequently enacted by the Secretary of State were a foreign affairs matter not subject to judicial review); Bethlehem Steel Corp. v. United States, 140 F. Supp. 2d 1354 (Ct. Int'l Trade 2001) (reviewing determinations made by the Department of Commerce regarding countervailing duty investigations); Pub. Citizen v. Kantor, 864 F. Supp. 208 (D.D.C. 1994) (holding that the GATT Uruguay Round negotiations were not subject to APA review)).

[29] *See* Robert D. Putnam, *Diplomacy and Domestic Politics: The Logic of Two-Level Games*, 42 INT'L ORG. 427, 452 (1988) (noting that "international policy coordination is hampered by high transaction costs").

[30] *See id.* at 435–41 (describing the process of international negotiation and noting that, for international negotiators to reach and implement an agreement, the range of outcomes acceptable to sovereigns at the international level must overlap with the range of outcomes acceptable to domestic political constituencies).

making future coordination more difficult.[31] Indeed, some scholars have suggested that the incentive to shirk in the international regulatory context may be so strong that once an agency has agreed to a rule internationally, it will implement the rule as a fait accompli domestically.[32] In other words, the agency will not appropriately consider comments that conflict with the international agreement, but rather will reject them out of hand and offer a pretextual rationalization.

C. Implications of Agency Shirking

The implications of this model of administrative rulemaking are troubling. To the extent the public is excluded from the opportunity to participate in rulemaking, the legitimacy of the administrative state is degraded.[33]

Public participation in the international negotiation of regulations is highly circumscribed.[34] International negotiations are often clouded by secrecy and few legal protections exist for groups affected by the regulations.[35] Affected groups face the additional problem of funding participation in negotiations conducted abroad.[36] The domestic administrative process may therefore be the only reasonably accessible avenue for public participation.

Finally, if agencies are shirking their legal responsibilities without repercussions, we might question the efficacy of the judiciary's role in the regulatory regime. In particular, courts are reluctant to intrude on the executive's authority to make international agreements,[37] and they are reluctant to look behind the curtain to the genesis of a rule (that

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31 *See id.* at 439 (noting that "involuntary defection" can have the same detrimental effect on international agreement as voluntary defection).

32 *See* Stewart, *supra* note 8, at 78–79 (suggesting that an agency committed to implementing a global regulatory norm may do so using justifications that merely rationalize a fait accompli); *see also* Zaring, *supra* note 8, at 305 ("After international agreement, the domestic rulemaking that follows is the train that follows the engine . . . .").

33 *See supra* notes 21–25 and accompanying text (describing the importance of public participation in the administrative process).

34 *See* Livshiz, *supra* note 12, at 991–95, 998–1004 (describing hurdles to the public's ability to affect the U.S. negotiating position prior to an international negotiation and to participate in intergovernmental organization rulemaking).

35 *See, e.g.*, Stewart, *supra* note 8, at 71 (noting criticism of global regulators for secrecy and lack of access for affected parties); David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEX. INT'L L.J. 281, 303 (1998) (describing secrecy as one of the characteristics shared by international financial regulatory organizations).

36 *See* Livshiz, *supra* note 12, at 1002–03 (noting the resource barriers to public participation in international rulemaking).

37 *See id.* at 996 (noting courts' deference to the executive branch).

is, the process that led to international agreement).[38] Courts need to overcome this reluctance in order to ameliorate the strong incentives to shirk faced by agencies in the international context.

Analysis of how agencies actually behave is essential to understanding how the courts and agency overseers should proceed. The stakes are high. International harmonization is quickly becoming a significant mode of regulation. For harmonization to have any credibility, it must incorporate public participation.

II
Analysis of Agency Implementation of International Regulations

In this section, I construct a theoretical framework to analyze whether agencies take seriously public participation in the domestic implementation of international regulations, or whether these regulations are implemented as a fait accompli. I then apply the framework to two case studies. Ultimately, I find that, contrary to the presumption in some of the literature, agencies do not implement international regulations as a fait accompli. However, the international regulations still exert a potentially illegitimate influence on agency decisionmaking.

A. Four Modes of Agency Action

There are two key actors in my analysis: the implementing agency and the public commenters. Given some international regulation, each actor can have one of two preferences: adherence to the international regulation or divergence from the international regulation.[39] From these sets of preferences, four modes of agency action emerge.[40] Table 1 illustrates these modes.

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38 *See* Stewart, *supra* note 8, at 80 (noting that "[p]rior informal discussions between the agency and interested persons" are not part of the record before the court) (citing Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir. 1977)).

39 The "diverge" option can be further subdivided into two categories: (1) diverge by implementing more stringent regulations (that may leave the agency in compliance with the international agreement) or (2) diverge by implementing less stringent regulations (which will likely put the agency out of compliance with the international regulation). *Cf.* Comm. on Banking Regulations and Supervisory Practices, *International Convergence of Capital Measurement and Capital Standards*, ¶ 1 (July 1988) [hereinafter *Basel Accord*], *available at* http://www.bis.org/publ/bcbsc111.pdf (stating that the Basel Accord was intended as a minimum standard to be achieved by national regulators). I put this subdivision aside.

40 While this framework for agency action is original, administrative law and regulatory design scholars have used a similar method to isolate a crucial element of agency action. *See* James Q. Wilson, Bureaucracy: What Government Agencies Do and Why They Do It 75–83 (1989) (describing four types of agencies, with each type a product of

TABLE 1

	Agency Preference	*Commenter Preference*	*Agency Action*
1. Internationalist	Adhere	Deviate	Adhere
2. APA-following	Adhere	Deviate	Deviate
3. Domestic-focused	Deviate	Adhere	Adhere
4. Split-personality	Deviate	Adhere	Deviate

I term an agency as acting in an "internationalist" mode when it is so strongly committed to an international regulation that it disregards contrary public comments and implements the international regulation domestically. As I discuss in greater detail below, when an agency is acting in this mode, its reason for choosing a certain course of action—whether stated or unstated—is adherence to the international regulation. This mode of action may violate the agency's APA obligations to dispose rationally of all substantive comments in a manner allowed by the governing statute.[41] It is this mode of action that is feared by commentators who argue that once an agency reaches an international agreement on a regulation, it will implement the regulation as is domestically, regardless of public comments.[42]

I describe an agency as "APA-following" when it shifts its own preference for adherence to an international regulation in response to contrary public comments. An APA-following agency will choose to adopt a commenter's proposal when its only reason for rejecting it is its divergence from the international regulation. This pattern of preferences and action suggests that an agency is taking its obligations toward public participation seriously.

I term an agency "domestic-focused" when its initial preference is to diverge from the international regulation, but that preference is overcome by commenters' preference for adherence. In this mode, the agency's preference and course of action are shaped primarily by domestic concerns. Its initial preference to diverge indicates that it is more concerned with the substance of domestic regulation than with international harmonization. Its final decision to adjust its preference in response to public comments demanding adherence indicates that the agency takes its obligations in the *domestic* rulemaking process

"the way those [outside] interests are arrayed in the agency's environment"); Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. (SPECIAL ISSUE) 167, 179 figs.1 & 2 (1990) (depicting four agency types based on whether the agency is other-regarding or self-regarding and whether the polity would or would not ratify the agency's decision).

[41] *See supra* notes 19–25 and accompanying text (describing the APA's public participation requirements).

[42] *See* sources cited *supra* note 32 (discussing fait accompli hypotheses).

seriously (even though its ultimate, substantive decision is to adhere to the international regulation).

Finally, I describe an agency as acting in the "split-personality" mode when its initial preference to diverge from an international regulation is so strong that it disregards contrary comments and implements a divergent rule. The split-personality mode is not the mirror image of the internationalist mode. What is potentially problematic about the internationalist mode is that the agency may disregard public comments primarily because the comments propose diverging from the international regulation. The potential problem with the split-personality mode is not that the agency acts only because the comments propose adhering to the international regulation. Rather, it may indicate the agency has been given irreconcilable incentives.[43] That said, an agency may have good reason to reach an international agreement on a regulation, only to choose to diverge from the agreement when implementing the regulation domestically.

If agencies acted consistently in only one of these four modes of action, the implications for courts would be relatively clear. In particular, if agencies consistently adopted the internationalist mode, it would indicate that agencies were not complying with their administrative law obligations when implementing international regulations. However, as the following case studies will demonstrate, agencies use all of these modes of action, sometimes within a single rulemaking. The implications are therefore more complicated.

B. The Federal Reserve Board and the Basel Accord

In January 1989, the Federal Reserve Board (Board) published final rules regarding minimum capital adequacy requirements, based on a capital adequacy measure issued by the Basel Committee on Banking Regulations and Supervisory Practices (Basel Committee).[44] These rules were the culmination of a years-long, iterative process of policy development involving Congress, the other U.S. banking agencies, the Basel Committee, and interested private parties.[45] The Board first issued a Notice of Proposed Rulemaking (NPRM) on capital adequacy requirements in January 1986.[46] These rules were displaced in

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[43] In particular, Congress (and potentially the President and his appointees) may have created strong incentives for the agency to reach an international agreement that compete with the agency's incentives to regulate domestically in a certain way.

[44] Capital; Risk-Based Capital Guidelines, 54 Fed. Reg. 4186 (Jan. 27, 1989) [hereinafter Basel I Final Rules] (codified as amended at 12 C.F.R. pts. 208, 225).

[45] *See id.* (describing the process leading to the issuance of the final rules).

[46] *See id.*; *see also* RAYMOND VERNON ET AL., IRON TRIANGLES AND REVOLVING DOORS: CASES IN U.S. FOREIGN ECONOMIC POLICYMAKING 141 (1991).

