

Comparative Report

# **A comparative analysis of transnational private regulation: legitimacy, quality, effectiveness and enforcement**

Fabrizio Cafaggi, Scuola Nazionale dell' Amministrazione, Rome, Italy /EUI

[fabrizio.cafaggi@eui.eu](mailto:fabrizio.cafaggi@eui.eu)

**PRELIMINARY DRAFT  
NOT FOR CIRCULATION**

June 2014

In the framework of the Research Project

## **Private Transnational Regulatory Regimes - Constitutional Foundations and Governance Design**

Coordinator:

FABRIZIO CAFAGGI, Scuola nazionale dell'amministrazione/European University Institute

In collaboration with:

COLIN SCOTT, University College Dublin, Dublin, Ireland

LINDA SENDEN, Utrecht University, Utrecht, the Netherlands

And with the case study rapporteurs:

JOHN BIGGINS

FEDERICA CASAROSA (PROJECT ADMINISTRATIVE COORDINATOR)

DONAL CASEY

JOHN CONLEY

PANAGIOTIS DELIMATIS

BUCHARD EBERLEIN

ELENA FAGOTTO

WILLEM VAN GENUGTEN

NICOLA JÄGERS

AGNIESZKA JANCZUK

FIONA DE LONDRAS

LOKKE MOEREL

EVGENI MOYAKINE

DEIRDRE NORRIS

PAUL VERBRUGGEN

CYNTHIA WILLIAMS

Funding provided by:

HAGUE INSTITUTE FOR THE INTERNATIONALISATION OF LAW

[www.hiil.org/privateregulation](http://www.hiil.org/privateregulation)

EUI European university Institute

University College Dublin

University of Tilburg

Author:

Fabrizio Cafaggi

Professor at the Scuola nazionale dell'amministrazione. Director of the Centre for judicial cooperation EUI. Visiting Moris Tabaksblat Hiil Chair. On leave from Trento University. Coordinator of the HILL project.

Copyright Fabrizio Cafaggi

**TABLE OF CONTENTS**

.....	<b>1</b>
<b>LIST OF ABBREVIATIONS.....</b>	<b>5</b>
<i>Executive summary.....</i>	<i>8</i>
<i>Four aspects of transnational private regulation: some working definitions.....</i>	<i>13</i>
MAPPING THE REGULATORY SPACE: TRENDS AND PATTERNS OF TPR ACROSS SECTORS.....	25
<i>The increase of TPR.....</i>	<i>25</i>
<i>Forms of TPR : organizations and agreements.....</i>	<i>29</i>
<i>Modes of governance of TPR and interest representation.....</i>	<i>30</i>
CHALLENGES OF TPR.....	34
REGULATORY INSTRUMENTS AND THE STRUCTURE OF THE REGULATORY RELATIONSHIPS.....	35
<i>Gap filling of governance models and its effect on regulatory processes.....</i>	<i>40</i>
<i>Regulatory contracts and gap filling by domestic laws.....</i>	<i>43</i>
<i>Governance design and the influence of regulatory instruments.....</i>	<i>45</i>
<i>Transformations of the regulatory process: governance design and regulatory instruments.....</i>	<i>46</i>
<i>The correlation between governance and the regulatory process.....</i>	<i>48</i>
<i>Implementation of private standards.....</i>	<i>50</i>
THE EMERGENCE OF TRANSNATIONAL PRIVATE META-REGULATORS.....	51
REGULATORY INSTRUMENTS: DISTINGUISHING BETWEEN META AND INDIVIDUAL REGULATORS.....	55
MULTIPLE ACTORS INVOLVED IN TPRS : THE SEARCH FOR COMMON FEATURES IN THE PRESENCE OF CONFLICTING OBJECTIVES.....	56
DECONSTRUCTING THE PRIVATE SPHERE: CONFLICTS AND INSTITUTIONAL RESPONSES.....	57
HOW DO CONFLICTING INTERESTS IN THE PRIVATE SPHERE AFFECT POWER ALLOCATION IN MULTILEVEL STRUCTURES?.....	59
HOW CONFLICTS WITHIN THE PRIVATE SPHERE AFFECT GOVERNANCE AND PROCESS REGULATION?.....	61
THE VOLUNTARY NATURE OF PRIVATE STANDARDS IN COMPLEX REGULATORY ENVIRONMENTS: RETHINKING LEGITIMACY AND EFFECTIVENESS.....	62
THE INTERACTION BETWEEN CONTRACTUAL AND ORGANIZATIONAL FEATURES OF TPR AND THEIR EFFECTS ON VOLUNTARINESS.....	63
THE INFLUENCE OF PUBLIC ACTORS OVER THE VOLUNTARINESS OF PRIVATE STANDARDS.....	65
THE BINDINGNESS OF THE STANDARDS AND THEIR ENFORCEMENT.....	66
MULTIPLE ENFORCEMENT MECHANISMS AND THEIR COORDINATION.....	67
SANCTIONS AND ENFORCEMENT BY PRIVATE BODIES.....	68
COMPLEMENTARITY BETWEEN PUBLIC AND PRIVATE ACTORS IN TRANSNATIONAL REGULATION.....	70
THE ROLE OF PUBLIC ACTORS WHEN THERE ARE CONFLICTS IN THE PRIVATE SPHERE.....	79
EVALUATION OF TPR.....	82
CORE FINDINGS AND POLICY RECOMMENDATIONS.....	86
<b>APPENDIX 1.....</b>	<b>103</b>
THE ELEVEN PROJECT CASE STUDY SECTORS.....	103
<b>APPENDIX 2.....</b>	<b>105</b>
CASE STUDY TEMPLATE.....	105

## List of abbreviations

B2B	business-to-business
B2C	business-to-consumer
BCR	Binding Corporate Rules
CAC	Codex Alimentarius Commission
CCBE	Council of Bars and Law Societies of Europe
CSO	civil society organization
DFA	Dodd Frank Act
DGR	Dangerous Goods Regulations
EASA	European Advertising Standards Alliance
ECB	European Central Bank
EPFI	Equator principle Financial Institution
FAO	Food and Agriculture Organization of the United Nations
GAP	Good Agricultural Practices
GFC	Global Financial Crisis
GFSI	Global food safety initiative
GRI	Global reporting initiative (GRI),
GSCP	Global social compliance Programme
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IATA	International Airline Transport Association
IBA	International Bar Association
IBAC	International Business Aviation Council
ICAO	International Civil Aviation Organization

ICC	International Chamber of Commerce
ICoC	International Code of conduct for private security providers
IFAD	International Fund for Agricultural Development
IFALPA	International Federation of Airline Pilots' Associations
IFBA	International Food and Beverage Alliance
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ILO	International Labour Organization
IO	International Organisation
IOSA	IATA Operational Safety Audit
IOSCO	International Organization of Securities Commissions
ISBA	International Accounting Standards Board
ISDA	International Swaps and Derivatives Association
ISEAL	International Social and Environmental Accreditation and Labeling Alliance
ISO	International Standard Organization
ISOA	International Stability Operations Association
LAR	Live Animals Regulations
MNC	Multinational Company
MoU	Memorandum of Understanding
OECD	Organization for Economic Co-operation and Development
PSC	private security companies
SEPA	Single Euro Payments Area
SRO	Self-Regulatory Organisation
TBT	Technical Barriers to Trade
TI	Transparency International
TPR	Transnational Private Regulation

UIA	Union Internationale des Architectes
USOAP	Universal Safety Oversight Audit Programme
VP	Voluntary principles
WHO	World Health Organization
WTO	World Trade Organization

## Executive summary

1. Transnational private regulation (TPR) is a growing phenomenon. It creates new markets and dissolves old ones. TPR contributes to the regulation of existing markets, it increases the protection of fundamental rights and it enables or disables communities to participate in global rule making. The standing of TPR and its role regulatory control continues to grow. TPR presents new characteristics departing from more conventional forms of domestic self-regulation. It reflects a transfer of regulatory power from the domestic to the transnational and from the public to the private sphere with significant distributional consequences. Such transfers modify but do not necessarily reduce the role of States especially in relation to standards' implementation and enforcement. While there is a common core of similar features across regimes, the degree of sector specificity is high, determined by context-specific institutional and economic factors, different drivers and regulatory needs. The Report addresses the development of transnational private regulation in three macro-areas: financial markets, consumer protection and fundamental rights. It encompasses 11 case studies focusing on four dimensions: legitimacy, quality, effectiveness and enforcement. The 11 case study sectors are briefly outlined in Appendix 1. These case studies have been conducted in the context of the research project *Transnational Private Regulation: Constitutional Foundations and Governance Design*.
2. **A definition.** Within the project, transnational private regulation is defined as encompassing those regimes that regulate the conduct of private actors across jurisdictional boundaries primarily through standards, which are voluntary, at least as a matter of formal law. We refer to transnational rather than international to mean that regimes are created and governed primarily by private actors – albeit frequently in collaboration with public entities - and that transnational private law rather than public international law provides the main regulatory toolbox. We speak of private instead of self-regulation to include all those regimes where there is not a full overlap between regulators, regulated, and the final beneficiaries. Therefore private regulation includes (1) the conventional forms of self-regulation which literally presuppose coincidence between regulator and regulated, (2) single stakeholding, where the regulator belongs to a different constituency from that of regulated, and (3) multistakeholder regulation where the regulator represents multiple constituencies among which feature regulated entities.
3. **Successes and failures.** The analysis focuses on the emergence and drivers of transnational private regimes, their impact on the allocation of regulatory power, wealth transfers between public and private entities and, within the private sphere, the distributional consequences of TPR on different private actors. It looks for the conditions under which different forms of global, regional, and transnational



regulation (public, private and co-regulatory) emerge or dissolve; more specifically when do they succeed or fail in terms of legitimacy, quality, enforcement and effectiveness.\_

4. TPR regimes constitute an expression of transnational legal pluralism. They are characterized by lack of a formal hierarchy as they constitute the result of private autonomy and self-governance of communities across the globe. In case of conflicts there is not a predetermined criterion to define their solutions. Regulators have to negotiate or defer the final decision to domestic courts. When regimes are multiple and private regulators are competing, regulatory pluralism may translate into overlap and multiply compliance costs without concrete social benefits. This process often produces 'spontaneous disorder' which may increase costs without producing benefits.
5. **The diversity of the transnational private sphere.** The Report concentrates on private regimes primarily governed by non state actors and sheds light on the diversity within the private sphere and the conflicts that arise therein. The demand for transnational private regulation comes from different sources within the private sphere and from public actors. The research shows a rich and diverse universe of private regimes characterized by the aim of mediating between different interests represented by private constituencies within industry and amongst NGOs. Many differences across sectors can be explained not only by the objectives but also by the power allocation among different actors participating in the regulatory process.
6. **Institutional complementarity between public and private organizations.** TPR emerges and evolves in a regulatory space organized around existing public international and domestic institutions. At the international level it interacts horizontally with international laws whereas vertically it interplays with domestic legal orders especially in relation to implementation, monitoring and enforcement. Private regimes often complement existing public regimes, sometimes they produce rules and standards that are later incorporated or referred to by international and/or domestic laws. At other times such regimes specify, through technical rules, principles drafted by public institutions in particular international organizations. The interaction may imply potential conflicts over regulatory power between public and private but the analysis in the case studies confirms that most of the time public actors operate as facilitators or even promoters of TPR rather than competitors. This is especially true when heterogeneity in the private sphere prevents private regulators from reaching effective cooperation among private actors giving rise to disruptive regulatory competition. The relationship between private and public is dynamic and the analysis of various cases studies shows that changes in the public sphere with the emergence of multipolar power centres influence the identity and instruments of TPR over time.
7. **Empirical analysis.** The research findings are based on empirical analysis encompassing desk research and interviews in the context of the 11 case studies.

They are a result of a comparative institutional analysis of the case studies integrated with scholarly literature and policy research by international institutions. The case studies deal with a wide range of regulatory regimes addressing different regulatory demands from risk regulation (food safety, financial markets) to human rights protection (private security, project finance, data privacy), from asymmetric information (advertising, professional regulation) to transaction costs' reduction (food safety, bank payment systems, over the counter(OTC) derivatives, accounting standards) and environmental regulation (food safety, project finance). The selected regimes operate in combination with different international public regimes and/or with public regulation enacted only at domestic level.

- 8. Comparative methodology.** We have applied a comparative methodology to transnational regimes rather than analyze them according to the traditional state-centered units. The unit of analysis is the regulatory regime with its functional rather than territorial boundaries. Its scope is defined by the activity of regulated entities, the membership of the regulated rather than by geographical and administrative boundaries. Instead of comparing state laws we compare regimes' legal and institutional frameworks and their governance. To engage in such analysis we had to draw on methods used by comparative social sciences because in the legal domain the use of comparative methodology in transnational law is still underdeveloped. The case studies have been drafted on the basis of a common template that has been adapted and modified according to the findings over the duration of the research project. Research tools include in-depth interviews, questionnaires and desk study. The comparative analysis primarily focuses on the structural rather than the content dimension of the regimes, but fully takes into account the regulatory objectives of each regime.
- 9. Describe the state of the art and recommend changes.** The objectives of the study are both descriptive and normative. We compare different sectors to identify common features and diverging elements of private regimes grounded on the specific characteristics of the sector. We identify trends related to the organization of the global regulatory space. We analyze the impact of transnational private regimes on the evolution of regulatory states and the allocation of regulatory power between public and private actors at transnational and domestic level. The existence of common features may suggest the need for a unitary, yet not uniform, approach to TPR with the identification of general principles related to governance and process regulation, taking their distributional consequences duly into account.
- 10. Organizing the regulatory space: Meta-regulators.** One significant innovative feature is the multiplication of private meta-regulators. These are non-state actors who have amongst their roles the steering of a self-regulatory capacity of transnational private regulators. They emerge within sectors to respond to fragmentation and to foster either mutual recognition or some degree of harmonization in standard setting and implementation (e.g. the Global food safety initiative (GFSI), Global social compliance Programme (GSCP)). But they also operate

across sectors to define common rules, primarily focusing on reporting and auditing and in some, still limited areas, in relation to enforcement and arbitration (e.g. Global reporting initiative (GRI), Transparency International (TI)). In some instances they try to define rules for the entire regulatory process but are limited in scope (ISEAL for environmental and social standards).

- 11. Certification, auditing and reporting: rethinking compliance.** A second relevant change concerns the role of certifiers, auditors that have moved from monitoring compliance to a much more complex and comprehensive structure which influences both the demand and supply of transnational rules. Not only do they monitor regulated entities but often define the standards to be complied with and the sanctions to be administered in case of violation. Certification scheme owners design codes of conduct or guidelines with minimum requirements that have to be met in order to access and maintain certification. Increasingly certification has expanded its scope and includes different regulatory domains within the macro label of sustainability. Monitoring compliance with international standards is changing the actors and instruments of regulatory processes and contributes to transfer regulatory power.
- 12. Private benefits versus public interest?** Transnational private regulators show considerable variations along their various dimensions. One variation particularly relevant both for governance and process is that between (1) those regulators who pursue primarily the interests of the regulated entities and (2) those with a broader scope that aim for consumer, environmental, human rights or investor protection, involving collective or public interest objectives. The former tend to maximize private benefits, the latter combine private (those of regulated) and social (those of the beneficiaries) benefits. The different combinations between private and social benefits related to private standards emerge both from the choices of governance structure, their inclusiveness, openness, transparency and from the main features of the regulatory process and in particular the standard setting procedures. One of the main challenges is to align private with public interest objectives. Starting from the declaration of their mission statement and objectives, private regimes display a strong differentiation depending on whether they are also aimed at benefiting external constituencies like consumers, investors, fundamental rights organizations and the public at large. But even within this category important differences exist as to how compliance with private standards may contribute to achieve the regulatory objectives and how the related costs are allocated.
- 13. Is there a common core?** Is differentiation across sectors too significant to permit the definition of unitary principles? The research shows that at a high level of abstraction it might be possible to identify common characteristics. This finding is not simply an academic exercise but it can bring about important policy implications. Common principles may contribute to define a common metric to evaluate regulatory performance and governance accountability and to stimulate changes that may increase effectiveness and legitimacy. Policy makers operating at regional

level like EU or at global level like many international organizations (OECD, World Bank, IMF, FAO) can refer to these general principles when engaging in regulatory collaboration with private actors. Evaluation is crucial for legitimacy and for effectiveness especially when the objectives of stakeholders differ or even conflict. These unitary principles have to be tailored to regimes that differ not only across sectors but also functionally in relation to the specific objectives (risk regulation, protection of human rights, transaction costs reduction, and so on). Some are characterized by a strong emphasis on public and collective interests, others tend to be more club-like, but they all tend to project the effects of their activity beyond the members.

**14. A world of changes.** The Report provides policy makers and regulators with relevant information concerning strengths and weaknesses of TPR and makes concrete suggestions as to how to address some of the shortcomings in the current institutional framework. In addition the Report is aimed at promoting mutual learning across regimes operating in different sectors. Unlike the public sector, where mutual exchanges occur rather often, the transnational private sphere seems characterized by a much higher degree of isolation. Regulators do not look beyond their sectors to find innovative answers and solve governance processes issues related to accountability and effectiveness. The lack of opportunities for mutual learning may be explained but not justified by the high degree of sector specificity. However, we believe that (1) there is room for exchanges even if the level of differentiation may discourage any exercise close to identification of best practices across sectors, at least for the time being, and (2) that a degree of policy and regulatory transplant might occur both within and across sectors in order to promote regulatory innovation. Clearly the process of mutual learning will, in the medium term, facilitate the definition of common principles which will certainly foster the definition of clearer patterns of relationships with international and domestic public organizations.

## ***The Report***<sup>1</sup>

### **Four aspects of transnational private regulation: some working definitions.**

15. The Project has focused on four dimensions of transnational private regulation: legitimacy, quality, effectiveness, and enforcement. Over the course of the project the definitions of the four concepts have evolved due to the empirical findings which contributed to refine the notions and provided insights for sectoral comparison. The empirical segment has fed the conceptual framework which in turn has shaped the next stages of the research. We gained a better understanding of their interaction and of the difficulty of isolating causal correlations making one dimension dependent upon the other. Clearly effectiveness is correlated to legitimacy but, as we shall see, there is not a single unilateral causal link. At times effectiveness influences legitimacy, in other instances legitimacy influences effectiveness. The definitions below are the outcome rather than the premise of the research project but in the course of the report the conceptual evolution that has occurred will become clear. They represent working definitions without any ambition to have universal application.

16. **The sources of legitimacy: Voluntariness, consent and dissent, exit.** A key dimension of TPR legitimacy is related to the voluntary nature of private standards and the choices made by the regulated based on consent. Entry, participation, and exit of regulated entities are or should be based on voluntary choices. But consent is also necessary when third parties are affected by the regime and the regulatory

---

<sup>1</sup> This report draws upon the 11 case studies and the additional research subprojects that have been completed during the 4 years duration of the project. A previous draft was presented and discussed at UCD Dublin in October 2013. I am grateful to the excellent research team that has contributed to the investigation and to all the stakeholders that in different forms have provided us with knowledge and understanding of a complex yet rich and fast evolving regulatory world. In particular I would like to thank Linda Senden and Colin Scott for coordinating the research teams at Tilburg and UCD and Federica Casarosa for the administrative coordination of the project. I would like to thank David Raic for his support and encouragement throughout the project and Sam Muller for his suggestions and the interaction with numerous initiatives organized by HIIL. I would like to thank Tim Lytton and the group of scholars that commented on a manuscript at Albany law school which has provided the conceptual framework of this report and the participants in the Dublin workshop where a previous draft was discussed. My gratitude goes also to Anne van Aaken, Laszlo Bruszt, Sabino Cassese, Kevin Davis Katharina Pistor and Dick Stewart for the many conversations on the topics we have had over the course of the last four years and the challenges they have posed to many of my assumptions. There are many other individuals and organizations whom have contributed to the research with their generosity and time but Jan Eijbouts, Oliver Gray, Gerart Hartsink, Kristin Komives, Mikhail Scheltema deserve special recognition. It has been a wonderful intellectual journey. Responsibility for the contents of the report remains with me.

choices therein. To what extent voluntariness is based on real consent is an empirical question that has been addressed for each regime. For a standard to be legitimate it has to be based on consent of both those who commit and those who are affected by the regulator's decisions. The research has focused on the potential misalignment between de jure and de facto consent and the stakeholders' whose consent is necessary to ensure legitimacy.

- 17. Consent and governance.** In relation to voluntary standards consent provides the regulator with the authority to govern the scheme, ensure compliance and enforce violations. The value and forms of consent vary according to the institutional environment and the organization of the regulatory space. Consent plays differently in contexts where multiple standards and regulators exist from contexts where the private regulator is a monopolist. But the quality of consent may vary depending on its scope. Consent may be purely procedural or it may concern the content of the applied standard. Voluntariness in contractual governance is compatible with different degrees and forms of consent. But there are minimum requirements concerning both the procedural and the substantive sides.
- 18. Voluntariness, legitimacy and dissent.** For a regime to be legitimate it is not sufficient that the regulated have agreed but it is necessary that it provides stakeholders with the adequate legal tools to contest the framing and the content of the decisions. Voluntariness is not limited to consent but it should also include dissent. Legitimacy depends on the possibility and quality of dissent as much as consent. Dissent may be expressed through voice or exit. Dissent may concern the standard and give rise to alternative regulatory schemes or may be related to the implementation of the standard by regulated entities that have first joined and therefore consented. It is important to underline that the notion of legitimacy is compatible with contestability if not with contestation and it does not presuppose consent throughout the process. We claim that dissent does not necessarily reduce legitimacy. In fact it may increase it when it forces changes over time.
- 19. Assessing legitimacy.** The definition of voluntariness thus has to incorporate consent and dissent, voice and exit. When private standards are voluntary, assessing legitimacy implies an inquiry into the nature, validity and effects of consent. When private standards become mandatory as they are incorporated into legislation or administrative acts the immediate source of their legitimacy stems from the authority of law rather than the consent of regulated entities and affected communities. Clearly a different metric for assessing legitimacy is required when the private standard becomes mandatory by way of legislative incorporation or judicial recognition. Private regulators are charged with the pursuit of public interest by legal obligation not by their own choice. The issue is complex since incorporation of private codes into public law may occur without the private regulator's consent and or approval, the impact of which is hard to measure.

20. In relation to legitimacy the conventional distinction between input and output legitimacy has been further articulated to explain the current features of the analysed TPR regimes. First **the distinction between procedural and substantive legitimacy** has clearly emerged. **Procedural legitimacy** concerns the structure of the regulatory process and that of governance. It is related primarily, but not solely, to standard setting and the requirements that make the process legitimate. It includes analysis of who frames the process and the degree of effective participation of the regulated entities, the management of conflicting interests during the standard setting process within the regulated and between them and the beneficiaries. In recent years there have been changes in the governance of many TPRs, notably in financial services post the financial crises, evidenced by the increased use of committees, working groups and taskforces to make the process as accessible as possible – more legitimate. Procedural legitimacy concerns the ability of all stakeholders to participate in the rule making process and to hold accountable those involved. Every aspect of the regulatory process with an impact on procedural legitimacy, along with transparency, ex ante definition of binding rules, duty to justify the choices made (especially when they produce negative consequences over a group of stakeholders) and identification of a standard's impact will have to be considered when assessing legitimacy.
21. **Procedural legitimacy** does not end at the standard setting stage but it concerns the entire regulatory process including monitoring and enforcement. Legal legitimacy is linked with compliance. There is widespread consensus that a high level of compliance corresponds with high legitimacy. However we shall see that lack of compliance may depend upon different reasons and not necessarily on the perception of illegitimacy. Therefore low compliance does not necessarily imply lack of legitimacy. The alternatives between monitoring strategies influence the degree of legitimacy: For instance the option between hierarchical, contractual (third party) and peer monitoring are not legitimacy neutral. In principle contractual monitoring has a higher degree of legitimacy. The involvement of the regulated in monitoring compliance with the standard should in principle increase the legitimacy of the process in relation to regulated entities although it may at the same time increase the risks of collusion between regulators and regulated thereby decreasing legitimacy towards outsider affected communities. Hence choices about monitoring have an impact on the degree of legitimacy and the different claims. Procedural legitimacy becomes really relevant when it relates to enforcement. Existence of a dispute resolution mechanism, accessibility and costs, impartiality of the enforcer, rules about evidence, proportionality of sanctions all affect process legitimacy. Lack of an effective enforcement mechanism reduces the degree of legitimacy. Compliance with these requirements should be reflected in the assessment tool.
22. **Substantive legitimacy** instead focuses more on the regulatory output e.g. the standard, its objectives, the relationship between regulators and regulated, the nature of distributional consequences, fairness of costs and benefits allocation



resulting from standards' implementation. Substantive legitimacy is linked to outputs and impact rather than process. As it will be clear the notion of legitimacy is grounded in the relationship between process, output and impact components. The approach taken in the research and followed in the report links the two dimensions since it assumes that process influences outputs and symmetrically that outputs influence procedural choices. How the process is regulated will influence whose interests are protected. Symmetrically the definition of regulatory objectives will influence procedural features.

- 23. Legitimacy by whom?** The findings show that transnational regulatory processes combine activities of multiple regulators often acting independently. This segmentation can have both positive and negative effects. It can increase functional separation among stages of the regulatory process (rule making, monitoring, enforcement and evaluation) and mitigate conflicts of interest but it may also multiply loci of decision making power reducing the overall accountability due to lack of coordination. Depending on the concentration of power the unit of analysis for legitimacy might be a single regulator or a group of entities that exercise standard setting, monitoring and enforcement independently one another but in relation to the same standard. When the regulatory process follows the latter pattern (a group of entities regulating the same standard) it is important that the regulated entities are well informed beyond the boundaries of the individual organization they belong to. Multiple standard setters in the area of food safety can increase legitimacy of individual regulators if regulated firms are well informed about alternatives.
- 24. Legitimacy towards whom?** To whom should regulation be accountable to in order to be legitimate? And for what? The foregoing distinctions operate differently, depending on whose perspective is considered, that of regulated entities or those of the affected communities. Here the distinction between private benefit and public interest regulation plays a major role. Both procedural and substantive legitimacy may be based on different metrics depending on whether they are evaluated in relation to the regulated whose behaviour should change or to the parties whose entitlements and rights can be affected by the implementation of the standard. One of the main challenges depend on the misalignment of interests between these two categories. In relation to the regulated there is a strong link between legitimacy, voluntariness and consent. Process legitimacy is related to the freedom of choice of regulated entities to enter, to exit, and to participate in the regime. The legitimacy vis-à-vis the potentially affected stakeholders will be related to transparency, contestability, ability to participate in the regulatory process and the ability to negotiate the impact of standards' implementation. The latter unlike the former do not have a choice to join the regime.
- 25. Beyond legal dimension of legitimacy.** The notion of legitimacy should not be based only on legal metrics and mechanisms but also on social and market mechanisms. Economic and social institutions provide or deprive a scheme of its legitimacy and



influence the choices of the regulated to enter or exit it. As we shall see when entry and exit from a regime are voluntary, the motivations and incentives may be influenced by the communities where the regulated entities operate and by the market where their products and services are sold. Social and market institutions may positively or negatively have an impact not only on the choice to enter a regime but also on the level of compliance that the regulated may wish to have. Market mechanisms can provide further incentives to conform with the rules/participate in the regimes by putting economic pressure on regulated entities. One illustration is certainly provided by the increasing role of certification schemes, which operate through market mechanisms often governed by civil society organizations (CSOs) sometimes in collaboration with market actors. Clearly the role of market and social institutions change when entry and compliance are both mandatory (when private standards are incorporated into legislation) like in accounting, payment systems and civil aviation.

26. TPR regimes are characterized by a significant influence of **market legitimacy**. Often scheme owners operate in a competitive context where regulated entities can select one or more options. When multiple regulators are in place there is a supply and demand side of private standards, which operate with mechanisms similar to those of markets for services. Accordingly the good governance of the supply side provides legitimacy to the individual scheme vis-à-vis the other concurring or competing schemes. Some believe that in the context of voluntary standards legitimacy can be evaluated also by the number of participants to the regime e.g. the market share of each scheme. Accordingly a highly successful regime defined by the large number of subscribers should be considered more legitimate than one with a limited number. We believe that the number of participants to the scheme and the geographical diffusion may certainly be considered an indicator of the regime's capacity to respond to a demand for standards but we reject the overly simplistic direct correlation between the number of participants, geographical diffusion and the level of legitimacy. A second dimension of market legitimacy focuses more on the instruments deployed by the regulator to engage the regulated and to enforce the standard once they have subscribed to it. Accordingly there is higher market legitimacy where more market-based mechanisms are deployed.
27. A third component is constituted by **social legitimacy**. The social dimension of legitimacy goes beyond the conventional distinction that associates formal legitimacy with law and acceptance and consent with beliefs and social conventions. We take a broad definition of legal legitimacy that goes beyond the formal/procedural dimension. Yet even if the legal features of voluntariness are fully developed into the legal definition there is room and necessity for a complementary social dimension of legitimacy. This is characterized by the evaluation of communities related to the objectives and the procedures. Social legitimacy is strongly linked to monitoring and enforcement. Social institutions that monitor and evaluate the regulatory scheme and its effects may provide additional legitimacy.

The clearest illustration is the role that conventional and new media play in conferring or reducing legitimacy of the scheme by highlighting the negative and positive effects of the scheme and the behaviour of regulated entities especially when there is no compliance. This becomes of paramount importance when sanctioning operates primarily via a reputational mechanism based on publicity ensured by media. In this respect compliance becomes a function of social legitimacy as much if not more than legal legitimacy.

28. The role of communities in conferring or depriving the regimes of their social legitimacy varies depending on the sector and on how they are 'affected' by the standard implementation. It plays a very significant function in advertising, food safety, human rights, project finance, and has a more indirect impact in technical areas like payment systems and accounting where stakeholders may have less expertise. Relatedly social legitimacy increases when standards are communicated to final consumers, investors, and their compliance or lack of compliance may inform their choices. Hence the role of social legitimacy tends to increase in business-to-consumer (BtoC) but it is not irrelevant in business-to-business (BtoB) standards as well. As in the case of market legitimacy the weight of social legitimacy depends on the drivers of the regimes. When communities have stimulated or demanded a new regime it is likely that social legitimacy will stand high between the various legitimacy modes. When communities are passive recipients (like in the OTC derivatives market for example) social legitimacy might play a more modest role based primarily on contestation.
29. **An integrated notion of legitimacy including not only legal but also economic and social institutions** permits evaluation on how they concur to provide or deprive a regime of its legitimacy vis-à-vis the regulated and the affected stakeholders. It suggests that legitimacy cannot coincide with an analysis purely based on validity rather it should also include the potential effects and consequences produced by a standard's implementation. These consequences depend not only on the legal framework but also on the socio-economic environment(s) the standard will operate in. The analysis in the case studies will show how the emergence and the disappearance of regimes are related to the concurring strengths and weaknesses of the different forms of legitimacy. Often it is the reduction of social and economic legitimacy that indicates the decline of a regime and its coming to an end.
30. **Legitimacy deficits as drivers of regulatory changes.** We believe that there is a correlation between the sources of legitimacy (e.g. which type of institutions give recognition) and the drivers of a regime. The research has investigated which events trigger changes and regulatory innovation. It shows how global and general (financial markets) or specific crises (food safety, human rights) might redefine legitimacy claims by both regulated entities and by affected communities and trigger responses by the individual regulators or by the entire sector. The answers rely primarily on reforming the process rather than the governance structure of the regimes that in many instances has kept stable over time. This said, the use of

consultation and public discussion over the causes of regulatory failures has increased after the global financial crisis (GFC) and the modifications of processes has affected the internal structure including the relationship between the board and the technical committees.