1987 by rules proposed in conjunction with the Bank of England.[47] The U.S.-U.K. proposal spurred to action the Basel Committee,[48] which at the time consisted of the central bank governors of the Group of Ten (G-10) countries and Luxembourg.[49] The Basel Committee issued a consultative paper in December 1987, giving national regulators six months to consult with their national banking associations.[50] The Board subsequently "deferred action" on its previous proposal and, in March 1988, issued a revised NPRM based on the consultative paper.[51] The Basel Committee issued its final guidelines in July 1988 (Basel Accord), approximately six months before the Board issued its final rules.[52]

1. *The Politics of Harmonization*

Driving these formal processes was a complex set of political and economic considerations. The latter half of the twentieth century saw a significant increase in international banking integration.[53] A series of bank failures in the 1970s and early 1980s exposed the side effects of integration: The failure of a single bank in one country could have devastating effects internationally.[54] These failures, combined with an international debt crisis in 1982, prompted domestic and international regulatory concern for the stability of the banking system.[55]

The meager levels of capital that banks were holding relative to total assets were of particular concern.[56] Such highly leveraged banks

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[47] Basel I Final Rules, *supra* note 44, at 4186; *see also* VERNON ET AL., *supra* note 46, at 144 (describing the negotiations between the U.S. and U.K. agencies).

[48] *See* Ethan Barnaby Kapstein, *Between Power and Purpose: Central Bankers and the Politics of Regulatory Convergence*, 46 INT'L ORG. 265, 280–83 (1992) (describing the developments that led up to the Basel Committee's action).

[49] Comm. on Banking Regulations and Supervisory Practices, *Proposals for International Convergence of Capital Measurement and Capital Standards*, ¶ 1 n.1 (Dec. 1987), *available at* http://www.bis.org/publ/bcbs03a.pdf. The member countries were Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. *Id.*

[50] *Id.* ¶ 2.

[51] Basel I Final Rules, *supra* note 44, at 4186.

[52] *Basel Accord*, *supra* note 39.

[53] Between 1960 and 1985, assets of U.S. banks abroad grew from $3.5 billion to $458 billion, and between 1962 and 1985, the proportion of international claims to total assets of the domestic offices of U.S. banks increased from two to sixteen percent. VERNON ET AL., *supra* note 46, at 130.

[54] *See* Kapstein, *supra* note 12, at 325 (noting the "international repercussions" of the 1974 failures of the Herstatt Bank in Germany, the Franklin National Bank in New York, and the 1982 collapse of Banco Ambrosiano in Italy).

[55] *See id.* at 328 (arguing that the banking crises of the 1970s and the 1982 debt crisis led to increased international cooperation).

[56] Kapstein, *supra* note 48, at 275 ("[T]he average ratio of capital to assets in [U.S.] money center banks . . . had dropped to a postwar low of 4.5 percent, while it had fallen to

are less likely to meet their obligations, which reduces public confidence in the banking system overall.[57] The Basel Committee agreed to study the issue in 1982, and Congress expressed its concern in 1983 with the passage of the International Lending Supervision Act, which directed U.S. bank regulators to work with their foreign counterparts to ensure that banks held sufficient capital.[58]

However, the paradigmatic accounts of the politics of the Basel Accord point to agency entrepreneurship as the source of international standards harmonization.[59] On one account, the pursuit of international agreement was sparked primarily by domestic political pressure on U.S. regulators. The American Bankers Association (ABA)[60] reacted negatively to supplementary capital measures the Board proposed in 1986.[61] The ABA worried that unilateral U.S. regulation of capital standards would put U.S. banks at a competitive disadvantage because holding capital is relatively costly.[62] At the same time, harmonization work at the Basel Committee level had stalled.[63] Federal Reserve Board Chairman Paul Volcker worked with Robin Leigh-Pemberton, the Governor of the Bank of England, on a bilateral agreement to break the impasse, forcing action at the Basel Committee.[64] Another account emphasizes the ability of the "dominant financial centers" to implement banking regulations

around 2 percent in the banks of France. These levels appeared inadequate in light of the debt crisis . . . .").

57 *See* JAMES C. BAKER, THE BANK FOR INTERNATIONAL SETTLEMENTS: EVOLUTION AND EVALUATION 71 (2002) ("The larger a bank's capital-to-assets ratio, the more likely it will be to meet its obligations. Stronger capital adequacy standards tend to increase public confidence in banks."); Kapstein, *supra* note 48, at 275–76 (arguing that capital augments public confidence by reducing the odds of bank failure).

58 For a declaration of this policy, see International Lending Supervision Act of 1983, 12 U.S.C. § 3901 (2006).

59 *Cf.* Kapstein, *supra* note 48, at 267 (arguing that the pursuit of a single capital adequacy standard was a reflection of the state of international and domestic regulatory politics); Simmons, *supra* note 10, at 595 (arguing that, due to the size of the internal U.S. market, domestic regulators have an incentive to act unilaterally).

60 The ABA is a trade group representing banks. *See* About the American Bankers Association, AM. BANKERS ASS'N, http://www.aba.com/About/Pages/default.aspx (last visited Nov. 9, 2012).

61 *See* Kapstein, *supra* note 48, at 280 ("[T]he ABA argued that the new rules would undermine the ability of U.S. banks to compete." (footnote omitted) (internal quotation marks omitted)).

62 *See id. But see* Hal S. Scott, *The Competitive Implications of the Basle Capital Accord*, 39 ST. LOUIS U. L.J. 885, 895 (1995) (arguing that the Basel Accord could not have leveled the playing field and its purpose must therefore have been maintaining the soundness of the international banking system).

63 *See* Kapstein, *supra* note 12, at 339.

64 *See* Kapstein, *supra* note 48, at 281–83 (describing the development and effects of the bilateral accord).

unilaterally.[65] U.S. financial dominance, however, provided strong incentives for foreign regulators to emulate U.S. regulations.[66] On this view, U.S. regulators pursued international cooperation as a marginal strategy to encourage cooperation and mitigate the externalities from potential deviation by foreign nations.[67] Finally, a recent revisionist account suggests that the Board pursued international harmonization as a means of outflanking its domestic regulatory competitors.[68] International agreement on the Board's preferred approach persuaded the other U.S. banking agencies to cooperate on that approach.[69] Once an international agreement was in place, other agencies felt that they either had to acquiesce or live with the status quo.[70]

The underlying political dynamics help explain the strength of an agency's commitment to implementing an international agreement. In this regard, it is crucial to note that Basel I is not a binding agreement under international law. Rather, it was an informal agreement among the G-10 bank regulators.[71] However, the fact that so many countries—most not party to the agreement—have adopted its standards has given the accord the aspect of soft law.[72]

2. *Rulemaking Analysis*[73]

Given these political dynamics, I now turn to the rulemaking itself. The Board's final rule contains an extensive discussion of its

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[65] *See* Simmons, *supra* note 10, at 591 (arguing that harmonization resulted from "decisions imposed by the dominant financial centers").

[66] *See id.* at 602 ("[P]rudential regulations are a competitive advantage that other jurisdictions have an incentive to copy.").

[67] *See id.* at 597 ("If negative externalities are significant, the question the dominant financial center faces in formulating its international policies is how it can change the choices of other financial regulators at reasonable cost.").

[68] Daniel Hemel, Note, *Regulatory Consolidation and Cross-Border Coordination: Challenging the Conventional Wisdom*, 28 YALE J. ON REG. 213, 232 (2011).

[69] *See id.* at 237 (arguing that negotiations at the international level limited options for domestic regulators).

[70] *See id.* (arguing that the other banking agencies were faced "with an either-or choice between risk-based capital standards and the status quo").

[71] *See* Lawrence L.C. Lee, *The Basel Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1, 6 (1998) (noting that, although the Basel Accord is not binding, the "Accords' methodology now applies to virtually all financial institutions worldwide").

[72] *Id.* at 7–8 ("Unlike a hard law which places obligations on members, a soft law places no legally binding duties on the signatories. The [Basel] Accords as a soft law could, nevertheless, merge multi-jurisdiction compliance procedures for those banks operating in cross-border transactions."); Zaring, *supra* note 35, at 303–04 (noting the views of one commentator that the Basel Committee's work has "some sort of legal effect" and can therefore be characterized as "international soft law").

[73] While I adopt the technical terms used by the regulators in order to describe the provisions of the rulemaking, a technical understanding of the provisions is not crucial to

disposition of public comments.[74] I examine whether the Board changed the final rule as compared to the NPRM in response to public comments, and whether its decision to change or not was consistent with the Basel Accord. In particular, I look at whether the Board relied on adherence to the Basel Accord as a reason for its decision. My analysis demonstrates that the Board adopted both the internationalist mode and the domestic-focused mode in implementing its final rule.

The analysis begins by determining which provisions are probative of the Board's compliance with the APA. As a first cut, in order to be probative on my model, the agency's preference has to be at odds with the preference of the commenters. Where commenters unanimously supported the agency's preference, it is unclear whether the agency was acting because of its own preference or the preferences of the commenters. Therefore, I excluded provisions where the agency and the commenters initially agreed. I excluded additional provisions because of the peculiar sequencing of the Basel Accord and the Board's final rules.[75] In some cases, the Board changed a provision, but the alteration merely reflected changes to the consultative paper contained in the Basel Accord.[76] In other words, the Basel Committee incorporated comments on the Board's NPRM into the final accord. The changes the Board made subsequently are not probative for my purposes. Finally, I include some provisions that would not otherwise be probative under these criteria because the Board's *explanation* of its decision is probative. Altogether, I found six probative provisions in the Board's final rules.

a. Internationalist Mode

Four of these provisions were implemented in the internationalist mode.

(1) The Board proposed, "[c]onsistent with the [Basel] framework," to recognize only bank, but not nonbank, guarantees of local government revenue obligations[77] for the purpose of determining the

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my point. Rather, what is crucial is demonstrating how the regulators responded to comments.