- 31. Effectiveness.** The notion of effectiveness focuses on the capacity of the regime to achieve its objectives. It differs from efficiency, which concentrates on the costs and benefits of the regulatory process. A regulatory process is efficient when the costs it imposes are lower than the produced benefits. A regulatory process is effective when it is capable of achieving its stated objectives. In simpler terms effectiveness assesses whether or not a regime works. There are certainly close connections between the two notions especially from the perspective of regulated entities but they should be kept analytically separate.
- 32. Compliance and effectiveness.** Compliance is a relevant part of effectiveness. Compliance with the standards by regulated entities is an important indicator of effectiveness, but levels of compliance do not always coincide with it. There might be instances of a high level of compliance which do not translate into the achievement of the stated objectives. This might depend on capacity of the standard to produce the stated objectives. But it can also relate to the governance of the regulatory process in particular to coordinate regulated entities while managing systemic risk. One of the problems is related to the aggregate effect of compliance and the ability to govern collective action problems. This emerges clearly in risk regulation where the achievement of the objectives is dependent upon the ability to govern the interaction among the regulated: we have examples of systemic risk in financial markets, product related risks in food safety and environmental risks in project finance and food production. The achievement of the regulatory objectives is related to the cumulative effect of compliance by the sum of regulated entities but it is also connected with (1) the number of participants to the scheme, (2) the degree of regulatory competition and (3) other institutional variables in particular the degree of power concentration. The capacity to reduce corruption, to improve food safety, to reduce carbon emissions is both a function of the effectiveness of the standard and its compliance by a sufficiently high number of participants.
- 33. Why do the regulated comply?** Compliance in regimes based on voluntary standards is grounded on incentives and motivations. The reasons regulated entities join a regime influence their motivations to comply. But individual motivations are only one component that has to be considered when evaluating effectiveness. There are two related dimensions: compliance by individual regulated entities and compliance by the community of regulated entities. Regulators that limit their compliance analysis to the behaviour of individual entities, leaving aside the level of cooperation among them, are unable to assess their performance. The level of compliance with a standard depends on collective behaviour, control of free riding, incentives to cooperate between regulated and regulators and among the regulated engaging in joint problem solving. Thus, a regime may be ineffective when individual

entities do not engage in joint problem solving, even though their individual compliance with the norms is high. The effects of standards implementation are often the result of coordination of conduct among regulated entities especially when, as is the case in risk regulation, there is a high degree of interdependency and joint problem solving is required.

- 34. The role of gatekeepers.** Compliance with standards is subject to multiple mechanisms of monitoring and control. Increasingly third party verification has come to play a significant role. In addition to compliance programs that regulated entities are bound to adopt in order to meet the requirements, professional entities control compliance during the process of implementation and after the standard has been implemented. Third party verification is highly sector dependent and organizations vary significantly but there is a clear uniform trend that broadens the range of actors and instruments to a third category beyond the binary distinction between regulators and regulated entities.
- 35. Measuring effectiveness and compliance.** Effectiveness and compliance can be measured according to specified criteria and indicators. Compliance concerns the conduct of the regulated, effectiveness relates to the objectives whose achievement may depend upon a series of different variables. Different indicators should be selected for compliance and effectiveness. The definition of performance indicators significantly contributes to determine and qualify both the objectives and the impact of regulatory regimes. The notion of effectiveness is correlated to the capacity to define objectives and criteria to evaluate and measure, when possible, their achievement. Litigation can convey information about compliance but should not be considered (as is often the case) as a performance indicator (such that a low level of litigation would suggest a high level of compliance as this is not always true).
- 36. Effectiveness for whom?** The perspective of effectiveness might differ depending on whether it is evaluated from the point of view of the regulated or that of the beneficiaries. For regulated entities an effective regime is primarily one which solves the collective action problem, often one of the main drivers to voluntarily join a regime. Firms might want to contribute to reduce corruption, control personal data transfer, increase product safety, reduce pollution, and the like. But they can only do it collectively and by effectively controlling free riding. **An effective regime is one, which adequately tackles collective action problems.** For beneficiaries effectiveness is measured by evaluating the achievement of the regime's objectives and the fairness of the distribution of benefits across the different stakeholders' categories. **An effective regime is that which meets its objectives.** The research has broken down the different perspectives through which effectiveness can be measured.
- 37.** Quality of the regulatory process is defined in relation to its transparency and its ability to adapt to regulatory demands by regulated entities and by beneficiaries. Quality measures the completeness of the process; the allocation of tasks among different actors and the degree of coordination. In particular regulatory quality is

related to the degree of procedural specification. Standard setting, monitoring and enforcement have to be *ex ante* defined in order to make the regulator(s) accountable.

- 38. Enforcement.** Enforcement of TPR broadly refers to any system or mechanism by which some members authorized under the regulatory regime act in an organized manner to ensure compliance with the rules and norms of the regime and react in the case of violations. The boundaries between prevention and punishment are blurring and the menu of sanctions and their administration suggests continuity rather than big breaks between *ex ante* compliance and *ex post* enforcement. TPR is characterized by multiple mechanisms including domestic courts, administrative authorities, private enforcers (through both collective and individuated contractual remedies), arbitration.
- 39. Multiplicity of enforcement mechanisms.** We have worked under the assumption that multiple enforcement systems are in place and they include domestic courts and administrative enforcers in addition to private dispute resolution mechanisms created by the regime. Among the selected regimes none has clearly indicated the willingness to limit the recourse to domestic public enforcement regimes. Arbitration is a potential additional forum for TPR but its use has been so far rather limited, certainly in the case of commercial arbitration. One of the main issues is that of (lack of) coordination among these systems and the resulting difficulties in administering sanctions to regulated entities for the same infringement. The empirical research has addressed the concrete interaction between enforcement and sanctioning mechanisms and its consequences on effectiveness. On the other hand the research has looked for allocation of tasks among different enforcement mechanisms. Four types of disputes have been distinguished to identify the different allocation between enforcers: (1) disputes between regulator and regulated, (2) disputes between regulated entities (3) disputes between regulator and third parties (affected communities) (4) disputes between regulated entities and third parties.
- 40.** Enforcement of TPR has proven to be one of the biggest challenges. Critiques have underlined the lack of effective enforcement and the weaknesses of the sanctioning systems. We rejected the idea that voluntary standards make compliance optional and concluded, as with the theory well-grounded in contract law, that voluntariness requires binding rules that ensure compliance with the commitments (*pacta sunt servanda*). While investigating regimes we have looked for quality and effectiveness of enforcement mechanisms in relation to the procedural requirements and the sanctioning strategies. Within procedural requirements we have looked at independent and impartial enforcers within the scheme and of structural separation between standard setting, monitoring and enforcement.
- 41.** The starting point of the analysis is the need to have an enforcement system that enables the achievement of regulatory outcomes. Such enforcement can either be part of the regime or outside the regime but still accessible to solve conflicts. There

has been a progressive trend in TPR, as it becomes more institutionalised, towards including enforcement mechanisms that ensure effective and proportionate sanctions. However this does not necessarily imply that to qualify as a transnational regime the regulator has to set forth internal enforcement mechanisms. From the empirical research we observe different approaches: (1) those that do not have their own mechanisms and 'delegate' implicitly to public enforcement regimes (domestic courts and administrative authorities) and to informal mechanisms; (2) those that define their internal enforcement mechanisms and try to preclude or limit the use of public regimes as they try to achieve exclusivity; (3) those that create their regime on the assumption that domestic enforcement regimes are at work and operate in a complementary fashion. . When transnational private regulators limit their scope of activity to standard setting (ISO, GRI) we have looked into the complementary mechanisms used to enforce those standards once adopted by regulated entities.

- 42. The contractual basis of enforcement in disputes between regulators and regulated and between regulated.** The voluntary nature of regimes influences also enforcement. The authority and the powers of the enforcer have a contractual basis. The enforcer's power to administer sanctions and the commitment by the infringing regulated entity to subject itself to the sanctions and comply with them are generally based on the organizational contract between regulators and regulated (see for example ICoC Association charter art 12.2.8). The contractual basis is in theory compatible with very different models of relationships between enforcers and infringers, ranging from hierarchical to cooperative. Whereas in TPR the contractual foundations may broaden or narrow the enforcing powers and the degree of discretionary power, thereby creating potential for abuse of power. The potential 'abuse' of enforcement power can be controlled not only through the conventional techniques for policing contracts but also through general due process principles that limit parties' autonomy and the discretion of the enforcer while implementing the organizational contract (see for example art. 67 of ICoC) where references are made to fairness and accessibility of grievances procedures). **Control may thus translate into voiding the contractual clause or reviewing the decision of the enforcer by way of appeal.**
- 43.** More problematic is the enforcement system from the perspective of affected communities and regulatory beneficiaries who are in general outside the organizations and do not have agreements concerning their rights and obligations with the regulators. Investors and depositors in financial markets, consumers in food safety, and civil aviation, human right holders in private service companies have difficulties enforcing their rights or protecting their expectations. Hardly any systems recognize the failure to achieve regulatory objectives as a tort and the privity requirements make the use of contract as an enforcement mechanism rather limited. Increasingly the enforcement systems created by private regulators have opened to these actors by broadening the scope of standing and access to justice. Often regulated entities are forced to introduce grievance mechanisms ensuring



access to consumers, investors and human rights holders (see for example the Ruggie principles in corporate social responsibility). Additionally at domestic level public entities often provide affected communities better access to justice either through judicial or administrative enforcement.

- 44. Ensuring compliance beyond enforcement.** The boundaries between the assessment of compliance and enforcement are undergoing significant revision in TPR. Assessing compliance includes identifying the major potential factors of non-compliance and the strategies that can be harnessed to address the related risks. Ensuring compliance is a strategic element of regulatory credibility. In this perspective enforcement becomes one of the instruments to ensure compliance. TPR schemes present a wealth of alternative modes through which compliance can be ensured for example in auditing, quality assurance and certification schemes. On the one hand they may be seen as signalling devices to the public and other stakeholders about regulatory performance and effectiveness. On the other hand they can constitute complementary ways to enforce standards that may be combined with more traditional dispute resolution mechanisms. Often regulated entities rectify their conduct and fix regulatory failures on the basis of the intervention of certifiers before the regulator is even aware of non compliance.
- 45. Integrating legal and non-legal sanctions.** Correspondingly to the definition of legitimacy we have adopted an integrated notion of enforcement that encompasses legal and non-legal sanctions. The use of market and social institutions to ensure compliance presuppose a working framework of non-legal sanctions that most of the time coexist rather than replace legal sanctions. Non legal sanctions are based on reputational effects and more broadly brand-damaging consequences that can arise out of violations. They empower social and market actors to punish violations via transactional choices (contract termination, refusal to deal, boycott). This combination reflects the multiplicity of functions performed by enforcement of regulatory standards in TPR combining , persuasion, compensation and punishment.
- 46.** The result is a complex notion that within the legal infrastructure takes into account private and public, judicial and administrative, enforcement mechanisms and then looks at the interaction between legal and non-legal instruments, which in the world of TPR play a very important role. The investigation considers the extent and the mode of complementarity between these enforcement mechanisms and their consequences on effectiveness and legitimacy. Empirical analysis has investigated the effects of enforcement on compliance and on the standard setting procedures.
- 47.** Current academic investigations have focused primarily on legitimacy and worked on the identification of procedural requirements aimed at ensuring compliance with international rule of law standards. This project advances the understanding of effectiveness and its link with the other three dimensions, in particular legitimacy, highlighting when there is a positive or negative correlation and its governance implications. It underlines that an effective regulatory process requires the definition

of ex ante measurable outcomes, the necessity to integrate knowledge and learning during the life of the standard, focusing on continuous improvements and revisability of the objectives. Furthermore, it broadens the definition of legitimacy examining the interaction between legal, market and social dimensions.

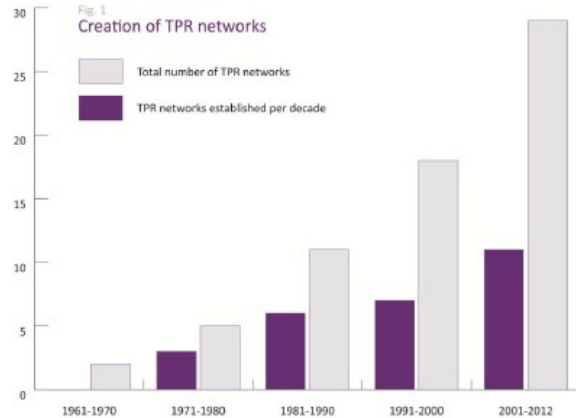


## ***Mapping the regulatory space: trends and patterns of TPR across sectors***

### **The increase of TPR**

- 48.** Increases in global trade and competitiveness, investment flows, the birth of new markets, large-scale privatization in different parts of the world, technological innovation and new developments in ICT, security and growing concern for both the environment and human rights violations, all call for new and more incisive forms of cross-boundary regulation. Because of the weaknesses and shortcomings of conventional public international law-making and institutions, TPR is one potential response to the challenges posed by these transformations to domestic and international regulatory environments. By no means is it the only one, and the research shows it suffers from significant weaknesses. Within the domain of public transnational regulation, such as IOSCO and the Basel Committee, new forms have developed in the last 10 - 15 years modifying significantly international rule-making, introducing more effective forms of participation of private actors and hybrid governance that overcome the rigid divide between public and private.
- 49.** TPR regimes have increased significantly since the mid-1990s (see fig. 1). Public regulators increasingly delegate the implementation and enforcement phases of regulation to private sector bodies or implement at domestic level standards defined by private bodies at transnational level (the European Advertising Standards Alliance in the field of advertising, or the International Airline Transport Association in civil aviation, the International Swaps and Derivatives Association in the area of derivatives, the International Accounting Standards Board in the area of accounting). Domestic public regulators may rely on private standards and incorporate them in legislation (e.g. the food and sustainability standards of the Global Food Safety Initiative, UTZ Certified or GLOBALG.A.P.). Such domestic public regulators may alternatively let the private sector work out technical standards, limiting themselves to principles-based regulation; for example Binding Corporate Rules (BCR) developed within the EU legislative framework for data protection.

Figure 1 – The creation of TPR networks



Source: Rulejungling: When lawmaking goes private, international and informal, HiiL Trend Report, 2012.

**50.** (1) One of the main drivers of TPR development is related to monitoring compliance with private and public standards by multinationals. Domestic public systems suffer from weaknesses inherent to their scope of intervention and to limited resources worsened by the recent financial crisis. National monitoring of compliance of global firms operating across jurisdictions has proven very ineffective for lack of coordination among national regulators. In many areas, public regulation has moved, even at domestic level, to a supply chain approach, transferring to regulated and third parties (such as certification firms auditors) the costs of monitoring compliance and the burden of acting in the case of non-compliance through, for example, voluntary product recalls. The proliferation of certification and auditing regimes shows the relevance of this transfer, which clearly does not negate the role of national authorities but restructures the allocation of tasks between private global intermediaries and domestic supervisors in monitoring compliance. In the area of compliance monitoring we observe regional integration with common standards and often pooled resources between neighboring public regulators.

**51.** (2) Another driver of TPR is harmonization of standards, in particular at the regional level, when public regulation presents significant national variations. Regulatory divergence may reduce choices among competing private regulators as the case of derivatives in financial markets shows in relation to trading platforms and clearing houses. Often in the case of systemic risk it is necessary to share information in order to trace risks across different jurisdictions. Harmonizing rules about risk assessment constitutes the minimum level below which regulatory failure is likely to occur. When risk interdependency is high and the risk is systemic, divergences leading to regulatory arbitrage may have disruptive effects. Different rationales for

harmonization with similar outcomes concern professional regulation where transnational private regulators have to overcome national divergences in public regulation. To some extent harmonization through private standards represents a reaction to regulatory divergences in the public domain which may occur at the standard setting level or, more likely, at the implementation level, when different regulators are called to monitor regulated entities' conduct. Clearly this kind of harmonization has to grapple with local regulatory divergences and, only in limited circumstances, may supersede them by setting stricter uniform standards as in the case of binding corporate rules (BCR) in data protection or the ICoC in private security companies (PSC).

- 52.** Increasingly we observe forms of regional regulatory integration between private and public actors which complement or support wider forms of global integration. This is the case in financial markets where considerable attention is now given to regional financial integration; in regional financial infrastructures the role of exchange, clearing and settling common platforms governed also by private actors is paramount (World Bank, 2013). Similar forms of regional integration occur also in food safety, civil aviation, advertising and other areas where the existence of a regional public infrastructure is defining the scope of private regimes. As mentioned one of the most diffused models of TPR is multilayer and includes three levels national, regional and international with the regional level reflecting the highest level of harmonization or reduction of compliance costs via mutual recognition.
- 53.** (3) In many instances private regulation serves the purpose of regulating entry to markets and/or to supply chains. Some organizations define their standards and require their future participant members to be compliant with them in order to become members. For example, in the case of civil aviation in order to become an International Airline Transport Association (IATA) member each airline company has to undergo an audit and show that it is compliant with the 900 standards. In the field of private security the Oversight Mechanism of the International Code of conduct (ICoC) for private security companies (PSC) require companies to be compliant with the code before becoming members. In order to become a member of the Global Food safety Initiative (GFSI) scheme owners have to show compliance with the rules in the GFSI Guidance. Similarly, in the field of professional services the compliance with requirements defined by codes of conduct is a precondition to access the market for services. Other organizations do not make compliance with standards a *de jure* precondition for membership but it is a *de facto* precondition. Participants have to comply with governance rules and then may or may not adhere to the standards.
- 54.** Entry TPR poses relevant issues concerning the potential anti-competitive effects when entry regulation is not justified by the need to ensure quality of goods and services. Some regimes make clear that adhesion should not result in anti-competitive behavior and undertake the obligation of monitoring potential anticompetitive effects (for example art. 4.d. of the Equator principles association

rules, 2010). So far the scrutiny by competition law authorities on regulatory regimes has been relatively soft, but clearly some areas like that of rating agencies would benefit from a deeper examination and more effective intervention ensuring wider and more effective regulatory competition.

55. (4) A fourth common ground for many private regimes is cost reduction associated with harmonization of standards. Cost reduction is certainly a major driver in competitive markets for the use of TPR. In financial markets the creation of integrated payment systems, the Master Agreement in the derivatives market or harmonized financial reporting rules are directed at reducing direct and indirect costs (See art II.e of the ISDA bylaws, 2013 and ISDA, *Global Derivatives: More Change Ahead*, 2013: 8). There is a demand for higher speed and reliability with the reduction of the number of parties involved in the system. Cost reduction in food safety, for example, is concerned with traceability and the ability to govern risks associated with a transnational supply chain at a reasonable cost (see *UTZ Certified, Annual Report*, 2012: 3). Cost reduction was a major driver for the definition of IOSA, a standard in civil aviation driven by increasing code-sharing among airlines (see *IOSA, Benefits for airlines and regulators*, 2013). This demand for cost-reduction does not always translate into equal opportunities and frequently only those who have large enough economies of scale can access the new regimes. Hence, often, costs reduction is correlated to thresholds based on company's size.
56. A fifth is related to risk management. The area of financial markets, civil aviation and that of food safety all show that private regulation has been used to create new markets or to integrate existing ones by harmonizing local standards or creating mutual recognition regimes among existing transnational standards. Such integration operates through the creation of infrastructures, trading platforms or similar instruments that facilitate transactions, reduce costs and govern risks associated with expanding the territorial and functional scope of markets. Management of systemic risk drives the standard setting process both in the public and the private domain of financial markets. The regulatory strategy and the obligations for the financial institutions are aimed at combining trade increase with systemic risk management. For example in the area of over the counter derivatives (OTC), these financial instruments have to be traded and cleared through central electronic platforms on the basis of the interplay of both public and private rules (in US title VII, VII FDA, in Europe Regulation 648/2012, ESMA technical standards, for the private the ISDA master agreement and ISDA...). Clearing houses use a variety of risk mitigation instruments like default funds or high quality membership required by the public regulatory framework to assist regulatory effectiveness. Professional regulation instead combines two different rationales: promoting freedom of establishment or free circulation of professionals and, to a more limited extent, responding to the needs of a global market for professional services.
57. Thence, TPR operates along a functional and a territorial dimension. **The functional**, which cuts across jurisdictional boundaries and reflects the scope of a market and its

boundaries. This is the case of data protection where the regulatory scope is defined by the operational geography of the MNCs. Similarly in the field of security, where the code is adopted by private security companies whose operations cut across jurisdictional boundaries. **The second**, more conventional, dimension is **territorial**. It **reflects the traditional administrative boundaries**, mirroring regional or State units composed by a private actor. This is clearly the case in professional regulation, accounting, and advertising. However, the lack of a powerful actor like the State makes the territorial dimension much less rigid and more permeable to influences by extraterritorial drivers. There are also instances where both a territorial and functional dimensions coexist (as in the area of food safety).

### **Forms of TPR : organizations and agreements**

- 58.** TPR develops both in frameworks characterized by treaty-based regimes and in frameworks where soft law and informal international law making are the primary instruments. The research fully acknowledges the development of new forms of public regulation at the international level, which do not meet the formal requirements of public international law and take different features ranging from transnational regulatory networks to public/private partnerships. These developments characterize financial market regulation to a greater extent than other areas like human rights, data protection or food safety. The higher degree of informality, compared to conventional public international law, is often associated with the dimension of voluntariness, which differentiates it from the binding more conventional treaty-based international law. The main formal difference lies in the nature of the relationship between the organizations and its members. Whereas members of IOs and Treaty based organizations have a legal obligation to implement the treaty (as compliance is mandatory), in transnational regulatory networks compliance is voluntary and its forms are left to the discretion of each participant. It should be clarified that International Organisations (IOs) have increasingly used soft law as well (for example, International Civil Aviation Organization (ICAO) Code of conduct on the sharing and use of safety information, and FAO, principles for responsible agricultural investments, codes of conduct for responsible fisheries). Empirical evidence reveals that voluntary compliance does not reduce effectiveness but at times increases it vis-à-vis those regimes characterized by mandatory effects.
- 59.** Standards and principles concerning regulatory processes are produced by new organizations like transnational regulatory networks (e.g. IOSCO, IAIS, ICN) and by more conventional IOs (e.g. FAO, WHO, ICAO, OECD) privileging less formal regulatory instruments to engage in cooperation. These new forms differ from private regulation, which can be highly formalized, and use private law instruments for standard setting, monitoring and enforcement. We believe that, unlike soft law, for the most part **TPR is voluntary as to adoption of principles/standards but not in relation to the compliance of principles/standards**. We therefore distinguish

between TPR and international soft law and analyze their interaction, which occurs more frequently than that between private regulation and treaty-based regulation.

- 60. Transnational private standard setting organizations are multilevel structures** that operate via decentralized bodies according to territorial and/or functional distribution of tasks. Global private standards are adapted and adjusted to local conditions including legal principles of domestic legislation when there is a territorial model (such as in the case of advertising where the EASA system is based on the collaboration of local self-regulatory organizations (SROs) working at country level). In functional models the division of labor does not follow jurisdictional boundaries but rather the communities of the regulated (such as in the case of ISDA). This adaptive process to local frameworks or specific markets is the core task of implementation which affects both the legitimacy and the effectiveness of TPR.
- 61.** The research, highlights a common denominator in many TPR regimes: the co-existence of different regulatory levels and their coordination via agreements or, to a much more limited extent, via a hierarchy (see in the food safety area, the so called Certification Capacity Enhancement in West Africa for cocoa farmers that provide for common training materials for UTZ Certified, Rainforest Alliance, Fairtrade International; or the relationship between GLOBALG.A.P. and the benchmarked standards, as detailed in the GLOBALG.A.P. Benchmarking Regulations, 2012). When coordination uses agreements the standard setter concludes MOUs or partnerships with local regulators. When it is hierarchy the local are members that subject themselves to the control of the umbrella organization.
- 62.** Implementation often occurs via regulatory chains whose length, level of coordination, and distribution of power vary from sector to sector. Many codes of conduct require signatories to make explicit reference to compliance with obligations set forth in commercial contracts concluded by the regulated or by participants to their supply chains (see, ICC Consolidated Code on marketing and advertising at art. 26; ICoC on private security services at art. 18, and the BRC in the field of data protection) or into internal compliance programs (see ICoC on private security companies at art. 44). A clear case is the Principle 8 of Equator Principles 3<sup>rd</sup> Ed. requiring the insertion in financing and lending contracts (between lenders and borrowers) of covenants showing compliance with the principles.

### **Modes of governance of TPR and interest representation**

- 63.** There is a clear distinction between regimes based on organizations (the majority) and regimes grounded only on agreements among regulated entities. Organizations presuppose the creation of a legal entity with or without legal personality. The organization operates on the basis of its constitutional documents (e.g. charters and bylaws) and gaps are filled by the choice of applicable law or by the law of the seat. Agreements, on the other hand, do not imply the creation of a legal entity and

commitments are made between the parties. Agreements take place among regulated entities which may commit to comply to common rules. They may be supported by a limited governance structure like a committee that defines the strategic choices and revise the rules when they need adaptation. The contractual model is valuable only for very limited number of regulated. When the number increases the complexity requires the adoption of an organization that separates the function of standard setting, monitoring and enforcement.

- 64.** The differences between organizational and contractual models affect both the definition of legitimacy and that of effectiveness and efficiency. A more complex governance structure stemming from the creation of an organization permits a higher level of inclusion and participation but increases transaction costs, may reduce transparency and trigger the risk of bureaucratization. Hence, it may increase legitimacy but decreases efficiency. Contractual arrangements tend to be underinclusive. Regimes grounded on contractual arrangements among the regulated this often means that beneficiaries and affected communities remain outside of the organization. This is quite common in financial services for example the OTC Derivatives regime. The legitimacy towards affected stakeholders is primarily or exclusively based on the inclusiveness in the standard setting process via consultation. Hence, when contracts are used efficiency may increase at the expense of legitimacy.
- 65.** Contracts can in principle be used for setting up the regime and for regulating the process. The research shows that they are mainly deployed for the latter function (e.g. contractual agreements used in certification and benchmarking activity within food safety regimes). We have found very few purely contractual regulatory regimes including multiple actors coming from industry and civil society organizations. For example, multi-party codes of conduct can be considered contracts concluded by the members of the organization, which are subsequently adhered to by regulated entities that commit to comply with the codes (such as in the Voluntary Principles Initiative case and ICoC). A variant is to consider the codes unilateral acts of the organization; in this case regulated entities undertake the obligation to comply with them through individual contracts concluded with the regulator.
- 66.** There is a host of examples of contractual models that have evolved over time into organizational models. The most common instance is a code or a set of principles drafted by a number of entities that requires the creation of an entity to administer its implementation and enforcement. Examples include the Equator principles applied to project financing whose 3<sup>rd</sup> edition was enacted in June 2013. It was only in 2010 that the Equator Principle Financial Institutions decided to create an association characterized by a single stakeholding interest representation named the Equator Principles Association, long after the Principles were first enacted (2003) and eventually revised (2006). Similarly in the field of private services company, the ICoC code was enacted in 2010 but only in 2013 was an association created. In this case, unlike the previous one, the association is multi-stakeholder and it includes



industry, CSOs and governments. A third example is that of UTZ Certified, where the standard was initially developed in a bilateral contract between a Dutch retailer and a producer in Guatemala and then developed into a Dutch foundation that issues codes of conduct related to coffee, tea and cocoa. Analogous developments have occurred in payment systems. This evolutionary pattern suggests that **management of a private regulatory system needs some type of infrastructure, which sooner than later requires the creation of a legal entity**. Contractual regimes tend to evolve into a complex system organized in legal entities with a governance structure that enables the scheme owners to control implementation and compliance.

67. The organizational model is by far the most diffused instrument to govern transnational private regulators. It is primarily represented by two families of legal instruments: associations and foundations or functional equivalents in common law systems. Legal systems differ; especially in the common-law systems the associational model takes the form of non-profit corporation or variations around that form.
68. Traditionally at the domestic level, multi-stakeholder models that include several constituencies have been correlated with associations while the foundational model, due to its managerial features has been used for single stakeholder, where only one constituency is represented. **The research reveals that this is not the case at transnational level**. The use of foundational models, common in northern Europe, has been correlated with multi-stakeholder organizations with differentiating forms of interest representation. They range from entities with a board of trustees and a board of directors where the different constituencies are represented to entities where the board has limited representation whereas the committees present a broader representation. Often, for example, the standard setting committee is composed by multiple stakeholders which may not be represented in the board of directors. For instance, in the IASB case, the International Financial Reporting Standards Foundation (IFRS )created in 2001 is an independent organization having two main bodies, the Trustees and the IASB, as well as an IFRS Advisory Council and the IFRS Interpretations Committee. The Trustees appoint the IASB members, they exercise oversight and raise the funds needed, but the IASB has responsibility for setting International Financial Reporting Standards (international accounting standards). This a case where market legitimacy is combined with legal legitimacy.
69. From a functional perspective we have identified two sets of families within transnational private regulators: one which emphasizes the transnational dimension in its composition and operations (IASB, ISDA, Equator Principles, GFSI, ICC, IFALPA, IBAC, IATA, ISEAL), the other based on a multilevel structure where a national, a regional, and a transnational layer coexist (IFBA, EASA, IBA, EPC). The former might afterwards create national chapters for the purpose of implementation and adaptation to local contexts but the dominant player is the transnational unit. The latter is built on local units, which want to foster cooperation and promote harmonization or at least mutual recognition. **The two models often reflect**



**different allocations of regulatory power.** In the latter the power is often primarily allocated to the lower units that delegate some to the upper ones. The power chain is bottom-up. In the former, instead, the power is allocated to the transnational level and the national chapters are 'delegated' some tasks. The power chain is top-down. The different power-flows translate into different regulatory schemes and organizational models.

- 70.** The transnational model tends to be more open to stakeholders' inclusion. Among them there are new models (e.g. ICoC association) that present a multi-stakeholder structure since the outset and models that have evolved towards a multi-stakeholder organization from a single stakeholder one. A sharp difference within multi-stakeholder models exist between those that incorporate different interests within a relatively homogeneous group (industry) and those that include representation of heterogeneous interests coming from industry, civil society organizations and governments. Many examined organizations have a multi-stakeholder structure within the industry (GFSI, EASA, IASB, ISDA, EPC, GLOBALG.A.P.), a smaller group has a multi-stakeholder composition that includes also CSO (ICoC, VPs, ISOA), and an even smaller group involve governments. A minority is single stakeholder (Equator Principle Association, IATA, IBA, UIA). This sample does not necessarily represent the broader TPR system where the multistake/multiconstituency is growing especially in the area of sustainability standards. The territorial model tends to be more focused on single constituencies especially when it is the outcome of coordination between national trade and professional associations (e.g. IBA). An exception is the International Standard Organization (ISO) where the territorial model is moving towards a stronger multi-stakeholder composition.
- 71.** The representation of interests can take different forms and engage both the organization and the regulatory process. In some instances the involvement of multiple stakeholders occurs at the organizational level, in other instances at the standard setting procedure level (for instance, in several regimes the standard setting procedures include open consultations where stakeholders can participate, such as in GLOBALG.A.P., EASA, UTZ Certified, ICC, IASB, EPC). In the organizational model it deploys membership, in the procedural model rights to participate in consultation or other deliberative processes. This might be the outcome of a deliberate institutional design, which distinguishes different strategies of multistakeholding or can be determined by the different identity of stakeholders: specific standards may require involvement of stakeholders that might not have an interest in participating in the organization. The drivers towards multi-stakeholder are related to both legitimacy and effectiveness. Legitimacy requires participation of those affected by the standards, effectiveness concerns primarily those regulated entities whose change of behaviour is instrumental to the achievement of the regulatory objectives.

- 72.** The multi-stakeholder model is characterized by (1) a higher degree of formalization of the standard setting process than that found in a single stakeholder model, and (2) the endorsement of principle-based regulation. The former evolution results in the adoption of standard setting principles defining procedural requirements the regulatory body has to abide by. The latter is motivated by the inclusion of multiple stakeholders, which makes it more difficult to reach consensus over detailed and specific rules. Multiple stakeholders' involvement in the organization may increase transaction costs (e.g. decreasing efficiency) while improving effectiveness. In multi-stakeholder models there is often stronger delegation to the board or to the secretariat when principles have to be implemented.
- 73.** TPR influences the governance of regulated entities as well.

### ***Challenges of TPR***

- 74.** Transnational private regimes define, in principle, voluntary standards. Unlike public regulation where standards are usually mandatory in private regulation regulated entities are legally free to choose whether to enter a regime. This freedom should also permeate the participation and the choice of leaving the regime when deemed appropriate. As will become evident there is gap between the *de jure* and *de facto* character of the ability to choose. Many regulated entities are not really free and they might be forced to enter a regime and comply with the standards so as not to forego economic opportunities. The empirical evidence shows that social and economic factors constrain choices and limit voluntariness. These limitations affect the definition of legitimacy and the effectiveness of procedural requirements set up by regimes. In order to fully understand the limits of choice and the consequences for legitimacy we need to investigate the allocation of power within and between regimes and the role of conflicts among constituencies belonging to the private sphere. When choices are limited governance reforms are needed to re-establish the space of choice.
- 75.** Although the use of TPR as a complement or a substitute to public regulation is thus increasingly frequent, and likely to be on the rise in the years to come, the choice to rely on private regulators has also backfired in some cases. The 2012 fires in textile workshops in Karachi and Lahore (in which over three hundred died) were partly attributed to the 2003 abolition of labour inspections by the government of Punjab with the aim of creating a more 'business-friendly environment'. Examples of partly ineffective private regulation are countless. The self-regulatory solution chosen in the United States for the monitoring of banks' risk exposure (the Consolidated Supervised Entities scheme) contributed to sparking the subprime mortgage crisis. The European Commission's decision to rely on a private institution to stimulate migration towards the pan-European Single Euro Payments Area (SEPA) did not lead to the expected improved results. The legitimacy of TPR, in particular the inclusiveness and transparency of the norm-setting process, is a serious challenge.