[74] Basel I Final Rules, *supra* note 44, at 4187–97.

[75] *See supra* text accompanying notes 44–52 (describing the timing of development of the Basel Accord and the Board's final rules).

[76] *See, e.g.*, Basel I Final Rules, *supra* note 44 at 4189 (regarding treatment of claims on foreign countries); *id.* at 4192 (regarding treatment of "netting of interest and exchange rate contracts between counterparties for the purpose of calculating the risk-based capital ratio").

[77] *Id.* at 4190.

risk weight[78] assigned to claims on non-central government securities.[79] Commenters from the financial guaranty insurance industry argued that this treatment created an incentive for banks to hold local government obligations issued by banks, rather than by financial guaranty insurance companies.[80]

The Board rejected the comments. "Because the [Basel] Accord does not recognize nonbank private sector guarantees . . . recognition of private sector financial guarantees for risk-based capital purposes . . . would be inconsistent with the framework agreed upon by the G-10 countries."[81] This pattern of comments and action fits the internationalist mode. The Board proposed a rule that adhered to the Basel Accord. Commenters proposed that the Board deviate. The Board rejected the comments and implemented the Basel rule as is. Perhaps just as importantly, it did not engage with the substance of the comments, but rather rejected them solely because they proposed deviating from the Basel Accord.

(2) The Board proposed assigning a 20% risk weight to claims on U.S. government-sponsored agencies.[82] Approximately half of the commenters supported the proposed risk weight; approximately half proposed a lower risk weight of 10%.[83] The Board implemented the rule as proposed, resolving the dispute by appealing to the Basel Accord. "In view of the structure of the [Basel] framework, the Board has determined to maintain the [twenty] percent risk weight for claims on all government-sponsored agencies."[84] The Board's reasoning here fits the internationalist mode. The Board proposed to adhere to the Basel Accord, some commenters proposed to deviate, and the Board adhered, offering no reason for its decision other than the rule of the Basel Accord.[85]

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78 A central project of the Basel Accord was determining how to assign risk to various forms of assets. *See Capital Standards for Banks: The Evolving Basel Accord*, 89 FED. RES. BULL. 395, 396 (2003) (noting that the amount of capital that banks have to hold relative to their assets depends on the riskiness of the assets).

79 Some assets are less risky than others (for example, residential housing loans are seen as less risky than commercial loans), and so should require banks to hold different levels of capital in order to offset the risk. *See id.* (noting that commercial loans are weighted at 100% and residential loans at 50%).

80 *See* Basel I Final Rules, *supra* note 44 at 4190 (noting the commenters' objections).

81 *Id.* at 4190–91. The Board then suggested that "the treatment of private sector financial guarantees may be considered in the future in connection with international discussions on refinements to the risk-based capital framework." *Id.* at 4191.

82 *Id.*

83 *Id.*

84 *Id.*

85 The Board did offer an additional conclusory statement: "The Board continues to believe that the debt obligations of government-sponsored agencies should not be accorded the same treatment as other direct government obligations that carry the explicit

(3) The Board, consistent with the consultative paper, proposed a 5% conversion factor "for calculating potential future exposure of exchange rate contracts with a remaining maturity of over one year."[86] Commenters argued that 5% was too high.[87] The Board rejected the comments and maintained its proposed standard: "The [Basel] Supervisors' Committee decided against reducing this factor in light of the risks relating to the volatility of exchange rates and because currency swaps, unlike interest rate swaps, involve an exchange of principal on maturity."[88] The Board also followed the now-familiar internationalist mode here. However, the reason that it offered for its decision was more complex. The Board justified its decision both by referring to the Basel Accord and by adopting its substantive reasoning. This sort of mixed reason raises difficult questions about judicial review to which I return later in the Note.[89]

(4) The Board, consistent with the consultative paper, proposed to use the *original* maturity of claims on foreign banks and credit conversion factors for off–balance sheet loan commitments in order to determine the appropriate risk weight.[90] Commenters objected and "overwhelmingly favored the use of *remaining* maturity."[91] At the international level, the Basel Committee revised its proposal and applied risk weights to claims on non-OECD banks based on their remaining maturity in the Basel Accord.[92] However, it maintained the use of original maturity with regard to off–balance sheet loan commitments (giving banks an extended transition period during which they could continue to use remaining maturity).[93] The Board adopted this partial revision in its final rule.[94] This is the internationalist mode again, complicated by the sequencing and revision of the Basel Accord and the Board's rule. The Board proposed to use original maturity; commenters objected and demanded that the Board use remaining maturity. The Board compromised, but only insofar as it adopted the rule of the Basel Accord. In effect, it rejected comments

U.S. Government guarantee." *Id.* The question, of course, is *why* the Board continued to believe so.

86 *Id.* at 4192.

87 *Id.*

88 *Id.*

89 *See infra* Part III.B (discussing how courts should review domestic implementation of international regulations).

90 Basel I Final Rules, *supra* note 44, at 4192–93.

91 *Id.* at 4193.

92 *Id.*

93 *Id.*

94 *Id.* ("The final guidelines provide for this transition rule so that those banking organizations that currently track loan commitments according to their remaining, rather than original, maturity will have sufficient time to adjust their internal information systems.").

to the extent that they advocated a position inconsistent with the Basel Accord.

Finally, the Board's action with regard to term-subordinated debt instruments—while not strictly internationalist on my model—may be revealing. The Board's March 1988 proposal tracked its existing capital guidelines.[95] There appeared to be no comments on this provision of the NPRM. However, the Basel Accord contained a slightly different version,[96] and the Board adopted that provision in its final rule.[97] This pattern of action may help to illuminate the soft law force that the international regulation had on the Board's domestic actions.

b. Domestic-Focused Mode

The Board also implemented two provisions in the domestic-focused mode. First, the Basel Accord instructed national regulators to allow banks to place claims on the central governments of OECD-member countries in the 0% risk-weight category.[98] It also gave national regulators discretion to incorporate interest rate risk by directing banks to place assets with longer-term maturity into a higher risk-weight category.[99] The Board proposed to use this discretion to assign a 0% risk-weight to U.S. government securities with a remaining maturity of ninety-one days or less, and a 10% risk weight to U.S. government securities with a remaining maturity of more than ninety-one days.[100] The Board identified three groups of commenters: one group argued that the method of incorporating interest rate risk was flawed "because it did not take into account all assets, liabilities, and off–balance sheet transactions";[101] one group "expressed concern about the framework's lack of a more sophisticated approach to

[95] *Id*. at 4189 ("Consistent with the Board's existing capital guidelines, the March 1988 proposal stated that subordinated debt issues and limited-life preferred stock must have a minimum original weighted average maturity of at least seven years to qualify for inclusion in Tier 2 capital.").

[96] *Id.* ("The revised [Basel] Accord specifies that term debt instruments must have a minimum original term to maturity of over five years to qualify for inclusion in Tier 2.").

[97] *Id.* ("Accordingly, the final risk-based guidelines state that term subordinated debt instruments and intermediate-term preferred stock with an original average weighted maturity of at least five years are includable as limited elements within Tier 2 capital.").

[98] *Id.*

[99] *Id.* ("National supervisors were granted discretion, however, to place some of these claims, including long-term claims, in a slightly higher risk category in order to capture a degree of market and interest rate risk."); *Basel Accord*, *supra* note 39, ¶ 32 ("For the present, it was concluded that individual supervisory authorities should be free to apply either a zero *or* a low weight to claims on governments (e.g. 10% for all securities or 10% for those maturing in under one year and 20% for one year and over).").

[100] Basel I Final Rules, *supra* note 44, at 4189.

[101] *Id.*

interest rate risk";[102] a third group proposed that both short-term and long-term government securities be treated as 0% risk securities because of the "absence of credit risk."[103] This last group was concerned that other G-10 countries would place all of their own central government securities in the 0% risk bucket, putting U.S. banks at a competitive disadvantage.[104] Ultimately, the Board eliminated the distinction in its final rule.[105]

This rulemaking is domestic-focused in the following way: The Board proposed to use its discretion to implement regulations more stringent than those required by the Basel Accord (though the more stringent regulations were clearly contemplated in the Accord). Presumably, the Board thought that it was important as a domestic regulatory matter to incorporate interest rate risk into its rules. Commenters objected and asked that the Board adhere to the floor set by the Basel Accord—and in particular, they pointed to the practice of other G-10 countries. In response to the comments, the Board relented.

The Board's risk-weight treatment of mortgages is an even stronger example of the domestic-focused mode. The Basel Accord assigned a 50% risk weight to a certain type of residential mortgage.[106] The Board proposed assigning a 100% risk weight to the mortgage in order "to avoid the appearance or reality of regulatory credit allocation among private sector borrowers."[107] Commenters "overwhelmingly opposed" the Board's proposal, arguing that it would put U.S. banks at a competitive disadvantage.[108] In response to the comments, the Board revised its proposal, adopting the Basel Accord's 50% risk weight in the final rule.[109]

To abstract to the model, the Board proposed to deviate from the international agreement, citing domestic regulatory concerns. Commenters overwhelmingly proposed to adhere. The Board complied with the comments, adhering to the agreement in the final rule. This is an even more pure example of the domestic-focused mode than the

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102 *Id.*

103 *Id.*

104 *Id.* at 4190.

105 *Id.*

106 *Id.* at 4191 ("The Board's March 1988 proposal assigned a 100 percent risk weight to loans secured by owner-occupied 1–4 family residential mortgages, rather than the preferential 50 percent risk weight proposed by the [Basel] Supervisors' Committee.").