For instance, TPR in the field of civil aviation generally suffers from a lack of participation by consumer organizations. One of the questions is thus how TPR regimes can be made more legitimate, without undermining their effectiveness. Challenges concern governance, regulatory instruments, evaluation of regulatory performance, ability to achieve the stated objectives, capacity to foster legal and organizational innovation.

### ***Regulatory instruments and the structure of the regulatory relationships***

- 76.** TPR deploys primarily **private law instruments** to set standards, implement them, and ensure compliance. They design markets, regulate them, or more specifically are used to assess and manage risks associated with global markets. Their structure is determined by the necessity to standardize the obligations and rights of regulated entities and the interests of third parties non-members of the regulatory entity. They do not operate as stand-alone instruments but interplay with other private tools and with the underlying public regulation.
- 77.** Regulatory instruments generally are separate from the governance instruments that create and regulate the organization like charters and bylaws. As repeatedly underlined there is a strong link between the two, which emerges by looking at the practices (even if it might not be written on paper). In fact there are often three concurring instruments : (1) the charter and bylaws of the regulatory body, (2) the general standard setting procedure and (3) the individual standard. It is only by examining them together that the overall regulatory framework emerges. Depending on the structure of the regulatory chain and the organizational model adopted by the regulator, they can have either a contractual or an organizational character. Standards may be included in regulatory contracts taking the form of codes of conducts, guidelines, regulations, memoranda of understanding or, framework agreements signed by the regulated entities. Alternatively, they can be part of the internal regulation of an organization, an association or a foundation and take the form of corporate directives or regulations which bind the members.
- 78. Contracts and property rights as regulatory instruments.** Regulatory contracts are by far the most diffused instrument to define the standards and the modes of compliance in TPR but not the only one. Much is also achieved via definition of resource management through property rights (PR). When the regime aims at regulating the use and exploitation of a resource or a pool of resources, collective ownership may play an important role. The definition of PRs influences the conduct of regulated entities and the obligations owed in relation to the common resource strongly depend upon the characteristics of ownership. PRs operate as instruments to regulate conducts of regulated entities and the relationship between them and the beneficiaries. For instance the definition of property rights concerning land and

natural resources affects the private standards agricultural producers have to comply with when bound by food quality and safety standards. Similarly the rights of indigenous communities affect those enterprises that commit to the Equator Principles and have to abide by principle 7 of IFC (2011). The use of property rights, both individual and collective, as regulatory instruments has been less investigated than regulatory contracts because it developed in areas like environment, water, air, cultural goods, the Internet, which have not been the primary object of the empirical research carried out in this research project. However, their use in TPR is clearly very relevant.

- 79. Information regulation.** We observe relatively little use of information regulation, but for labeling, compared to public regulation at the standard setting level. The situation is different in relation to compliance monitoring, where both certification and auditing are instruments directed at collecting information. There is also limited use of outcome standards and the definition of regulatory objectives is often not well defined making regulatory performance's evaluation rather difficult. However, in some instances preferences for process or output over input standards have been clearly expressed (see the ISEAL standard setting code at 6.3.2). Clearly there are differences across regimes. Professional regulation, including to a limited extent accounting, tends to focus on performance whereas food safety and advertising have a stronger inclination towards output standards.
- 80. Certification.** An increasing role is played by certification schemes where regulated entities join the regime by signing bilateral contracts with certifiers that share common rules imposed by the accredited body in compliance with the rules designed by the scheme owner. In the area of certification and audit regulatory contracts are aimed at ensuring compliance with obligations by parties who voluntarily joined the scheme. We find certification in the area of food safety and human rights, environmental and social standards, much less in financial markets where risk management is dealt with different instruments. Certification is primarily managed via contracts.
- 81.** The standard setting function operates via different instruments depending on the technical level of the norms and the objective to regulate members of closed groups or market participants. There are technical standards in the sector of accounting, e.g. the International Financial Reporting Standards (IFRS), payment systems (the SEPA rulebooks) developed by the EPC, food safety the GlobalG.A.P. and UTZ Certified standards in food safety, civil aviation (DGR and LAR). Similarly in the case of derivatives the ISDA Master agreement has a high technical dimension. Less technical are the codes in the advertising sector (EASA Recommendations) or in the field of human rights protection (ICoC). In the area of professional services, codes are related to the membership to the association and to the relationships with clients and the ethical principles that should be followed. The analysis shows a wide variety of instruments and different degrees of specificity.

- 82. Choice of regulatory instruments.** How the instrument choice is made by transnational private regulators is generally not supported by an ex ante impact analysis, but some information can be inferred from the position paper issued by the regulator that often precedes the enactment of the standard and the standard setting procedure. The regulatory instrument's selection is the outcome of a complex process that has to abide by the standard setting procedures. Standard setting procedures, when codified, indicate the criteria to be used when defining the standard, the minimum content of the regulatory contract which includes definition of objectives, effects, procedural steps and revision process (see for example the ISEAL Standard Setting Code and the EASA standard setting procedure). These instruments also define the procedures to appoint the competent committees and to involve in the drafting and implementation process affected stakeholders or potentially regulated entities that are not members of the standard setting organization. Standard setting procedures hence contribute to defining the content of the regulatory contracts that determines the quality and nature of the relationship between regulators and regulated.
- 83.** Regulatory contracts define standards, modes of compliance and enforcement. **The relationship between regulators, the regulated and, to a limited extent, the beneficiaries is the main subject matter of regulatory contracts.** In particular, they define the obligations of regulated entities and, so far to a limited extent, the rights of final beneficiaries towards the regulator and the individual regulated. In many instances contracts are concluded with the regulator, in other, more limited, instances they can be conceived as contracts among the regulated. In the former case, the regulated has an obligation vis-à-vis the regulator but not towards the other regulated; in the latter case, the regulated commits both towards the regulator and towards the other regulated. **In both instances they are multilateral contracts but their design differs.** The two models reflect different approaches to the relationship between regulator and regulated and to the role of the community of regulated entities. The existence of horizontal obligations among regulated may translate into forms of peer monitoring and mutual learning that do not materialize in the hierarchical model where the relationship regulator/ regulated is bilateral.
- 84.** The use of regulatory contracts is consistent with the voluntary nature of the standards. Not only the participation in the contract is voluntary but often the content of the regulatory contract is full of default rules that allow participants to the regime to deviate or modify the regime. Regulatory contracts not only permit participants to freely enter and exit the regime to the extent that their voluntary feature is ensured not only *de jure* but also *de facto*, but they also may have a strong impact on the relationship between regulators and regulated. For instance the combination between mandatory and default rules shapes the freedom of regulated entities to deviate from the model and signal the regulator the desirability of sub-regimes or to an even larger extent to engage the basic pillars of the regime. It is for the regulator when the standard is adopted to indicate if, how and with which

consequences regulated entities can change individual rules. To the extent that these are not totally independent legal orders this choice has to be compatible with the domestic principles of contract law that fill gaps and with public international law (see below).

**85.** The definition of the (criteria to identify the) parties and the content of the regulatory contract is often determined ex ante by a separate document which states the procedural requirements to define the standards. In other words, the standard setting procedures contribute to definition of the regulatory contract. They regulate entry to the regime and the allocation of power to change the contract. The inclusiveness and participation of stakeholders imply that the content of the regulatory contract that defines the standard is often determined not only by regulators and regulated but also by third parties that may be affected by the implementation of the standards in the contract. This constitutes a major difference with exchange contracts. Regulatory contracts often influence not only the conduct but also the governance of regulated entities. Such influence ranges from minimum requirements like the creation of a compliance program and officer to more structural modifications that affect the sourcing or the financial policies of regulated entities. Similarly to public regulation, we have examples of 'delegation' to regulated entities in TPR as well.

**86. Differences between exchange and regulatory contracts.** Regulatory contracts differ significantly from exchange contracts not only in relation to the content but also to their effects. They generally produce third parties effects to a much greater extent than exchange contracts. When defining reporting standards in financial markets the standard produces effects on regulated entities that have to comply with the standard but also with investors that (should) benefit from the information. When defining standards concerning advertising practices the standards not only influence the behaviour of advertisers and the industry but also consumers and customers addressed by the advertisement. Given that the regulatory process imposes on regulated entities obligations in the interest of third parties, third parties effects are structurally inherent to regulatory contracts. Third parties effects may or may not be consented upon depending on whether affected stakeholders have participated to the standard setting, monitoring and enforcement process. In principle, third party effects should translate into benefits but regulatory contracts may also generate negative externalities and or undesirable distributional consequences for non-signatories. The regulatory contracts examined don't often internalize these effects by considering the distributional consequences on third parties and, thus, present significant shortcomings. Current contract law regimes, due to the principle of privity, are often inadequate to provide the legal framework that enables the pursuit of the regulatory function.

**87.** The procedure of contracting determines the nature of the relationship between regulators and regulated and the nature of the regulatory contract. One can distinguish between **standardized regulatory contracts**, where regulated entities are



given only a take it or leave it option to enter the regime, and **relational regulatory contracts** where definition of standards is shared and the regulated play some role in defining the content of the contract. To the extent that the regulatory contract is seen as a contract between regulators and regulated where third parties participating in the drafting process are not technically parties to the contract, the majority of regulatory contracts are standardized and not relational.

**88.** The regulatory contract often defines the degree of freedom of contract by regulated entities. Regulatory contracts often determine the relationship between regulated entities as it is the case when a regulatory contract is used to regulate an exchange or trading platform. Regulatory contracts may simply indicate via default rules guiding principles that regulated entities may either subscribe to or deviate from. Alternatively regulators may define rules that are binding for regulated entities. In the latter instance regulated entities' freedom of contract is highly constrained and regulated entities may have only limited space to exercise their private autonomy.

**89. Individual and collective regulatory contracts.** Regulatory contracts can be distinguished between collective and individual. Collective regulatory contracts are those linking the regulator with the entire group of regulated entities. For example when ISDA drafts the master agreement the link does not imply a binding commitment). Individual regulatory contracts are those linking the regulator with individual regulated entities. The latter have been deployed when the regulated are not members of the organization (for example, in the GFSI case the benchmarking regime is based on the contractual agreement between GFSI and each applicant scheme owner). When both, collective and individual, are deployed the relationship between the two instruments is rather strong. The content of the individual regulatory contract strongly depends upon the collective contract. As the case of trading platforms in financial products demonstrates the content of the standard agreement influences the private autonomy of the traders while defining the terms of their transactions. But even when private regulation is not used to create and regulate markets the degree of discretion for regulating individual relationship is functionally and legally limited. Coordination of regulated entities' conducts requires minimum common requirements. The principle of non-discrimination imposes serious constraints on unjustified differences among regulated. However when the regulated are requested to adopt compliance programs the structural differences among the regulated may permit wider differentiation. Individual regulatory contract or instruments that concern implementation of standards may reflect a stronger degree of differentiation vis a vis regulatory contracts focused on standard setting.

**90.** Collective regulatory contracts are focused on rights and obligations of regulated entities vis-à-vis the regulator and other regulated. They regulate entry, obligations and exit. When the regulatory scheme is regulated by both an organizational charter and a code it is likely to find entry and exit regulated in the organizational document.

Entry in and exit from the organization coincides with joining and leaving the scheme. Entry is often subject to minimum requirements and to commitments whereas exit might be voluntary (withdrawal) or forced ( termination).

91. Regulatory contracts do not address individual regulatory performance except in a few cases which mainly concern meta-regulators (EASA with regards to national SROs in advertising, ISEAL with regards to UTZ Certified in food safety) ( see below). They are defined in general codes; it is very rare that individual contracts between regulators and regulated entities define specific targets and indicators to verify quality of regulatory performance of regulated entities.
92. Regulatory contracts may differentiate regulated entities and apply different rules. Collective regulatory contracts may partition the community of regulated entities and differentiate rights and obligations depending on the size, the position in the supply chain and the market share. There is a growing trend towards more nuanced distinctions often driven by reporting and analysis concerning effectiveness.
93. The choice of regulatory instruments is a strategic dimension of effectiveness and influences the quality of regulatory performance and the overall legitimacy of the process. Two main issues have been examined in the comparative analysis:
  - a. the correlation between the instrument choice and the relationship between regulator and regulated entity. For example how the degree of voluntariness influences the relationship. One would assume that the lower the degree of *de facto* voluntariness, the stronger the hierarchical dimension of the relationship regulator/regulated. The correlation is more complex and (lack of) voluntariness and hierarchy are not always strictly correlated.
  - b. the correlation between heterogeneity of regulated communities and the instrument choice. Save for a few exceptions, the findings show that: the higher the degree of heterogeneity, and the larger the transaction costs, the more likely is the use of standard regulatory contracts instead of relational regulatory contracts.

### **Gap filling of governance models and its effect on regulatory processes**

94. Standard setting, compliance monitoring and enforcement are defined through private regulatory tools primarily based on domestic private law instruments like contracts or unilateral acts, organizations like associations or foundations or trusts. Some of them draw on domestic legislation, some on transnational instruments. Private autonomy is the main source but when regulatory or governance instruments are incomplete domestic legislation fills the gaps. We have identified some key factors contributing to define a taxonomy of regulators that influences the outputs: membership and profit motives.



95. Given the incompleteness of charters and bylaws, the gap filling function of the legal system where incorporation of the transnational regulator occurs is very relevant. Among the organizations considered in the case studies there is a concentration in Belgium (6), USA (6), France (3) Switzerland (3) and the Netherlands (2) that have developed legislation and case law to accommodate the specific needs of transnational organizations, but other countries as well have been randomly selected by the founders. This applies, for example, to the UK, particularly relevant when it comes to TPR in financial markets. The remarkable differences among legal forms especially in the non-profit family make it difficult to identify common features across organizations. To the extent that gap fillers contribute to the definition of the organizational rules, the divergences increase differentiation even within the same regulatory field. For example, if two regimes choose the associational model, one incorporates in Belgium and the other in Switzerland, the gap fillers will be the Belgian civil code and the Swiss civil code. To the extent they have different rules, even if the initial models look the same, they are likely to diverge once the gap filling function becomes operational. In some legal systems, for example, the associational model is not widespread and it is replaced by some variations of the corporate model that makes the comparison rather difficult.

TABLE 1. Applicable law to fill gaps related to governance

US Law	6
Belgian Law	6
French Law	3
Dutch law	2
UK law	2
Swiss law	3
Other	7

96. **Membership versus non-membership based organizations.** As clarified earlier private regulatory regimes are regulated by organizational or contractual instruments and, to a limited extent, by property rights. Within organizational forms a key element is represented by **membership**. In membership-based organizations the regulated are members, either individually or collectively, whilst the beneficiaries might or might not be within the organizational boundaries. In the latter case they are not given membership but might be given some participatory rights, or ex post control over the performance and its objectives. In non-membership based organizations the regulated aren't members but may be linked contractually to the regulators. In this case the individual, generally standardized

contract is the instrument that defines rights and obligations between the regulator and the regulated (see the case of GLOBALG.A.P. benchmarking activity and in GFSI). Beneficiaries in this type of organization generally remain outside but might be given legally enforceable rights related to the process (comment in consultation proceeding) or the output (compensation when standard implementation reduces their rights and produces negative externalities). Contractual regimes are predominantly created by the regulated who agree to be subject to common rules without creating independent organizations. In this case the regulated and the signatories coincide. Rarely beneficiaries take part into contractual regimes.

- 97. Single versus multistakeholder organizations.** There is a trend from single to multi-stakeholder models that include several classes of regulated entities and in some instances also the final beneficiaries. The multi-stakeholder model, as mentioned above, is characterized by higher degree of formalization of the standard setting process and endorsement of principle based regulation. **Hence, the higher the number of stakeholders involved in the standard setting process, the more open ended the standard, often resulting in a postponement to a later stage the definition of detailed rules.** This is a clear instance of how governance may influence regulatory process. **The most recent example is the ICoC stakeholder initiative association where the creation of a multi-stakeholder association has been combined with the delegation to the board to draft certification detailed standards that ensure compliance with ICoC code (see art. 12 and 13 of the ICOC Articles of association).**
- 98.** Changes of governance concern interest representation. In the associational model instead of using differentiated membership various constituencies are organized within chambers and allocated equal voting rights in the board. Problems of interest representation are even more significant in relation to the foundational model. Here interest representation is organized through the creation of different committees. In particular, within some organizations there is remarkable autonomy in the technical committees engaged in standard setting whose scope of activities, composition and even accountability follow a different path from the governance bodies of the main organization. This occurs across the board but it becomes remarkable when the foundational model is deployed. The foundational model reflects a managerial approach, which maximizes efficiency often at the expense of inclusiveness. The changes to the conventional structure of this model at transnational level, have increased accountability without necessarily decreasing efficiency.
- 99. Profit versus non profit organizations.** Within this framework the selection of the regulator's legal form plays a key role in shaping the decision making process, its inclusiveness, transparency and the adequate representation of the affected interests and their relative power. The definition of the legal boundaries between insiders and outsiders and the distribution of rights and obligations is of paramount importance. The choice between non-profit and for profit forms is linked to the mission, but it also provides signals to outsiders about the implementation of

regulatory objectives. The existence of non-profit constraints, associated with the public availability of standards, contributes to fend off risks of commercializing and should provide stakeholders with sufficient guarantees that private benefits are outweighed by social interests, as it clearly the case for UTZ Certified. But a key feature to address organizational motivations is strict regulation of conflict of interests, which, lamentably, is often missing. Conflict of interest should prevent the regulators from setting standards that maximize the interests of (some) regulated entities at the expense of beneficiaries.

TABLE 2. Choice between for profit and non-profit<sup>2</sup>

Profit	2
Not-for-profit	22

**100.** Within the non-profit forms, the option between associational and foundational models, which might partly depend on the choice of the country of incorporation, has an impact on the legitimacy and effectiveness of the regulatory process. For example, in Belgium the associational model prevails, given their ad hoc legislation for international associations, whereas in the Netherlands foundations are used more frequently. In the UK the associational model is almost nonexistent and other models consonant with the common law tradition, such as the company limited by guarantee, are deployed. The use of the non- profit forms with the non-distribution constraint should ensure that the regulatory function and the public interest benefits are not diluted by profit- driven motivations.

### **Regulatory contracts and gap filling by domestic laws**

**101. Regulation and private autonomy.** A private regulatory regime, its governance and processes, are defined primarily on the basis of private autonomy by the founders and through subsequent agreements between the members, the committees and/or the board. Transnational regulators' private autonomy can be limited by mandatory national rules of the country of incorporation that apply to the organization. Parties are free to define both organizational and procedural rules that will characterize the regulatory process within the limits of domestic and increasingly of public international law. **These freedoms have generated innovative models, which significantly differ from their national counterparts even in case of gaps in the regulatory framework the reference point is still primarily the national legal system.**

---

<sup>2</sup> The following tables included in the document are based on the results of the 11 Case studies, where 2a sample of 24 TPRs were analysed.

- 102. Principle versus rule based.** Regulatory tools can be principle-based as it is the case in human rights and professional regulation or very detailed/rule based as in the case of payment systems, accounting and derivatives. Advertising and food safety stand somewhere in between. The choice between principle and detailed regulation is (1) partly determined by the technical scope, (2) partly by the heterogeneity of represented interests, (3) partly by the allocation of power across levels. Besides, the variable represented by the demand for technical regulation shifts the pendulum towards rule-based regulation. Accordingly, **we observe principle-based regulation when there is high heterogeneity of represented interests and/or when the regulatory power is limited because it stays primarily in the hands of local standard setters** as in the case of advertising.
- 103.** Regulatory contracts as organizational charters are incomplete and domestic legal systems rather than transnational contract laws provide the gap fillers. English and American contract laws are often referred to by the regulatory instruments (for example the ISDA Master Agreement in the derivatives market), whereas continental European systems are rarely mentioned. It is more difficult to identify the applicable law for contractual regulatory instruments when parties are silent on the issue. References to private international law could be the solution but the application of general principles to multi-party regulatory contracts is not an easy task and, in the absence of a uniform set of principles, private international law varies between legal systems.
- 104.** Given the importance of domestic legislation as a gap filler both in relation to governance and to the regulatory instrument there is a clear imbalance between North America and Europe on the one hand, and the rest of the world on the other. The extent of gap filling by domestic legal systems contribute to the definition of the regulatory process, distribute power among different constituencies, and provide rights to third party stakeholders. The lack of transnational common principles translates into a biased selection of domestic regimes which may have significant distributional implications on regulatory power.
- 105.** The use of contracts as regulatory instruments addressing process has brought about important changes in the forms and function of contract, including the requirements for enforceability. The relevant role of freedom of contract while designing the standards has provided the necessary flexibility to modify conventional contract law, directed at regulating exchanges, enabling agreements and contract to perform regulatory functions. **Regulatory contracts pervade the scene; they are used by single organizations to define the relationship between regulators, regulated and third parties including beneficiaries.** But **regulatory agreements**, including memoranda of understanding, agreements, codes of conduct, and framework contracts also **characterize the forms of cooperation between regulators in a single field and across sectors when potentially conflicting objectives have to be balanced.**

## **Governance design and the influence of regulatory instruments**

- 106.** The full representation of the regulatory relationship and the space of choice for regulated entities results from the combination between contractual and organizational features. More specifically between the governance devices and the regulatory instruments. This combination strongly depends on whether members and regulated entities coincide or differ and what is the position of beneficiaries. Three models can be identified:
- a. Regulated entities are members while beneficiaries are outsiders (see the case of Equator principle association, where the only members are the financial institutions).
  - b. Beneficiaries are members and regulated entities are linked to the regulator via contracts (see the case of GFSI where the benchmarked scheme owners have only contractual relationship with the organization).
  - c. Both regulated entities and wider beneficiaries are members and they create a multi-stakeholder organization (see the case of ICoC where NGOs, private securities companies and states are members of the association).
- 107.** When regulated entities are members of the organization (professional regulation, civil aviation) participatory tools in the standard setting process are provided by governance rules rather than by the contract (e.g. members' right to participate in standard setting process, or to vote on the standard in the general assembly, or to ask for revision). When there is no coincidence between members of the regulatory organization and regulated entities (as it is the case in derivatives, food safety, accounting), the main participatory tool for the regulated is supplied by the procedural requirements. The standard is drafted by a technical committee and open to public consultation to which the regulated can participate as any other stakeholder. In many regimes regulated entities have been given opportunities, if not rights, to make comments on drafts of standards (as in accounting standards, food safety, bank payments, advertising, derivatives, and data protection). **Thence, the influence of regulated entities over the content of the standard is only indirect:** through the organization, when regulated are members, and through voluntary adoption, when they are standard takers. However, the role and effects of consultative rights is uneven across sectors and regimes, though there is a relatively consistent trend towards the application of the principles of transparency and duty to give reasons.
- 108.** The relationship between regulators and the regulated is then strongly affected by the membership variable. Models differ significantly depending on whether the regulated is or is not a member of the organization. The weight differs significantly depending on whether the organization is membership or non-membership based.

But even within the memberships' organizations there are important variations. Clearly, membership's weight varies *de jure* and *de facto* depending on the size of the organization. Thence, in large organizations regulated entities can influence the standard setting process only if they are able to coalesce. Coalitions depend on homogeneity of interests and by the degree of competitive pressure coming from other regulators.

## **Transformations of the regulatory process: governance design and regulatory instruments**

- 109.** Legitimacy and effectiveness have driven the process of regulatory innovation both in relation to organizations and to procedures. Changes have influenced governance, process and the correlation between the two. It has become clear that there is a correlation between governance design, procedural features and regulatory output. We shall examine first transformations of governance, then innovations of process and eventually the relationship between the two dimensions.
- 110. Governance reform: structural separation.** Probably the most important dimension of governance reform related to transnational regulators, aimed at increasing legitimacy, concerns the separation of standard setting, monitoring and enforcement. Functional separation may be achieved within a single organization via the creation of separate divisions or by allocating regulatory tasks to different entities. Functional separation translates into structural separation where each function is performed by an individual entity with some degree of legal independence. Such separation has been promoted by several institutions both, external – like courts or public overseers - and internal by some class of internal stakeholders. There is clearly a convergence over the need to reach a higher level of separation aimed at reducing conflicts of interest while keeping the regulatory process coordinated and effective. However, the process is far from being completed. In many instances conflicts of interests are not clearly addressed either by specific rules or by a clear structural separation of the different components of the regulatory process. **A structural reform process may ensure a functional separation among bodies in charge of the different phases, for instance through a structural separation between the entity in charge of standard setting and that in charge of enforcement. In addition to structural separation, a stricter definition of a conflict of interest regime is needed compared to that ordinarily available for conventional private law (see the final section of the report).** Such an approach acknowledges the long-observed risk for contractual instruments to be exercised hierarchically and for them to embed inequalities in power and opportunities between regulated and third parties.
- 111. Process innovations.** Innovations have concerned not only the organization and its functions but also and predominantly the regulatory process. Transnational regulators have been urged to define rules introducing procedural requirements

related to standard setting, monitoring and enforcement by their own stakeholders and/or by public bodies interested in incorporating those rules in legislative or administrative acts. The standard setting process and, to a more limited extent, monitoring and enforcement have been subject to important changes driven by the demand for higher accountability coming from outside and inside the organizations. Compared to fifteen years ago most transnational regulators have today internal procedures to set standards that limit their discretion and increase their accountability. By internalizing stakeholders in the regulatory process such rules minimize the risk of generating external negative effects, which have been of the major drawback of traditional self-regulation. The rules about the rule-making process differ depending on which stakeholders have access to the governing bodies or act from outside.

**112. Rules about standard setting.** The diffusion of principles and rules concerning standard setting has become a common feature of transnational private regulators enhancing transparency of the regulatory process. In several cases, there is evidence of the introduction and revision of the standard-setting procedure used by transnational regulators, such as in the EPC, whose Change management process is in its version 4; in IASB, where the Due Process Handbook has been modified in 2006 and more recently in 2012; in EASA, where the standard setting recommendation procedure adapts to specific issues addressed; in GLOBALG.A.P., where the regime provided for a standard-setting procedure in 2007 from the previous undefined one, as well as in the UTZ Certified (in 2009), the ICC (in 2010), and the Equator Principles (in 2013) cases. Compliance with standard setting rules is a condition of validity. Standard setting committees are bound by new and fairly complex procedural rules that define the number of drafts related to the standard and the nature of stakeholders 'involvement' at each stage of the process, the notice and comment obligations. **Overall there is an increased formalization of procedural rules aimed at ensuring stronger legitimacy.**

**113.** In many instances it is possible to identify a correlation between governance transformations and standard setting rules. In the field of accounting and financial reporting the governance reform that generated IASB is correlated to the adoption of the Due Process handbook. In the field of human rights, the multi-stakeholder governance of ICoC has resulted into the definition of rules about certification that were not present in the national codes to the same extent. In relation to the Equator Principles the creation of an association is related to the latest revision of the principles. Governance changes have modified the regulatory process and contributed to identify some of the potential negative externalities of private regimes by giving voice to affected communities. The correlation takes place between enforcement rules and governance as well. When regulators create internal dispute resolution bodies, they define due process rules to be complied with by the enforcers; to a limited extent they engage in a definition of sanctioning policies and their execution. For instance, in the EPC case, the Scheme Management



Committee provides for specific rules on the sanctions, complaints handling as well as appeals procedure (see SEPA Scheme Management Internal Rules, vers. 4.0, 2012).

- 114.** While these rules are increasing process-legitimacy they are still based on problematic behavioral assumptions. Innovation in process regulation has not fully grappled with incomplete information and organizational bounded rationality. All organizational models have to address the problem of incompleteness. It would be a mistake to assume ex ante full information by private regulators about the effects of the incentives of the regulated and the effects on affected stakeholders. Transnational private regulators as public regulators also suffer from severe information deficits. Lamentably standard setting procedures are still designed assuming complete information. The information deficit is only taken into account when the standard is revised. Whereas we do not see standards including in their development the notion of incremental information e.g. the idea that information about implementation and its effects becomes available only when regulated have to apply the standard and may face unexpected hurdles. Therefore standards should be adaptable to information availability and incorporate changing variables. Procedural rules should be characterized by more accurate behavioral assumptions.

### **The correlation between governance and the regulatory process**

- 115.** Analysis of the regulatory process has been undertaken in many research projects covering some of the organizations examined in the case studies. **Less attention has been paid to the choice of governance and the selection of private law legal forms.** This report fills that gap by analyzing the role of private governance, focusing on the functional outcomes of legal forms' choice and its relationship with the regulatory process' design. To analyze this correlation one important question is **whether the selection of the foundational form instead of that of an association may affect the definition of the regulatory process and the content of the final regulatory product (e.g. the standard).** We have investigated whether, for example, the choice between an associational and a foundational model affects (1) the type of standard, (2) the relationship between regulators and regulated,(3) the procedural requirements (4) the definition of the regulatory objectives. The expectation based on national models was that associations would have more participatory standard and opt for responsive regulation whereas foundational models would tend to less inclusive and favor command and control. The findings however show a different picture!
- 116. Process' rules influence allocation of power within the organization.** The research has examined the differences in the distribution of decision-making power within associations, foundations and for-profit companies determined by the new standard setting procedures. Clearly the associational model permits the largest spectrum of alternatives related to the involvement of regulated and beneficiaries;



however, as mentioned the opportunities of foundational models and trust-like organizations have proved to be unexpectedly wide. We often see that the foundational model is correlated with the creation of committees aimed at involving stakeholders that cannot be directly included in the organizational structure, which is limited to a board of trustees. For example, various organizations establish a link between the accessibility and inclusiveness of the standards setting and the effectiveness of its impact (key examples are IASB, ISEAL and EASA). Fairness of regulatory outcomes both in terms of costs and benefits is often correlated with the degree of participation and adequate interest representation from the beneficiaries or society in general.

- 117.** The findings suggest more broadly that there might be a correlation between the governance of the regulator and the features of the regulatory process, its inclusiveness, the modes to select participants and the identification of affected stakeholders. The governance structure is determined by (1) the organizational form, (2) procedural requirements concerning standard setting and implementation, and (3) their relationship with regulatory contracts. There are models where members are regulators while regulated entities are selected via contracts. There are other models where membership defines both regulators, regulated and their relationship. Here the role of regulatory contracts may be limited. The space for regulatory contracts increases when membership is underinclusive whereas decreases when membership is overinclusive. When for example TPR is used to design new markets there are models where market designers are members of the organization while market participants are defined via voluntary agreements. There are different models where the organization includes both market designers and market participants. In the latter market participants have to become members of the organizations and be subject to their rules.
- 118. The relationship between process design and regulatory instruments.** Process design affects which outcomes can be expected, the type of legitimacy that regulators seek from the regulated and the beneficiaries. Procedural requirements that include inclusive consultation may expand the range of interests represented in the definition of the standard and contribute to define the potential positive and negative impact on third parties. A second dimension of the relationship is the regulatory response to the standard by regulated entities. Different instruments should be used depending on the importance of regulatory responses to the standard: rate of compliance, nature of infringements, motivations of violations, responses to sanctioning policies.
- 119. Changes primarily concern the increase of external accountability, that is, the role of third parties, the beneficiaries and the communities potentially negatively affected (their rights to be consulted and to be given reasons).** Whereas accountability towards the regulated (internal accountability) is addressed mainly via governance reforms, modifying the conventional features of the associational and

foundational models, accountability towards third parties is addressed primarily via participation to the standard setting procedures. As we have seen there are many instances where the standard setting committee is composed by members who are not necessarily part of the organization. In these instances the problems concern the representation of different categories of beneficiaries without membership that remain outside the decision-making process albeit affected by the standard and the allocation of decision making power between those inside and those outside the organizations. Clearly a different picture concerns multi-stakeholder bodies where regulated and beneficiaries are both represented within the organization.

- 120.** These rules are formally linked to the standard setting process, but in fact they redefine the governance and the allocation of power among stakeholders and between stakeholders and third parties. Detailed procedural rules including several consultation stages reduce the discretion of the organization and transfer control of the regulatory process over external stakeholders. Similarly, in relation to third party assessment of regulated compliance, as is the case for certification and/or auditing, fairly detailed procedural rules are designed for the certifiers and the auditors. This is clear in the food safety cases where the GLOBALG.A.P. standard and the UTZ Certified standard both provide for detailed contractual agreements between scheme owners, certifiers and regulated entities where number, type and timing of inspections, as well as conformance requirements and sanctions for non compliance are defined (see GLOBALG.A.P., General Regulations, 2012; UTZ Certified, Certification Protocol, 2012). Similarly in the civil aviation case, the IOSA Manual provides for in-depth analysis of the requirements to be implemented by airlines in order to achieve certification (see IATA, IOSA Manual, 2013).