107 *Id.*

108 *Id.*

109 *Id.*

first, because the Basel Accord did not specifically contemplate the more stringent regulation the Board initially proposed.[110]

C. The Banking Agencies and the New Accord

The Basel Accord was enormously successful in terms of adoption. More than a hundred countries around the world have enacted regulations based on it.[111] The vast majority of these countries played no part in developing the agreement, and none were under any international legal obligation to adopt it. Despite this success, by the late 1990s, key bank regulators felt that the Basel Accord was no longer an adequate basis for international banking regulation.[112]

Political momentum for reform grew at the international level in the decade following the adoption of the Basel Accord. Many international banks had grown significantly in both size and sophistication.[113] For these large banks, which were increasingly able to fine-tune their credit risk, the Basel Accord's simple risk-bucketing approach was too blunt an instrument.[114] The simplicity of the regulations as compared to the sophistication of the banks' risk-management techniques distorted the market. Banks held more or less of certain types of capital than was efficient in order to meet the Basel Accord's regulatory capital requirements.[115] Both the banks and their regulators saw this behavior as problematic.[116]

The New Accord emerged against this backdrop. In 1998, the members of the Basel Committee agreed to review the Basel Accord. Subsequently, William McDonough, then the chair of the Basel

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110 *See Basel Accord*, *supra* note 39, ¶ 41 ("The framework will recognise this [low record of loss] by assigning a 50% weight to loans fully secured by mortgage on residential property which is rented or is (or is intended to be) occupied by the borrower.").

111 Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 EUR. J. INT'L L. 15, 17 (2006).

112 *See* DANIEL K. TARULLO, BANKING ON BASEL: THE FUTURE OF INTERNATIONAL FINANCIAL REGULATION 89 (2008) (describing a 1998 conference hosted by the Federal Reserve Bank of New York and cosponsored by the Federal Reserve Board, the Bank of England, and the Bank of Japan, at which regulators pointed out the flaws of the Basel Accord and offered alternative approaches).

113 *See Review of the New Basel Capital Accord: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 108th Cong. 54 (2003) (statement of Roger W. Ferguson, Jr., Vice Chairman, Bd. of Governors of the Fed. Reserve Sys.) (noting the concentration of the banking industry and the complexity of the operations of large banks).

114 *See* TARULLO, *supra* note 112, at 90 (noting that bankers emphasized "the contrast between the blunt Basel I approach and the increasingly sophisticated . . . internal risk management techniques used by large banks").

115 *See id.* at 88–89 (arguing that the increase in securitization and the banks' development of sophisticated internal risk models led to increased regulatory arbitrage under the Basel Accord).

116 *See id.* at 88–90 (describing support from both bank industry associations and bank regulators for change).

Committee and the President of the Federal Reserve Bank of New York, promised a serious overhaul.[117] Between 1999 and 2003, the Basel Committee issued three sets of consultative papers on the new approach for public comment.[118] The Committee received hundreds of comments in response to each paper.[119] In June 2004, it issued an agreement entitled *International Convergence of Capital Measurement and Capital Standards*.[120] It issued an amended, comprehensive version of the New Accord in June 2006.[121] This agreement is enormously complex.[122]

In the U.S., bank regulators were running a parallel rulemaking process. In 2000, the U.S. banking agencies (Agencies) issued a joint Advanced Notice of Proposed Rulemaking (ANPR) regarding a "simplified regulatory capital framework applicable to non-complex banks and thrifts."[123] In the years that followed, however, the regulators had difficulty settling on a unified international position. The Agencies, which cover different segments of the banking industry, disagreed over the approach.[124] More broadly, political tension arose between the large banks (which would be governed by the more flexible advanced approaches under the New Accord) and the smaller banks

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117 *Id.* at 91.

118 *See* Barr & Miller, *supra* note 111, at 24–27 (describing the Basel Committee's notice and comment process for the New Accord).

119 *See id.* at 24–26 (describing comments received by the Basel Committee in response to its consultative papers).

120 Basel Comm. on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (June, 2004), *available at* http://www.bis.org/publ/bcbs107.pdf.

121 Basel Comm. on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework, Comprehensive Version* (2006), *available at* http://www.bis.org/publ/bcbs128.pdf. [hereinafter *New Accord*].

122 To give a blunt measure of its complexity, the comprehensive version of the New Accord is 333 pages long. *Id.* The Basel Accord (as updated), by comparison, is only 25 pages long. *Basel Accord*, *supra* note 39.

123 Simplified Capital Framework for Non-complex Institutions, 65 Fed. Reg. 66,193 (proposed Nov. 3, 2000) (to be codified at 12 C.F.R. pts. 3, 208, 225, 325 & 567); *see also* Barr & Miller, *supra* note 111, at 29 (describing the ANPR as one of "two advance notices of proposed rule-making regarding the [Basel] negotiations").

124 *See The New Basel Accord: In Search of a Unified U.S. Position: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 108th Cong. 21–22 (2003) (statement of Rep. Barney Frank, Member, H. Comm. on Fin. Servs.) (describing disagreement among the Agencies); TARULLO, *supra* note 112, at 100 ("Within the United States—with its peculiar allocation of federal banking supervisory authority to four different agencies—there was friction among national supervisors over the scope and nature of the Basel II exercise that has continued to the present."); Robert F. Hugi et al., *U.S. Adoption of Basel II and the Basel II Securitization Framework*, 12 N.C. BANKING INST. 45, 49 (2008) (noting that progress on the New Accord was hindered by disagreements among the Agencies); Hemel, *supra* note 68, at 240–41 (describing tension among the Agencies in response to the adoption of the New Accord).

(which would use a simplified approach).[125] In 2003, the Agencies issued a joint ANPR on the Basel Committee's final consultative paper.[126] In 2006, they issued a joint NPRM proposing to implement the New Accord.[127] And in 2007, after reviewing comments on the NPRM, the Agencies issued a final rule implementing the New Accord.[128] The "advanced approach" of the New Accord applies as a mandatory rule only to the largest banks in the U.S. In fact, Board Vice Chairman Roger Ferguson estimated in the lead-up to the implementation of the rule that only ten banks would be required to adopt the advanced approach and that another ten or so banks would adopt the advanced approach voluntarily.[129] Smaller banks would continue to use the framework established under the Basel Accord.[130]

The Agencies implemented the New Accord in all four modes. I counted twenty-six instances of the Agencies acting in the internationalist mode,[131] seventeen instances in the domestic-focused mode,[132]

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[125] *See* TARULLO, *supra* note 112, at 100 ("[S]maller banks that would not likely qualify for either of the two IRB approaches feared they would be disadvantaged.").

[126] Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord, 68 Fed. Reg. 45,900 (proposed Aug. 4, 2003) (to be codified at 12 C.F.R. pts. 3, 208, 225, 325 & 567).

[127] Risk-Based Capital Standards: Advanced Capital Adequacy Framework, 71 Fed. Reg. 55,830 (proposed Sept. 25, 2006) [hereinafter Basel II Proposed Rules] (to be codified at 12 C.F.R. pts. 3, 208, 225, 325 & 567).

[128] Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II, 72 Fed. Reg. 69,288, 69,289 (Dec. 7, 2007) [hereinafter Basel II Final Rules] (codified as amended at 12 C.F.R. pts. 3, 208, 225, 325, 559, 560, 563 & 567).

[129] *Review of the New Basel Capital Accord: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 108th Cong. 56 (2003) (statement of Roger W. Ferguson, Jr., Vice Chairman, Bd. of Governors of the Fed. Reserve Sys.). A 2010 International Monetary Fund report noted that fourteen "banking groups" qualified as "core" banks that were required to adopt the New Accord's advanced approach as of its publication. NICHOLAS LE PAN, INT'L MONETARY FUND, UNITED STATES: PUBLICATION OF FINANCIAL SECTOR ASSESSMENT PROGRAM DOCUMENTATION—TECHNICAL NOTE ON BASEL II IMPLEMENTATION PREPAREDNESS IN THE UNITED STATES 6 (2010). Another "two to three banks . . . [had] indicated their intention to opt in . . . and two to three more [had] expressed an interest in doing so." *Id.*

[130] *See* Hugi et al., *supra* note 124, at 51–52 (describing the different categories of banks). These smaller banks would be allowed to "opt into the standardized approach" that the Agencies promised to develop after implementing the New Accord. *Id.* at 52. However, the promised rule has "not yet been finalized." Verdier, *supra* note 8, at 453.

[131] *See* Basel II Final Rules, *supra* note 128, at 69,309 (provision on certain estimates reflecting economic downturn conditions); *id.* at 69,315 (provision on the credit risk weight of a bank's premises); *id.* at 69,323–24 (limit on the inclusion of excess reserves in Tier 2 capital); *id.* at 69,324 (provision on securitization-linked deductions); *id.* at 69,327–28 (definition of securitization exposures); *id.* at 69,329 (boundary between operational risk and other risks); *id.* at 69,331 (treatment of eligible margin loans); *id.* at 69,331–32 (treatment of retail lease residuals); *id.* at 69,333 (definition of the M maturity variable); *id.* at 69,344 (treatment of category-based haircuts); *id.* at 69,347 (calculation of expected positive exposure (EPE)); *id.* at 69,347 (use of effective expected exposure (EE)); *id.* at 69,351–52 (cross-default/cross-acceleration requirement); *id.* at 69,353 (40% restructuring haircut);

fourteen in the split-personality mode,[133] and two in the APA-following mode.[134] Many more provisions did not fit into one of these categories for reasons elaborated above, or it was unclear which category they fell into. In some instances, the Agencies implemented different parts of a single provision in different modes. It is not necessary to describe each of these fifty-nine provisions here. However, discussing a selection of particularly clear examples will help to illustrate how agencies implement international regulations.