### **Implementation of private standards**

- 121.** A key dimension of process regulation is related to implementation. It is at the stage of implementation that the correlation between governance and process becomes most relevant. It informs and adapts the standards by incorporating existing practices. Implementation of transnational private standards occurs when the global standards need to be applied in order to become binding and produce effects. The implementation of private standards follows very different patterns ranging from incorporation into domestic legislation (payment systems, accounting standards) to inclusion in commercial contracts between private parties (derivatives, food safety, human rights), from adoption of national codes (food safety, advertising) to adoption of MNC compliance programs. In other instances implementation occurs primarily through the specification of monitoring bodies like auditors (accounting) and certification schemes (food safety).
- 122.** Implementation is determined by standard setting procedures and more broadly by the design of the standard. The evidence shows not only variety in instruments of implementation but also different pathways. Some are all within the private sphere,

others include the public sphere. In the latter case the standards are defined by private bodies and incorporated in legislation at regional or national level ( see below). Clearly the evaluation of effectiveness will vary dramatically depending on whether implementation occurs through legislation, administrative activity or private contracting.

TABLE 3. Modes of implementation

Contract	9
Accreditation	5
License	2
Certification and auditing	6
Integration in national standards	9
Other	9

### ***The emergence of transnational private meta-regulators***

**123.** The emergence of private regimes is often characterized by the need to represent different interests within the private sphere. For example in food safety the emergence of retailer-led certification regimes was driven by the objective of taking regulatory power away from producers in order to gain control over the entire supply chain. In some sectors regulatory power is concentrated and we have *de facto* hierarchy with little participation by individual regulated entities. This is for example the case in accounting (IASB), civil aviation (IATA and IFALPA), derivatives (ISDA), professional regulation (IBA, CCBE). In other sectors there is instead more dispersion which may lead to fragmentation (food safety, private services companies). However even in these instances the multiplicity of regimes may not correspond to higher inclusiveness. We observe different degrees of regulatory fragmentation triggering various institutional responses. A first response is the emergence of private meta-regulators defining common rules and facilitating interaction among individual regulators. Private meta-regulators are more likely to operate in fragmented than in concentrated regulatory environments and where International Organizations are absent or weak. We find private meta-regulators in the area of sustainability and in relation to environmental and social standards (ISEAL), food safety (GFSI, GLOBALG.A.P.) less in financial markets, where IOSCO and other public institutions perform this function.

**124.** What is the relationship between the organization of the regulatory space and the emergence of meta-regulators? When private regulators are monopolists or operate within a regulatory oligopoly as for example in the case of accounting or

payments, private meta-regulators hardly emerge. This is, of course, fertile territory for public regulators to act as meta-regulators harnessing or enrolling private capacity for public purposes. The legitimacy challenges are mainly related to ensuring sufficient inclusiveness and interest representation both in the organizational governance and during the regulatory process.

**125. Creation of common principles.** Private meta-regulators define common principles applicable to individual regulators that may be mandatory or voluntary depending on the relationship they establish with their regulated entities. It should be underlined that voluntariness is related to the choice of subscribing to the meta-regime which then becomes binding on the regulator. Meta-regulatory Principles concern standard setting, monitoring and enforcement. They define minimum requirements about the process, the separation of functions, and compliance requirements. A paramount example of private meta-regulator is the International Standard Organization (ISO) that has produced standards concerning standard setting, monitoring compliance and to more limited extent enforcement. In relation to the case studies the research has identified a number of them. In the case of ISEAL members like UTZ Certified have to comply with the codes whereas non-members or observers, can voluntarily commit to comply with the Credibility principles. A second typology of private meta-regulation is that of best practices, as in the case of EASA in the field of advertising. Here, the common rules are distilled from practices of the national SROs in the form of Best Practice Recommendations. Members undertake to uphold the recommended standards in the operation of their self-regulatory systems. In both instances the main driver for compliance is peer pressure and in case of non-compliance is the political pressure and the threat to exclude them that provides adequate incentives rather than legal sanctions.

**126. Other types of private meta-regulators create equivalence rules among different regimes.** Equivalence criteria are established among regimes which perform similar functions in order to reduce costs of regulated entities that operate across jurisdictions. This form of meta-regulation aims at mutual recognition permitting large savings for regulated entities while simplifying effectiveness' evaluation for third parties (e.g. in the case of GFSI). Mutual recognition among private regimes is compatible with a higher degree of differentiation both among organizations and standards than common binding principles.

**127.** When examining mutual recognition it is important to look at the definition of entry requirements to fully understand whether the main purpose is to respond to fragmentation or to create a cartel. The two objectives are not mutually exclusive! The research shows that often the definition of equivalence criteria among similar regimes implies some degree of adjustment by the regulated entities to meet the equivalence standard. Hence, mutual recognition often translates into a modification of regulators' internal practices and sometimes even of their governance when affecting the involvement of stakeholders and other procedural requirements. This is clearly the case for GFSI and for GLOBALG.A.P. Even if mutual

recognition requires changes, the procedures and the objectives are different from those pursued by meta-regulators that aim at harmonizing criteria to evaluate regulatory performance. The comparison between the GFSI, ISEAL and the Fair trade international provides a good illustration of the different institutional responses to fragmentation and the desirability of more intense cooperation among regulators operating in the same or in contiguous fields.

**128. Public meta-rules.** A third variant occurs when public organizations like transnational networks (IOSCO) or international organizations (like FAO or OECD) define common rules for private regulation that self-regulatory bodies have to comply with. A sub-variant takes place when regional organizations like the EU define common principles or encourage private meta-regulators to define them as is the case in food safety certification, payment systems, advertising and civil aviation.

**129.** When do private actors strive for harmonization and when do they prefer mutual recognition with stronger degree of autonomy for each regulator? The research shows that in financial markets there is a stronger drive for harmonization whereas in other fields like professional regulation there is a stronger inclination towards mutual recognition. **A first variable to explain differences across sectors is certainly determined by the objectives of regulation and the nature of regulated risks.** When there is a higher degree of interdependencies of the conducts of regulated entities a stronger level of uniformity might be desirable. But we do not see a uniform pattern in risk regulation (differences are remarkable between financial risk and food safety). **A second factor is related to the homogeneity/ heterogeneity of regulated entities.** Heterogeneity might drive towards mutual recognition instead of harmonization. When only a subset of potential participants aims at having common standards, harmonization is not politically feasible and mutual recognition combines the interests of those favoring harmonization and those privileging the status quo. This is typically the case in professional regulation where often markets are still primarily local and professionals interested in common standards are a minority.

**130.** Organizational models. **Private meta-regulators adopt different organizational models resulting in distinct relationships with regulated entities.** Some like ISEAL and EASA are membership-based associations, others like GFSI differentiate the position of members from that of regulated entities, contractually linked with the meta regulator. **When the meta-private regulator is membership-based and the members are the regulated entities dialogue and cooperation seem to dominate. When the regulated entities (regulators) are not members as in the case of GFSI the obligations undertaken on the basis of individual contracts are binding and subject to sanctioning including expulsion.** Despite the objective of mutual recognition GFSI seems to take a more hierarchical approach in its relationship with scheme owners. **In some instances membership and contracts are combined.** This is the case of the Equator Principles where each EPFI has to sign an adoption agreement with the Association concerning their commitment to abide by the principles.

- 131.** The previous examples confirm the more general finding of a correlation between modes of governance and regulatory instruments' choice and output, which concerns not only individual regulator and regulated entities but also meta-regulators and individual regulators. **The distinction between membership and non-membership related to the individual regulators correlates to the choice between hierarchy and legally binding commitments versus steering and soft mechanisms to induce compliance.** When regulators are members of the meta private regulator we observe more steering than rowing (EASA, ISEAL, ISO). On the contrary when regulators are not members and do not have direct influence on the meta-regulators agenda and governance we observe more legally binding instruments and consequently more hierarchy (GLOBALG.A.P.).
- 132.** How are private meta-regulators modifying in practice the individual regulators' governance and the management? The role of meta-regulators is not limited to the creation of common principles or equivalence criteria, but can provide additional incentives to increase legitimacy of the regulators, especially towards third parties, and improve effectiveness. For example, the codes enacted by ISEAL have generated changes in standard setting practices by its members enhancing their legitimacy. In particular in the case of UTZ Certified there is a clear correlation between the enactment of a Code development procedure and the ISEAL Code of good practice for setting social and environmental standards. As such UTZ Certified had to adopt a set of rules that would result in compliance with the ISEAL Code.
- 133.** Different responses from private meta-regulators may be stimulated by inducing private regulators to engage in *ex ante* impact analysis concerning the desirability of a new standard, its innovative character vis-à-vis existing standards and, in particular, which benefits would regulated entities and third parties gain by modifying current standards. Whereas there are a growing number of regulators engaging in *ex post* evaluation of regulatory performance, we see only a limited number of organizations engaged into *ex ante* impact analysis focusing on the incremental benefits of a new standard. For instance, food safety regimes, accounting regimes, as well as payment regimes include forms similar to *ex ante* impact assessment to evaluate the desirability of new standards; however, the level of depth of their analysis is not comparable to the assessments adopted, in public regulation when deciding on the introduction of a new regulation.
- 134.** The emergence of meta-regulators is reflected also in the development of *ex post* evaluation based on reporting and auditing practices that regulated entities have to comply with. These general criteria vary significantly but we have not seen meta-rules for *ex post* evaluation of regulatory performance. Furthermore there is no correlation between *ex ante* impact assessment and *ex post* evaluation in the relatively few proposals advanced by meta-regulators. While many of these regulators define standards for regulated entities some are moving to the definition of principles and rules for regulators as well. See section below on evaluation.

**135.** Meta-private regulators operate not only in the area of standard setting but also in monitoring compliance and the enforcement. In advertising one of the primary objectives of the EASA is handling cross-border complaints. SROs members of EASA have to adhere to the Alliance's cross border complaints system and commit to cooperate in complaints handling. The EASA cross border procedure defines procedural rules to allocate the claims according to a regime based on the country of origin principle. It is an original example of privately designed international private law regime.

### ***Regulatory instruments: distinguishing between meta and individual regulators***

**136.** It is useful at this point to distinguish between regulatory instruments deployed by meta-regulators to ensure compliance and those used by individual regulators. In the former case the objective is to ensure legitimacy and effectiveness of the regulatory performance, in the latter it is to induce compliance by regulated entities, for the most part individual firms.

**137.** The relationship between meta-regulators (GFSI, ISEAL, EASA, IBA, CCBE) and regulated entities can be designed in different ways affecting the degree of voluntariness and the role of hierarchy. Principles and rules concerning the regulatory process are voluntarily adopted by private regulators but for the case of a membership based meta-regulator where standards are usually mandatory (GFSI, ISEAL). When individual regulators take part in meta-organizations which require compliance as a condition of membership they have legal obligations to adopt and comply with regulatory instruments. In this instance, participation in the organization is a voluntary act but when the regulated entity becomes a member it is bound by the standards. Compliance with them is a legal requirement that creates obligations towards other regulated entities and, to a limited extent, towards beneficiaries. These principles and rules once adopted become part of the organizational rules together with the charters and bylaws. As it is the case with UTZ Certified vis-à-vis ISEAL Alliance Guidance standards where ISEAL codes influence UTZ regulatory process and given the link outlined above their governance as well. It may be observed that non-compliance with meta-regulatory principles by one regulated organization is liable to damage the credibility of them all, and in this sense they are 'hostages of each other' with a collective interest in both the stringency of and compliance with the principles.

**138.** Single private regulators define standards for regulated entities with or without membership. Here, again, there are instances where regulated entities have to abide by those rules (e.g. once they become members they have to comply with organizational standards) and instances where they can freely choose to subscribe to them. In both instances, these rules become binding once they have been



subscribed to. The research shows that adoption is voluntary while, for the most part, compliance is binding ( but see the case of derivatives and ISDA). Sectors do not seem to affect the option between the two alternatives.

- 139.** The contractual nature of the instruments does not coincide with a single typology of relationship between regulators and regulated. While in principle the use of contracts suggests joint decision making on the standards, we see different types of regulatory contracts reflecting a wide variety of regulatory relationships within and across regimes. The majority of regimes does not deploy negotiated standard setting between regulators and regulated. Standards are usually predetermined by the regulator on the basis of a standard setting procedure and are included in standard contract forms by which individual firms are regulated. If one looks only at the contractual side, TPR regimes frequently reflect command and control rather than experimental or reflexive logics. In membership based organizations, the standards may be approved by the general assembly and that is a form of expressing consent. However, given the majority rule, it may be the case that a group of regulatees are bound by the standard even if it votes against its approval. Voluntariness should be seen in the light of the overall procedural requirements set forth by organizational rules as well. Once the broader picture is considered then more reflexivity emerges.

### ***Multiple Actors involved in TPRs : the search for common features in the presence of conflicting objectives***

- 140.** TPR differs from domestic self-regulation along various dimensions. Unlike conventional forms of private regulation, which are primarily organized around particular industries or professions, TPRs frequently include civil society organizations (CSOs). Often the participation of CSOs results in the creation of multi-stakeholder entities whose regulatory objectives become multifaceted. In the field of human rights an example a multistakeholder organization is provided by ICoC, where the governing association, recently created, is based on three pillars (the industry, the governments and the CSOs) which have to be equally represented on the board regardless of their numerical consistency in the general assembly. Even when regimes remain industry or professionally driven, they incorporate values and objectives that also promote interests other than those of the regulated as for example consumer protection in the field of advertising or food safety. For this reason it is often claimed that TPRs pursue public interest objectives.
- 141.** **The presence of CSOs characterizes regimes with a stronger focus on procedural requirements.** Emphasis of procedural requirements is also promoted by the interplay with public entities that explicitly call for inclusiveness, transparency and accountability ( see below). Surprisingly less attention has been (so far) paid by CSO driven regimes to the achievement of the regulatory objectives, which should



be their primary interest, given that they operate as agents of the regulatory beneficiaries. In some instances however as in the case of ISEAL, there is greater emphasis on defining objectives and impact analysis of the standard (see in particular the ISEAL impact Code). A partial explanation may be correlated with the existence of conflicts making the definition of clear objectives more challenging.

**142.** Increasingly regimes are composed of several classes of participants whose objectives might not be aligned. Within the case studies we have organizations that are industry or profession based where multiple interests are represented. Conventionally multistakeholder organizations are those where industry and CSOs, and sometimes government, are represented. We follow this definition but underline that conflicting interests may exist within one constituency like industry as the payment and the food safety case clearly show.

TABLE 4. Parties that established the TPRER (Multiple choice available)

<b>Industry associations</b>	13
<b>National professional associations</b>	3
<b>Multi-stakeholder national organization</b>	1
<b>Public regulators</b>	5 (+4)
<b>CSOs</b>	1
<b>Other</b>	7

**143.** A host of regimes present a well-structured multi-stakeholder feature by including industries and CSOs. For instance, in the food safety regimes, the inclusion of a body composed by stakeholders' representatives is usually included; similarly in the accounting regime a recent development initiated the establishment of an Accounting Standards Advisory Forum. In the field of payment systems, the SEPA Council has been reformed to include relevant stakeholders that had not been sufficiently involved.