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id. at 69,355 (requirement for obligors of hedged exposures to qualify for double default treatment); *id.* (calibration of the double default formula); *id.* at 69,357–58 (deductions of gains-on-sale and credit enhancing interest-only strips (CEIOs)); *id.* at 69,358 (use of the Internal Assessment Approach (IAA)); *id.* at 69,358 (treatment of securitization exposures under the Supervisory Formula Approach (SFA)); *id.* at 69,359 (inclusion of expected credit loss (ECL) in capital calculation); *id.* at 69, 364–65 (risk weight for certain senior securitization exposures); *id.* at 69,368 (estimate of K_{IRB}); *id.* at 69,369 (measurement of N for re-securitizations); *id.* (calculation of risk of securitization exposures); *id.* at 69,378 (materiality threshold for determining significance of equity exposures); *id.* at 69,381 (calculation of floor requirements under the Internal Models Approach (IMA)).

132 *Id.* at 69,306–07 (definition of default); *id.* at 69,308–09 (estimation of expected loss given default (ELGD)); *id.* at 69,310 (deletion of proposed supervisory mapping function); *id.* at 69,321 (public disclosure of noncompliance); *id.* at 69,336 (treatment of defaulted wholesale exposures); *id.* at 69,336–37 (treatment of certain residential loans); *id.* at 69,338 (treatment of collateral mitigating counterparty credit risk of certain transactions); *id.* at 69,350 (clarification of the fourth criterion of the definition of an eligible guarantee); *id.* (sixth criterion of the definition of eligible guarantee); *id.* at 69,355 (definition of double default guarantor; qualification of foreign financial firms with an outstanding long-term debt security graded investment grade or higher); *id.* (definition of double default guarantor); *id.* at 69,356 (rejection of proposed "second alternative approach" to guarantees and credit derivatives that cover retail exposures); *id.* at 69,361–62 (treatment of solicited versus unsolicited ratings); *id.* at 69,374–75 (treatment of New Accord exemption iii to holding regulatory capital against investors' interest if early amortization is triggered by certain events); *id.* at 69,381 (deletion of proposed 7% risk weight floor on equity exposures to investment funds); *id.* at 69,384–86 (level of public disclosure requirements); *id.* at 69,387 (amendment of public disclosure item (c)); *id.* (removal of requirement in proposed Table 11.7 item (b)).

133 *See id.* at 69,302 (transitional floors); *id.* at 69,309 (granularity of determination of economic downturn conditions); *id.* at 69,315 (inclusion of a specific definition of operational loss); *id.* at 69,318 (availability of the alternative operational risk quantification approach at the Bank Holding Company (BHC) level); *id.* at 69,324 (consolidated approach to insurance underwriting subsidiaries); *id.* at 69,326 (treatment of small- and medium-sized enterprises (SMEs)); *id.* at 69,350 (rejection of clarification of the unconditionality requirement in the definition of eligible guarantee); *id.* at 69,362 (two-rating requirement for originating banks); *id.* (use of lowest versus second most favorable rating); *id.* at 69,365 (prior written approval requirement to use the IAA); *id.* at 69,370 (treatment of market disruption liquidity facilities); *id.* at 69,375 (treatment of New Accord exemptions i and ii to holding regulatory capital against investors' interest if certain events trigger early amortization); *id.* at 69,375–76 (rejection of ten-year grandfathering periods); *id.* at 69,385 (frequency of quantitative disclosures).

134 *See infra* notes 135–39 and accompanying text.

1. *APA-Following Mode*

Unlike when the Board implemented the Basel Accord, the Agencies implemented two of the New Accord provisions in the APA-following mode.

(1) In the NPRM, the Agencies defined "financial collateral" that banks could use for the purpose of "mitigating the counterparty credit risk associated with" certain types of transactions using the same categories of assets as used in the New Accord.[135] "A substantial number of commenters" proposed that the Agencies add several asset classes to the definition, including "mortgages loans."[136] In response, while the Agencies did not accept most of the proposed additions, they did decide to go beyond the New Accord's terms and recognize an additional asset class, conforming residential mortgages, as financial collateral.[137]

(2) Consistent with the New Accord, the NPRM proposed a default 4.5% "excess spread trapping point" for certain securitizations.[138] Commenters argued that the proposed approach was inappropriate for certain types of securitizations—namely, securitizations

[135] Basel II Final Rules, *supra* note 128, at 69,338, 69,341–42; *see also* Basel II Proposed Rules, *supra* note 127, at 55,917 (listing asset classes comprising financial collateral); *New Accord*, *supra* 121, ¶¶ 145–46 (same).

[136] Basel II Final Rules, *supra* note 128, at 69,341.

[137] *See id.* at 69,342 (noting that the "inclusion goes beyond the New Accord's recognition of financial collateral" and, consequently, taking a "conservative approach" to banks' use of the asset as financial collateral). One could argue that, because the Agencies, in conformity with the New Accord, rejected most of the commenters' proposed additions, the implementation of this provision is just as easily classified under the internationalist mode. Ultimately, as I elaborate below, my point is that agencies do not necessarily approach the domestic implementation of international regulations from a single perspective—even as regards the implementation of a single provision of the regulation. Highlighting the APA-following nature of the implementation of part of this provision better illuminates the ultimate point.

[138] *Id.* at 69,375; *New Accord*, *supra* note 121, ¶ 598. The securitizations to which the default would apply were those "that do not require excess spread to be trapped, or that specify trapping points based primarily on performance measures other than the three-month average excess spread." Basel II Proposed Rules, *supra* note 127, at 55,943 n.10. One of the primary purposes of the New Accord was to strengthen the regulatory regime's approach to securitized assets. *See* Hugi et al., *supra* note 124, at 49 (noting that the New Accord was designed to be "more risk sensitive across various types of banking assets, including securitization exposures"). Excess spread is the "difference between the gross yield on the pool of securitized receivables less the cost of financing those receivables," and "[is] typically a source of credit enhancement for the certificates since it is commonly available to absorb losses on the assets." *Credit Card Securitization Manual*, FDIC, http://www.fdic.gov/regulations/examinations/credit_card_securitization/glossary.html (last visited Jan. 30, 2013). A securitization's governing documents may demand that "if specific performance indictors [sic] fall below certain thresholds, any excess spread will be 'trapped' into an account for the benefit of the certificate holders as a form of credit enhancement against future credit losses." *Id.*

of home equity loans and lines of credit. The Agencies noted that "the New Accord does not provide an alternative methodology," but agreed with the commenters and provided an alternative.[139]

In both of these instances, the Agencies proposed to adhere to the New Accord. Commenters objected to the Agencies' proposals and requested that the Agencies deviate from the New Accord. In the final rule, the Agencies acquiesced to the commenters' proposals and deviated.

2. *Split-Personality Mode*

The Agencies also implemented numerous provisions in the split-personality mode; they were so committed to deviating from the New Accord that they rejected comments asking for adherence. This mode is not inherently problematic. The Agencies may have negotiated certain provisions internationally in order to reach agreement, and then ultimately judged that those provisions were inappropriate for the domestic regulatory framework. However, if the Agencies agreed to international regulations that they could not implement at home, we might think that Congress was offering them inappropriate incentives.

One example illustrates the split-personality mode clearly. The New Accord included a provision that allowed banks using the advanced approaches to distinguish between exposures to small- and medium-sized enterprises and exposures to large firms.[140] The New Accord provided an adjustment in the risk weight formula for exposures to these smaller firms.[141] In the NPRM, the Agencies did not include a separate formula for these types of exposures. Several commenters objected, arguing that the exclusion of the provision could put U.S. banks at a competitive disadvantage. The Agencies acknowledged that the commenters "raised important issues," but refused to incorporate their proposals and maintained the rule as proposed.[142]

3. *Internationalist Mode*

Finally, I turn to the provisions implemented in the internationalist mode.[143] As part of the New Accord and the NPRM, the Agencies allowed banks to use certain techniques to mitigate the

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139 Basel II Final Rules, *supra* note 128, at 69,375.

140 *New Accord*, *supra* note 121, ¶ 273.

141 *Id.*

142 Basel II Final Rules, *supra* note 128, at 69,326. It is interesting, as a reflection of the underlying politics, that one of the reasons given for the exclusion was that, if included, the provision might "give rise to a domestic competitive inequity between banks subject to the advanced approaches and banks subject to the general risk-based capital rules." *Id.*

143 Analysis of the New Accord provisions implemented in the domestic-focused mode does not add anything to the analysis of similar Basel Accord provisions.

credit risk associated with securitization exposures. The Agencies proposed subjecting certain of these credit risk mitigants—credit derivatives—to a 40% haircut if they did not "include a distressed restructuring as a credit event that triggers payment under the derivative."[144] One commenter objected that the haircut was too punitive; another argued that it should not apply to certain exposures.[145] The Agencies rejected these comments, implementing the proposed rule and maintaining consistency with the New Accord.[146] They gave three reasons for their decision. First, they argued that the haircut accurately reflected the increased risk due to the missing distressed restructuring trigger. Second, they argued that the haircut "is consistent with the New Accord," and third that it "is a reasonably prudent mechanism for ensuring that banks do not receive excessive CRM benefits."[147]

As I elaborate below, these New Accord provisions present a potential dilemma for courts: The Agencies relied on both substantive reasons within their expertise as banking regulators *and* the fact of an international agreement to justify disposition of comments. This reliance on both the international agreement and reasons closely related to the Agencies' expertise as a justification for disposing of the comments suggests that hard-look review may not facilitate sufficient scrutiny in cases involving international agreements.[148]

D. *What Can Be Inferred from These Observations?*

If agencies *always* implemented international regulations in the internationalist mode, their behavior would confirm the fears of commentators, who argue that agencies simply implement international regulations as negotiated.[149] Even if the agency claimed that it was complying with the APA and sincerely considering public comments, its consistent behavior would suggest that the international agreement determined agency decisionmaking. Consistent action in the internationalist mode, in other words, would suggest that the agency was *not*, in fact, complying with its public participation obligations.

However, as the analysis in the preceding sections has demonstrated, agencies do not always act in the internationalist mode. They

144 Basel II Final Rules, *supra* note 128, at 69,353.

145 *Id.* ("One commenter contended that the 40 percent haircut is too punitive. [Another] contended that the 40 percent haircut should not apply when the hedged exposure is an OTC derivative contract or a qualifying master netting agreement that covers OTC derivative contracts.").

146 *Id.*

147 *Id.* (emphasis added).

148 *See infra* Part III.B.

149 *See, e.g.*, Zaring, *supra* note 8, at 305.

do not necessarily implement international agreements as a fait accompli. Sometimes an agency deviates from an international agreement. Often it adheres to an international agreement, but the process for getting there is more complicated than simple incorporation of the international agreement into domestic law: At times, the agency would prefer deviation but public commenters in the domestic notice-and-comment process urge adherence and the agency accepts their proposals. This diversity of behavior leads to a very different conclusion about the effects of an international agreement on agency rulemaking than if the agency consistently acted in the internationalist mode.

This diversity of behavior suggests that the modes of action I posited at the beginning of the paper are nothing more than a descriptive fiction. Agencies do not, as a general rule, pick a certain mode of action with regard to an international agreement and then act accordingly. Rather, my analysis suggests that agencies balance adherence to an international agreement against other equities—including public comments—in deciding how to proceed with a regulation. International agreements appear to be a factor in agency decisionmaking, but are not determinative. Broadly speaking, for example, the Agencies simply implemented parts of the New Accord as a domestic regulation.[150] However, as we have seen, they also deviated from it in several important respects.

International agreements exert their pull in two ways. Agencies may decide that international uniformity is, *in and of itself*, an important goal for domestic regulation. Or agencies may adopt international agreements' provisions because commenters in the domestic notice-and-comment process believe that adherence to the international agreement is important.

III
Implications for Courts

The conclusion that international agreements do have an effect, though not a determinative effect, on agency decisionmaking raises a

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[150] *See* Basel II Final Rules, *supra* note 128, at 69,289 ("The proposed rule was based on a series of releases from the Basel Committee on Banking Supervision (BCBS), culminating in the BCBS's comprehensive June 2006 release entitled 'International Convergence of Capital Measurement and Capital Standards: A Revised Framework' (New Accord)."). Even from this broad perspective, however, there was intense debate among the Agencies over whether and to what extent to implement the New Accord's standardized approach. *See* Verdier, *supra* note 8, at 451–52 (describing conflicts among the Agencies and noting that the "bifurcated approach would survive, so that Basel II would only be mandatory for core banks"); Hugi et al., *supra* note 124, at 51 (noting that the Agencies decided to implement the standardized approach in response to comments they received).

crucial question: Is their effect legitimate? In this section, I explore whether and when agency action taken under the influence of an international agreement sufficiently complies with domestic administrative law. In terms of the APA, this question can be reformulated as follows: Should adherence to an international agreement count as a legitimate reason for agency decisionmaking? Furthermore, is the courts' normal level of scrutiny sufficient to hold agencies to their administrative law obligations when implementing an international regulation?

While there may be little sympathy for banks whose comments are ignored,[151] the legitimacy of agency action matters. Regulations in a variety of fields, from pharmaceuticals[152] to transportation[153] and technical manufacturing standards,[154] increasingly have an international aspect to them. If agencies unreasonably ignore highly-organized and well-resourced groups such as banks, the implications for dispersed and underfunded groups may be ominous.

A. Should the Fact of an International Agreement Count as a Reason?

Reason-giving is part of the foundation of legitimacy in administrative law.[155] Unlike Congress, which need not give its reasons for enacting a law, agencies are required to explain why they enact a rule.[156] This requirement stems from the APA, which instructs agencies to incorporate into their rules a "concise general statement of their basis and purpose"[157] and instructs courts to "review the whole

[151] *See, e.g.*, Dennis Jacobe, *Americans' Confidence in Banks Falls to Record Low*, GALLUP (June 27, 2012), http://www.gallup.com/poll/155357/Americans-Confidence-Banks-Falls-Record-Low.aspx (reporting poll results that revealed the public confidence in banks to be at an all-time low of twenty-one percent).

[152] *See, e.g.*, Dagron, *supra* note 12 (studying the International Conference on Harmonization, a partnership between regulatory authorities in the U.S., Europe, and Japan, which harmonizes pharmaceutical guidelines).

[153] *See infra* notes 161–64 and accompanying text (describing international harmonization efforts by the Federal Aviation Administration).

[154] *See, e.g.*, TIM BÜTHE & WALTER MATTLI, THE NEW GLOBAL RULERS: THE PRIVATIZATION OF REGULATION IN THE WORLD ECONOMY 5–6 (2011) (describing the harmonization work of the International Organization for Standardization and the International Electrotechnical Commission).

[155] *See* Jerry L. Mashaw, *Small Things Like Reasons Are Put in a Jar: Reason and Legitimacy in the Administrative State*, 70 FORDHAM L. REV. 17, 18 (2001) ("Administrative law's struggle with the uses of reason and reason-giving as the foundation of legal legitimacy provides insights of a special sort into the relationship of law and reason . . . .").

[156] *See id.* at 19–22 (describing the differences between legislative and administrative lawmaking through the lens of reason-giving).

[157] 5 U.S.C. § 553(c) (2006); *see also* Mashaw, *supra* note 155, at 24–25 (citing and elaborating on the APA's requirement).

record or those parts of it cited by a party."[158] On top of these instructions, courts have built elaborate requirements for agency action. An agency must give detailed and contemporaneous explanations for its chosen course of action, or reviewing courts may reject its rule as arbitrary and capricious.[159]

Nor will just any reason do. Agencies may rely only on factors that Congress intended them to consider.[160] In some cases, Congress, in granting power to an agency, demands that the agency comply with an international agreement. For example, Congress instructed the Administrator of the Federal Aviation Administration (FAA) to "act consistently with obligations of the United States Government under an international agreement."[161] Pursuant to this statutory directive, the FAA has adopted a policy "to conform to International Civil Aviation Organization (ICAO) Standards and Recommended Practices to the maximum extent practicable."[162] As part of its rulemaking process, the agency analyzes the proposed rule's "International Compatibility."[163] If the agency fails to comply with ICAO standards, it risks reversal by the courts.[164] In this case, the fact of an international agreement counts as a legitimate reason for action, and the FAA may dispose of comments by reference to their deviation

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158 5 U.S.C. § 706.

159 *See* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 420 (1971) (requiring the agency either to provide the "full administrative record that was before the Secretary at the time he made his decision" or that the "administrative officials who participated in the decision . . . give testimony explaining their action").

160 Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 42–43 (1983).

161 49 U.S.C. § 40105(b)(1)(A).

162 Removal of the Requirement for Individuals Granted the Special Issuance of a Medical Certificate To Carry Their Letter of Authorization While Exercising Pilot Privileges, 77 Fed. Reg. 16,664, 16,667 (Mar. 22, 2012) (to be codified at 14 C.F.R. pt. 67).

163 *Id.* However, the agency does not necessarily implement ICAO standards exactly as formulated. *See* Flightdeck Door Monitoring and Crew Discreet Alerting Systems, 72 Fed. Reg. 45,629, 45,632 (Aug. 15, 2007) (to be codified at 14 C.F.R. pt. 121) (noting that the NPRM diverged from the relevant ICAO regulations in three areas and that one deviation remained in the final rule).

164 *See* British Caledonian Airways Ltd. v. Bond, 665 F.2d 1153, 1168 (D.C. Cir. 1981) (holding that the FAA Administrator's action "violated various multilateral and bilateral civil aviation agreements, which in turn violated section 1502 of the Federal Aviation Act of 1958" and setting the action aside). The *British Caledonian* court specifically did not reach petitioner's APA claims, resting its decision simply on the Administrator's violation of a statutory provision. *Id*. at 1168 & n.10. It is axiomatic that an agency cannot violate the constraints placed on it by Congress. *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (noting that "[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress"); *see also* LISA SCHULTZ BRESSMAN ET AL., THE REGULATORY STATE 433 (2010) ("An agency must ensure that its regulations are (a) within the scope of its statute and (b) consistent with the terms of its statute.").

from the international agreement. The agency is required by statute to comply with ICAO standards; the FAA needs no further reason to comply.

The Basel Accords are quite different. When implementing the first Basel Accord, the Board relied on two statutory provisions for its authority to act:[165] section 5(b) of the Bank Holding Company Act of 1956 (BHCA)[166] and section 910 of the International Lending Supervision Act of 1983 (ILSA).[167] These statutes gave the Board broad authority to enact regulations on capital adequacy. For example, ILSA directed the Board (and the other banking agencies) to "cause banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital for such banking institutions and by using such other methods as the appropriate Federal banking agency deems appropriate."[168] ILSA also included very general provisions on international harmonization. It instructed the Chairman of the Federal Reserve Board and the Secretary of the Treasury to "encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending."[169] Congress appears to have included the provision to further one of its stated objectives in enacting ILSA. In its declaration of policy, Congress directed the banking agencies to "consult with the banking supervisory authorities of other countries to reach understandings aimed at achieving the adoption of effective and consistent supervisory policies and practices with respect to international lending."[170]

These directives are extremely broad. In fact, one court reviewing regulations enacted pursuant to ILSA said that the statute is so broad that it provided no basis for review. In *FDIC v. Bank of Coushatta*,[171] the Fifth Circuit found that courts cannot review capital directives issued by the Federal Insurance Deposit Corporation (FDIC) pur-

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165 Basel I Final Rules, *supra* note 44, at 4197.

166 12 U.S.C. § 1844(b) (Supp. IV 2011).

167 12 U.S.C. § 3909 (2006). The Agencies appeared to rely on more elaborate statutory authority in implementing the New Accord. *See* Basel II Final Rules, *supra* note 128, at 69,429–31 (noting authority citations). However, on my reading, the only possible additional statutory authority for reaching an international agreement is a 1994 law that instructed the "Federal banking agencies" to "discuss the development of comparable standards with members of the [Basel Committee]." 12 U.S.C. § 1828 note (Review of Risk-Based Capital Standards).

168 12 U.S.C. § 3907(a)(1) (Supp. IV 2011).

169 *Id.* § 3907(b)(3)(C).

170 12 U.S.C. § 3901(b) (2006).

171 930 F.2d 1122 (5th Cir. 1991).

suant to ILSA[172] because "[t]he legislative history and language of the statute [(ILSA)] do not leave a court with a meaningful standard against which to judge the agency's exercise of its discretion"[173] and that the order was therefore exempt from review under the APA.[174] The court gave particular weight to the Senate Committee Report, which stated that "establishing adequate levels of capital is properly left to the *expertise* and *discretion* of the agencies."[175]

Despite the outcome of the case, the Fifth Circuit's analysis underscores why it is problematic to rely on adherence to an international agreement as a reason for agency rulemaking in the absence of statutory direction. The *Coushatta* court found that it could not review the FDIC's order because Congress had fully committed the decision to issue the order to the agency's expertise and discretion. However, when an agency relies on adherence to an international agreement as a reason for action, it is an open question whether it is exercising its expertise.[176] International agreement is what we might call a "contentless" reason. It is a reason "communicated from a particular source,"[177] not one with any particular substantive policy rationale. In

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[172] *See* 12 U.S.C. § 3907(b)(2)(A) (Supp. IV 2011) ("In addition to, or in lieu of, any other action authorized by law . . . the appropriate Federal banking agency may issue a directive to a banking institution that fails to maintain capital at or above its required level as established pursuant to . . . this section." (footnote omitted)).

[173] *Coushatta*, 930 F.2d at 1129. The court relied on the Supreme Court's decision in *Webster v. Doe*, 486 U.S. 592 (1988), in coming to its decision. *See Coushatta*, 930 F.2d at 1128–29 (applying *Webster*'s use of statutory language and legislative history to find congressional intent that the statute be "unreviewable").

[174] 5 U.S.C. § 701(a) (2006) (exempting from judicial review "agency action [that] is committed to agency discretion by law").

[175] *Coushatta*, 930 F.2d at 1129 (quoting S. REP. NO. 98-122, at 16 (1983)).

[176] I use "expertise" in a relatively narrow sense here. I do not mean to suggest that the Basel Committee is not an expert organization—the U.S. members of the Committee are, of course, the same regulators that formulate rules domestically. *See* Hemel, *supra* note 68, at 236 (noting that the Federal Reserve holds two seats on the Basel Committee and the other banking agencies each hold one). Rather, I argue that when an agency justifies its action by reference to an international agreement, its reasoning is underspecified. Because it does not specify precisely why the international agreement justifies the action, such reference does not provide an adequate basis for commenters and courts to determine whether the agency is exercising its expertise. The international agreement might embody the same position that the agency would have taken if it were enacting a purely domestic regulation, or there might be policy reasons why international uniformity itself is more important than the details of the policy agreed to. *See* Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 122–26 (2009) (describing international coordination games). Alternatively, adherence to an international agreement may simply represent a political choice by an agency. *See supra* notes 29–32 and accompanying text (describing the politics of international negotiation).

[177] Nina A. Mendelson, *Disclosing "Political" Oversight of Agency Decision Making*, 108 MICH. L. REV. 1127, 1128 (2010).

this way, using international agreements as reasons for agency action mirrors using political reasons.[178]

Whether political reasons should serve as a sufficient basis for agency action is deeply contentious.[179] The fundamental tension in the debate is: What legitimates agency action—democratic accountability or the exercise of expertise?[180] This tension was apparent in the Supreme Court's decision in *FCC v. Fox Television Stations, Inc.*[181] Justice Scalia, writing for the Court, held that a reversal in agency policy was not subject to more stringent justificatory requirements under the APA than the initial adoption of a policy.[182] He noted approvingly (for four members of the Court) that "the precise policy change at issue here was spurred by significant political pressure from Congress,"[183] suggesting that political reasons constitute an acceptable basis for a change of agency policy.[184] Justice Breyer, writing for four dissenters, argued that the law "does not permit [agencies] to make policy choices for purely political reasons nor to rest them primarily upon unexplained policy preferences."[185] Rather, Justice Breyer wrote, "[a]n agency's policy decisions must reflect the reasoned exercise of expert judgment."[186]

This tension between accountability and expertise is fundamental to understanding the divide over the use of political reasons. However, this tension is often absent in the context of international agreement. Reliance on adherence to an international agreement lacks the democratic legitimacy that political reasons may confer on an action. When an agency relies on an international agreement that the

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178 For an extensive discussion of political reasons, see generally *id.* at 1128–78. Professor Mendelson defines political reasons, for the purposes of her article, as "those contributed by or adhered to by the President and the politically-appointed executive officials who oversee the administrative process and who answer most closely to the President." *Id.* at 1128. Professor Mendelson focuses on the President, but acknowledges that Congress could also be a source of political reasons. *See id.*

179 *See generally id.* at 1131–46 (reviewing the debate and noting valid arguments on both sides).

180 *See id.* at 1129 (describing the debate between those who argue that legitimate agency action requires presidential supervision and those who argue that agencies should be free from political intrusion) (citing Jody Freeman & Adrian Vermeule, Massachusetts v. EPA*: From Politics to Expertise*, 2007 SUP. CT. REV. 51, 88).

181 556 U.S. 502 (2009).

182 *See id.* at 515 ("[The agency] need not demonstrate . . . that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better . . . .").

183 *Id.* at 523.

184 *Id.*; *see* Mendelson, *supra* note 177, at 1139 (noting that Justice Scalia "hinted that political preferences could be a reason for an agency decision").

185 *Fox Television*, 556 U.S. 547 (Breyer, J., dissenting).

186 *Id.* at 548.

President and Congress have not ratified, its action may be *both* unaccountable and inexpert.[187] And, when the international agreement in question is seen as the product of an illegitimate process, reliance on it as a reason for action and disposition of public comments delegitimizes the implementing regulation.[188]

Courts may be reluctant to intervene in the administrative process when doing so raises the costs of international coordination.[189] However, failure to require agencies to give a substantive rationale for decision and disposition of public comments beyond adherence to an international agreement undermines the APA. Ultimately, when an agency relies on an international agreement that has not been ratified by the President and Congress as a reason for taking some action or for dismissing an alternative proposal, and the statute does not specifically direct the agency to comply with the agreement, courts should presume that agencies have failed to fulfill their obligations to consider every aspect of a problem. Courts must force agencies to specify the *substantive* reasons for action—rather than allowing them to use "contentless" reasons—in order to ensure that their bases for action are legitimate.

B. How Should Courts Review Domestic Implementation of International Regulations?

Thus far, I have argued that agencies sometimes rely on adherence to an international agreement as a reason for action (and for disposing of commenters' proposals) and that such reliance may not be allowed under the APA because it is not sufficiently specific to determine whether adherence is an exercise of agency expertise. Now, I consider whether the level of scrutiny courts apply to purely domestic regulations is sufficient to enforce agency compliance with the APA in this context.[190]

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[187] Unaccountable because the international agreement was not authorized by democratically-elected officials in the legislative and executive branch; inexpert for the reasons elucidated *supra* note 176.

[188] For example, critics have described the Basel Committee as particularly opaque and distant. *See* BAKER, *supra* note 57, at 2–4 (describing the Bank for International Settlements as "one of the more enigmatic international financial institutions operating today" and as a "highly secretive organization").

[189] *See* Stewart, *supra* note 8, at 81–82 (reviewing court decisions that reflect an approach that applies different standards to internationally-negotiated regulations and purely domestic regulations).

[190] One might think that this question is answered by the fact that the Board and the Agencies did actually rely on the fact of an international agreement as a reason for enacting certain domestic regulatory provisions. However, I have not found a case in which these provisions were specifically challenged in the courts.

The status quo is unsatisfactory. Specifically, the current doctrine is vulnerable to concealment, and it may fail when agencies employ mixed reasoning. The Agencies' implementation of Basel II throws these problems into stark relief. In numerous instances, the Agencies gave as reasons for some decision that the action adhered to the New Accord *and* that it served some other purpose related to the Agencies' expertise.[191] Because the Agencies used multiple reasons—one of which was sufficient to justify their decision and one of which was not—it is unclear whether their overall rationale is legitimate. It is essentially impossible to determine which reason primarily motivated the Agencies' decision.

One possible approach courts could take would be to drop the improper reason and determine whether the remaining, legitimate reason(s) justified the agency's decision and disposition of comments.[192] And, in fact, one might assume that, were courts to hold clearly that reliance on certain international agreements was an improper basis for decision, agencies would begin to do this work themselves. That is to say, agencies would conceal the disallowed reason for action, putting forward only judicially accepted types of reasons.[193] But even if the remaining reasons justified the agency's decision, they still would not answer the question that began this paper—whether the reasons offered are simply a post hoc rationalization rather than a true reflection of the contemporaneous decision-making process.[194]

Courts generally confine their inquiry into the reasons for a decision to the agency rulemaking record.[195] They are loath to inquire into

[191] *See supra* notes 144–46 and accompanying text (describing an example in the context of mitigating risk).

[192] *Cf.* Warner-Lambert Co. v. Heckler, 787 F.2d 147, 161 n.11 (3d Cir. 1986) ("Even if we were to agree with Warner that the Commissioner erred by considering evidence of concomitant medication, we could not reverse his decision. As noted in the text the Commissioner rejected each study for more than one reason.").

[193] *See* Mendelson, *supra* note 177, at 1168 (arguing that agencies might put forward public-regarding reasons pretextually).

[194] *See generally* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 419 (1971) (disallowing litigants' affidavits containing "post hoc rationalizations" as an adequate basis for judicial review (internal quotation marks omitted)). Strictly speaking, the rule against post hoc rationalizations applies to reasons offered during the process of judicial review, not to reasons offered by the agency in the rulemaking process. *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 50 (1983) ("[C]ourts may not accept appellate counsel's *post hoc* rationalizations for agency action. It is well established that an agency's action must be upheld, if at all, on the basis articulated by the agency itself." (citation omitted)). However, I argue that the rationale behind this rule should apply to reasons offered insincerely by the agency in the rulemaking process.

[195] *See* Stewart, *supra* note 8, at 80 (noting that courts generally confine their review to the record generated after the formal initiation of a rulemaking).

the state of mind of an agency decisionmaker[196] and reluctant to look at the deliberations that initiated the rulemaking process.[197] As a result, deliberations at the international level may be left out of the review.[198] The review process proceeds instead by attempting to "flush out" impermissible motives through a close examination of the agency record.[199] However, if the process leading to the international agreement and its implementation is not part of the rulemaking record, the court may find it difficult to discern when an agency adhered to the agreement for impermissible reasons.

As Professor Stewart has noted, no court has subjected an agency's domestic implementation of an international regulation to a more stringent level of scrutiny than that applied to purely domestic regulations.[200] As courts review more international regulations, however, they will have reason to increase the strictness of their review. In order to create a record adequate to hold agencies to their administrative law obligations, they will have to "enhance the transparency of the facts, analyses, and considerations that underlie global regulatory decisions in order to expose them to public scrutiny and contestation."[201] This enhanced scrutiny may lead courts to demand that agencies include in the record the international processes leading to agreement on the international regulation, rather than simply review the record of domestic implementation.[202]

Two arguments counsel against adopting a more stringent level of scrutiny. First, higher scrutiny will, prima facie, increase the administrative costs of judicial review.[203] Second, courts may be reluctant to

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196 *See Overton Park*, 401 U.S. at 420 ("The court may require the administrative officials who participated in the decision to give testimony explaining their action. Of course, such inquiry into the mental processes of administrative decisionmakers is usually to be avoided.").

197 *See* Stewart, *supra* note 8, at 80 (noting that "[p]rior informal discussions between the agency and interested persons" are not usually part of the record before the court) (citing Home Box Office, Inc. v. FCC, 567 F.2d 9, 57 (D.C. Cir. 1977)).

198 *See id.*

199 *See* Cass R. Sunstein, *Factions, Self-Interest, and the APA: Four Lessons Since 1946*, 72 VA. L. REV. 271, 281–87 (1986) ("The various components of the deliberative approach may be understood as a means of simplifying the judicial inquiry. Those components are designed to help 'flush out' impermissible motivations without looking into subjective states of mind, and at the same time to minimize judicial intrusions on the merits." (footnote omitted)).

200 *See* Stewart, *supra* note 8, at 79, 84 (noting that no court takes what Professor Stewart calls the "parity plus" approach to international regulations, where it subjects "[d]ecisions implementing international agreements" to "greater requirements" than "purely domestic decisions").

201 *Id.* at 83.

202 *See id.* (suggesting that courts might adopt such an approach).

203 *See id.* at 84 (arguing that "the scope of review [under a parity plus approach] would extend significantly beyond that applied by courts under a parity paradigm").

intrude on the conduct of international affairs by the executive branch.[204] Judicially compelled disclosure is anathema to the confidentiality that is thought to be crucial to successful international negotiation.[205] In addition, judicial review adds an element of uncertainty to agency rulemaking.[206] Uncertainty, in turn, can complicate international negotiations. Specifically, if foreign negotiators doubt the ability of their American counterparts to deliver on their promises—in this context, to adhere to international regulations—they are less likely to come to an agreement.[207]

Both concerns are valid, but careful procedural design can ameliorate them. Judges must keep in mind the purpose of their inquiry—to flush out impermissible reliance on adherence to an international agreement as a reason for choosing a course of action—and restrain the inquiry to the minimum additional intrusion necessary to accomplish that purpose.[208] First, courts need not expand their normal inquiry if they find that the agency could *permissibly* rely on adherence to an international agreement as a reason for action. For example, the FAA's reliance on compliance with relevant ICAO regulations as a reason for a decision is permissible because the agency's governing statute demands such compliance.[209] Second, courts should, as a general rule, require agencies to disclose when they have relied on adherence to an international agreement as a reason for action.[210] Agencies, of course, are in the best position to know when an international agreement has motivated a decision. Where the agency relied entirely on adherence to an international regulation as its reason for action, courts would not need to expand their inquiry any further. They would simply focus on the legal question of whether the reliance was permissible under the governing statute. Where the agency used mixed reasoning to come to the decision, courts would have to engage

204 *See id.* at 81–82 (describing the paradigm—well-supported in case law—of "parity minus," where courts subject international regulations to *less* stringent oversight than normal because of the fear that intrusion will "impair the ability of the executive to conclude and promptly implement international agreements").

205 *See id.* at 84 (arguing that the government would resist intrusion on the "informality and confidentiality" of international negotiations).

206 *See* JERRY L. MASHAW, GREED, CHAOS, AND GOVERNANCE: USING PUBLIC CHOICE TO IMPROVE PUBLIC LAW 165 (1997) (noting that most commentators argue that the problem with judicial review is the uncertainty it creates).

207 *See* Putnam, *supra* note 29, at 439 (arguing that involuntary defection can be just as harmful as voluntary defection).

208 *See supra* Part III.A (discussing whether and when compliance with an international agreement should count as a sufficient basis for action).

209 *See supra* notes 161–64 and accompanying text.

210 *Cf.* Mendelson, *supra* note 177, at 1163–66 (arguing that agencies should disclose the content of executive supervision over their decisions in rulemaking documents).

in a mixed fact-law inquiry to determine (1) whether adherence to the international regulation was the primary motivating factor, and if it was the primary motivation, (2) whether such reliance was permissible. Finally, there might be some instances in which a court suspected that an agency was evading the requirement.[211] In such a case, the court would have to expand its inquiry further, drawing into the record the international process that led to the international regulation.[212]

Ultimately, where courts find that agencies have impermissibly relied on adherence to an international agreement as a reason for decision, they should remand the relevant provisions to the agency as arbitrary and capricious. When an agency acts in order to adhere to an agreement that it negotiated absent a statutory mandate it completely circumvents democratic controls on its action.

C. The Congressional Alternative

Courts may be loath to undertake the kind of in-depth review that I have suggested.[213] In the absence of judicial intervention, Congress may play an important role in maintaining the legitimacy of administrative action. Indeed, Professor Verdier has convincingly detailed the role that Congress played in shaping the Agencies' approach to implementation of the New Accord.[214] In response to pressure from smaller banks that feared the New Accord's advanced approaches would disadvantage them vis-à-vis larger banks, Congress held hearings in June 2003, at which some members voiced their skepticism toward the New Accord's approaches.[215] At about the same time, some members proposed legislation that would create a panel to coordinate the U.S. position at the Basel Committee.[216] The Agencies responded to congressional pressure with both substantive and procedural concessions. They committed to putting out an Advanced Notice of Proposed Rulemaking, which would allow the public to comment before the New Accord was finalized at the international level.[217]

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211 *Cf. id.* at 1166–70 (discussing problems with enforcing a requirement to disclose political reasons).

212 *See* Stewart, *supra* note 8, at 82–84 (describing the paradigm of "parity plus").

213 *See supra* notes 194–99 (describing courts' confinement of review to the rulemaking record); *see also* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843–44 (1984) (holding that, where congressional intent is ambiguous, courts should defer to agencies' reasonable interpretation of the statute); Stewart, *supra* note 8, at 84 (noting that no court has adopted the "parity plus" approach).

214 *See* Verdier, *supra* note 8, at 445–53.

215 *See id.* at 445.

216 *See id.*

217 *See id.*

They also agreed to study the New Accord's impact on capital levels following its adoption.[218] And they agreed to apply the New Accord's advanced approaches "only to large, internationally active U.S. banks."[219] Over the next few years, congressional pressure continued to shape the implementation of the legislation; the Agencies were forced to slow the pace of implementation and make numerous, specific changes in response to congressional demands.[220] Ultimately, Congress can play a powerful role in forcing agencies to respond to the public, explain their reasoning, and use inclusive procedures to develop regulations.

Conclusion

International regulation is certain to expand its reach in coming years. As decisions about American law and Americans' lives are increasingly influenced by decisions made abroad, the legitimacy of the domestic administrative state will be severely tested. In this Note, I have demonstrated that agencies do not simply implement international agreements domestically as a fait accompli. At the same time, the incentives for agencies to shirk their domestic administrative law obligations when implementing international regulations should not be ignored. Courts and Congress should remain vigilant and adaptable in enforcing agencies' obligations. Strong and persistent demands for public participation, democratic accountability, and reasoned discourse in the implementation of international regulations are necessary to preserve the legitimacy of the administrative state.

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218 *See id.* at 446 (noting that a U.S. study tailored to U.S. banks was necessary).
219 *Id.*
220 *See id.* at 448–53 (describing the implementation process from 2005 forward).