### ***Deconstructing the private sphere: conflicts and institutional responses***

**144.** The existence of conflicts within the private sphere affects three dimensions:

- a. They contribute to the definition of the governance regime, its openness, inclusiveness, and overall consistency.
  - b. They affect the definition of regulatory objectives, the solutions to trade-offs, and the allocation of power between local and global level.
  - c. They determine the allocation of regulatory compliance costs among the participants in the supply chain.
- 145.** The transnational private sphere is thus composed of various and often conflicting actors which may give rise to different regimes competing over shares of regulated entities at the global level (professional services, accounting and legal in particular, provide a good example of this competition). These actors represent the interests of regulated entities, of potential beneficiaries and, of parties that may be harmed or deprived of power by the enactment of private standards. The entry of new actors, in particular those representing the beneficiaries, increases interests' representation and internalize conflicts among regulatory objectives in the regimes and their governance. Conflicts not only emerge between industry and CSOs but also, within industries, between firms of different sizes and market shares and between CSOs; in particular the research shows that in many instances in financial markets, food safety, data protection and other areas, the interests of suppliers and retailers might be at odds as are those between large MNCs and SMEs. The latter are often distributional conflicts related to the allocation of costs and benefits that have not been internalized into the standard setting procedures and are solved through bargaining and informal means.
- 146. Conflicts about costs and benefits of regulation.** Transnational private regulation often enacts standards stricter than public ones, often assumed to be the floor. **Stricter standards imply higher costs on regulated entities, which may be distributed unevenly across the regulated entities and between them and third parties.** That is why distributional conflicts not only arise between industries and CSOs, but also between different regulated entities within the same industry over regulatory objectives and the allocation of regulatory burdens. Similarly conflicts might concern the benefits of regulation as in the case of certification where parties along the supply chain have to allocate the added value of a certified good. Often the standard setting body does not engage in direct allocation of costs but the market and the supply chains distribute the burdens. Hence, TPR has huge distributional consequences in terms of cost and benefit allocation, but the criteria are not defined through transparent procedures where contestation can take place.
- 147. Conflicts about scope, territorial and functional.** Conflicts may concern the scope of the standard and the boundaries of the communities that should be affected. Often transnational standards reflect a combination of global standards and local practices which emerge especially at the implementation stage (see above). The combination between global and local standards depends upon the relative strengths of different constituencies among regulated entities. **In markets**

**where the power is concentrated e.g. where there is a niche group of regulated entities, regulators tend to produce global standards and pay relatively little attention to the role of local private standards (derivatives market). On the contrary, when markets are regional and power is dispersed e.g. there is a large number of regulated entities, local standards play a more central role (professional services).** This emerges quite clearly in professional regulation where a global market for services is relatively underdeveloped compared to that of goods; global standards but for a few exceptions are generally principle-based and very generic while rules are produced at regional or domestic level. Clearly this is not the case when professional standards are technical standards. However, even in professional regulation together with advertising (the closest to local regulatory frameworks), there is a tendency to move the definition of some rules and principles to the intermediate level (Europe).

**148.** The emergence and consolidation of transnational regimes follows different patterns depending on whether they are industry or CSO driven, or from the combination of different stakeholders taking place within the organization. But even within industry-driven regimes it is hard to detect a single pattern; the main drivers for the creation of regimes differ as well. In some instances there is a strong technical component associated with professional expertise (lawyers, accountants, engineers), in other instances the emergence of a regime is determined by the need to reduce transaction costs for regulated entities (data protection, payment systems, food safety); in others by the necessity to preserve collective reputation (advertising and food safety). Hence it is difficult to cluster regimes according to the primary constituency that has promoted their creation. However there are some characterizing governance features that emerge depending on the identity of the dominant constituency and the presence or absence of CSOs.

**149. How do conflicts affect governance and regulatory processes?** Differences in patterns of interests influence both governance and process requirements of individual regulators. **Conflicts with the private sphere arise both in relation to governance and to process regulation but they should be kept distinct.** Inclusiveness, transparency and participation have characterized the evolution of process regulation while they have not radically modified organizational governance in industry-led models. CSO-led models, instead, have evolved towards wider representation of interests both in relation to organizational governance and regulatory process.

### ***How do conflicting interests in the private sphere affect power allocation in multilevel structures?***

**150.** Objectives of different private constituencies often differ also along jurisdictional boundaries. TPR is also about distribution of power among private actors. They have

different strategic preferences driven by the position they occupy in global value chains and within financial institutions. Power dynamics and allocation of regulatory power between the national, European and global level reflect the conflicts between those who favor uniform private rules and those who privilege local specificities, because they operate primarily in local markets or are underrepresented in governance bodies. For example, in payment systems and accounting there have been conflicts among regulated entities between large firms and SMEs, often represented by national trade associations. Conflicts also concern private actors located in mature economies versus actors located in emerging or recently emerged economies. The allocation of regulatory power at different levels may depend on the power shares of these two components, which may be reflected in preferences over alternative regulatory strategies: harmonization versus mutual recognition (see above p. 00). Similarly in the field of professional regulation allocation of regulatory power may be a function of the conflicts between professionals operating at local level and those involved in service supply at transnational level. Here again we observe tension between alternative regulatory strategies and in particular harmonization and mutual recognition.

- 151.** In industry-driven models the regulatory governance reflects, by and large, the allocation of economic power among regulated entities and the conflicts between them. We often see tensions or conflicts between large MNCs and national or local trade associations representing primarily SMEs interests. These conflicts concern the definition of objectives and the allocation of regulatory power across jurisdictional levels. MNCs often favor a centralized model whereas SMEs privilege a decentralized one. They influence the allocation of costs for regulated entities as well. We find these conflicts in payment systems between large multinational banks and national trade associations, in advertising between national SROs and big enterprises, especially internet service providers, in professional legal regulation between global and domestic law firms and the national bar associations, in derivatives markets between banks and end users, the buyers of derivatives.
- 152.** Slightly different types of conflict characterize areas like food safety, where regulatory design implicitly encompasses allocation of costs along the supply chain. Here, there has been a powerful redistribution of regulatory power due to market concentration at the retail level. There has been a shift from producer to retail regulation with significant power and wealth transfers from producers to retailers. It is an example of influence of the market structure over the allocation of market power reflected by the distribution of regulatory power. It is often the case in TPR that the distribution of regulatory power reflects that of economic power.
- 153.** CSO-driven regulatory regimes are not homogenous. Although the choice of case studies has not included specifically hypotheses of organizations with multiple and conflicting CSOs it is worth including them in the picture. In CSO-driven organizations, conflicts may arise between different approaches towards human rights, environmental or consumer protection, which translate into selection of

regulatory objectives and their priorities, for example, the trade-off between agricultural efficiency and environmental protection in food safety regimes, or that between electronic commerce and data protection. Increasingly CSO driven organizations and multi-stakeholder regimes pay closer attention to the distribution of regulatory burdens among regulated entities. Entry to the regime may be associated with different requirements according to the financial and technical capacities to meet the standard and the time span to reach full compliance may be differentiated depending on the firms' status at the time of application. These differences may translate into an allocation of costs that reflect differences in size and/or geographical origins of regulated entities.

- 154.** Standards, especially those related to sustainability, try to integrate environmental, social and safety dimensions but do not address potential conflicts especially when resources are limited and priorities need to be assigned. For example, the extent to which individual firms or their supply chain should be considered as the unit of analysis has huge distributional implications related to costs and benefits' allocation. The research reveals that stakeholders representing social interests are those who most favor a supply chain approach, whereas other constituencies have a less strong view about defining the impact of suppliers in multinationals' policies implementation and focus on individual firms rather than supply chains.

### ***How conflicts within the private sphere affect governance and process regulation?***

- 155.** Comparatively there are different dynamics related to conflicts depending on the maturity of regulatory regimes:
- a. One evolutionary pattern, reflected in food safety, other things being equal, suggests that the initial phase is characterized by a higher degree of conflicts over the allocation of regulatory power, giving rise to regulatory fragmentation and to some degree of overlap among regimes. Later it evolves into mutual recognition
  - b. A different evolutionary pattern reflects the market composition of regulators. When, as it is the case in accounting and derivatives, there are a few players and they reach an agreement among themselves, competition is limited and conflicts emerge during the implementation stages when local specificities have to be taken into account.
  - c. A third pattern which we find in advertising shows how a settled compromise between different players in the advertising, media and producers industry has been recently destabilized by giant Internet providers entering the advertising markets. The changes in the industry and technologies have

contributed to redefine the objectives of private regulation and the relationship between transnational private regulators and the States.

### ***The voluntary nature of private standards in complex regulatory environments: rethinking legitimacy and effectiveness***

**156. Standards in TPR are predominantly *de jure* voluntary.** They can be made available for free or for sale. As a result, regulated entities are in theory free to adopt them; once adopted they are free to stop using them, to exit the current regime, and move to a different one. However, once a standard has been subscribed to, the regulated entity is bound to comply. Adoption may be an individual choice or be made a prerequisite to become member of an association. In the latter instance voluntariness concerns the choice to become a member but membership is correlated to the subscription of the standards produced or endorsed by the regulator.

Table 5. Voluntary nature of TPR standard

The numbers concern the origin of the standards. Some of them become mandatory via incorporation by or endorsement of public institutions. But we shall deal with the latter issue in the following part of the report

Voluntary	22
Mandatory	2

**157. Voluntariness affects both legitimacy and effectiveness of TPR.** Voluntariness permits regulated entities to signal their appreciation and/or to express their dissatisfaction by using voice and exit options. The choice of opting into the regime clearly provides legitimacy via consent. Freedom to exit also reinforces the voluntary nature of the standard. **The legitimacy of voluntary standards is therefore mainly based on consent, whereas that of mandatory standards is grounded on formal authority.** But voluntariness also affects effectiveness. Given the voluntary choice to opt in, incentives to comply should be assumed to be relatively high. Whereas, when mandatory standards are in place incentives to comply have to be engineered by the regulator.

**158.** This is true in theory. However, the research shows a divergence between standards *de jure* voluntary, but *de facto* mandatory or at least where choices are severely constrained. In many instances **the regulatee's freedom to choose both (1) whether to opt in or to stay out and (2) to participate in the standard setting, is**

**limited** since many private standards have become a channel to enter a market of goods or services which makes their adoption quasi mandatory. Refusal to subscribe results in the inability to access the market. This is true for financial standards like accounting and derivatives, for food safety standards in relation to certification, for human rights standards in relation to procurement policies, for safety standards in civil aviation, and for professional regulation to exercise professional activities at the transnational level.

**159.** Limitations on voluntariness are even stronger if one shifts the attention to the regimes' potential beneficiaries. On the one hand they constitute one of the major driver for the creation of new transnational private standards; on the other hand the agency relationship with the governing bodies suffers from severe limitations and the power of the principals (the beneficiaries) to express their preferences and control the agents (the regulators) is disproportionately low. Consumers, investors, human rights holders have a very limited say in both the definition of objectives and in the selection of the regulatory instruments to pursue their interests. Limits to voluntariness force us to rethink the sources of legitimacy and the incentives' structure of regulated entities. Different institutional responses are needed to protect voluntariness related to (1) the entry/exit of regulated entities, (2) to the participation in the standard setting, and (3) the implementation process by affected stakeholders.

**160.** Limitations to voluntariness are determined by the power allocation among regulated entities that operate in the relevant markets and by the objective of re-allocating regulatory burdens and costs among regulated, and between them and third parties. Often distributional consequences are not negotiated but simply imposed on certain groups of regulated entities without their consent. A response to these limitations is the introduction of governance rules, which expand members' protection giving them a voice in the regulatory process (voting or veto power) or imposing constraints in the standard setting procedure. However, this constitutes only a limited response since it neither protects the freedom of choice related to entering a regulatory regime, nor does it address the freedom of those who are affected by the regulatory choices without being members of the organization setting and/or implementing the standards.

### ***The interaction between contractual and organizational features of TPR and their effects on voluntariness***

**161.** The current regulatory instruments are often premised on the voluntary nature of the standard but do not explicitly address questions related to the nature of consent by regulated entities and their effective participation in the standard setting and implementation process. Neither do they address the consent of the affected stakeholders and the instruments they can exercise to negotiate over negative



externalities produced by the standard. The practices show that most standards are not negotiated with regulated entities. The role of regulated entities emerges only by looking at the governance structure when they have membership and exercise voting power, approving or rejecting the standard. However in large organizations individual voting rights represent a very limited tool to protect voluntariness and ensure legitimacy. Transaction and coordination costs reduce the ability to have an impact on the decision.

**162.** The research shows that regulated entities are composed by heterogeneous communities with different, at times, conflicting interests. Current regulatory instruments often do not fully take into account such diversity and do not adequately prevent the emergence of conflicts. Two main tools have been used to address this problem:

- a. changing interest representation within the organization by having different 'chambers';
- b. differentiation of thresholds in standards among regulated entities based on different firms' capabilities.

The existence of conflicts and the instruments deployed to address and solve them influence the legitimacy of the regime. As repeatedly suggested conflicts are part of the physiology of regimes which want to internalize external effects. Yet their emergence and solutions does affect the degree of legitimacy.

**163.** The boundaries between inside and outside the organization do not represent the line between legal and non-legal instruments to ensure choices and express dissent. Being outside the organization and without membership does not imply lack of legal protection but simply a different, albeit generally weaker, protection. On the other hand outsiders affected by standards tend to use non legal instruments like social and market pressure to influence the agenda and the standard setting process and once standards are approved to affect their implementation.

**164.** The legal position of regulated entities vis-à-vis membership is relevant but it is not the only variable affecting voluntariness. First, it is often the case that there are complex regulatory chains that include multiple levels of standards' definition. **The structure of the regulatory process is the result of the interaction between multiple organizations whilst membership is limited to only one of them.** The regulated, even when they have membership, rarely have full control over the entire process. When regulators are multilevel, as it is often the case, regulated entities participate to one level. If they are part of the transnational level they have little control over the implementation process. If they are at the local level they have little control of the standard setting process.

**165.** Moreover, it is also important to specify how participation in the standard setting process is defined and consent is given. A deeper analysis of regulatory



instruments and organizational rules shows that **voluntariness only affects the choice of subscribing to an existing standard, as individual participation in the standard setting process by each of the regulated entities is low or non-existent.** Hence, the degree of real consent when choosing to opt into a regime is limited. Often, the exit option is much more effective, especially when it is exercised by significant number of participants.

- 166. If regulated entities lack control and oversight power, the situation is even worse for regulatory beneficiaries, which have fewer legal tools and rely heavily upon non-legal mechanisms to express consent or dissent towards the standards and its modes of implementation.** Consultation has been broadened, yet ex ante stakeholder mapping and a proactive approach is promoted only by a few organizations (see ISEAL Impact Code). Market and social institutions contribute to ensuring compliance affecting the regulated incentives, to monitor and detect violations and sanction them with non-legal sanctions. While they differ across sectors there is certainly a common thread that characterizes TPR: they have increased numerically and so has their relevance in the regulatory process.

### ***The influence of public actors over the voluntariness of private standards***

- 167.** So far we have considered how the existence of multiple interests within the private sphere with asymmetric allocation of decision making power may affect voluntariness and in turn legitimacy of the standard and more broadly the entire regulatory process. A second important factor affecting voluntariness is related to the intervention of public actors preceding or succeeding the enactment of the standard. In some instances, private standards are produced on the basis of formal delegation by public entities; in other instances they are incorporated into legislation or into administrative acts thereby becoming mandatory for regulated entities. They certainly remain private since private actors have produced them through private law instruments, but their voluntary nature is modified by public intervention. These changes affect both the sources of legitimacy and the incentives to comply. We find numerous examples of subsequent validation/incorporation by public institutions in the research from accounting to private security companies (in public procurement), from aviation (through memoranda of cooperation between ICAO and IATA, such as on the sharing of data between IOSA and USOAP, or formal recognition by ICAO as in the case of field guide in its technical instructions, e.g. DGR) to data protection (BCR validated by Data protection agencies), from food safety to professional regulation and payment systems (European regulations/Directives as well as Commission Communications and Resolutions).
- 168.** A different type of private standard is that produced by private actors on the basis of a formal delegation by public entities. The existence of a formal delegation

can make the standard mandatory from the inception. As the example of technical standard suggests, formal delegation does not necessarily transform a voluntary into a mandatory standard, but clearly the degree of public 'influence' is higher than that of ex post endorsement or incorporation. This is an example of private standard that is never characterized by full voluntariness; accordingly its legitimacy and effectiveness have to be evaluated following a different metric. Formal delegation is very rare and falls outside the scope of the analysis in the Report.

- 169.** The influence of the public sector in relation to the voluntary nature of the standards is not limited to standard setting. A powerful driver for the adoption and compliance with private standards is represented by due diligence to ensure compliance. In many instances, criminal or civil liability is limited or even excluded when there is compliance with private standards stricter than public standards or which demonstrate detailed compliance with a general principle, such as the obligation to market only food that is safe. Due diligence is stimulating not only the creation but also the harmonization of private standards in order to provide third party assurance organisations, public regulators and inspectors and also judges with reasonably manageable guidelines when evaluating compliance. We find reference to due diligence in food safety, civil aviation, data protection, private security and many other fields related to corporate social responsibility.

### ***The bindingness of the standards and their enforcement.***

- 170.** The voluntary nature of the regulatory instruments does not imply absence of binding force. The research shows that adoption is *de jure* voluntary while for the most part compliance is legally binding (for example, see the explicit statement in art. 5.b Equator Principles association). Most are enforceable instruments before domestic courts and/or private dispute resolution bodies. In some limited cases they are not immediately legally binding and compliance is primarily ensured either by including them in *commercial* contracts or by using reputational sanctions. Most disputes among the regulated are addressed before internal bodies, whereas disputes affecting third parties are more likely to be litigated before domestic courts but there exceptions as the case of advertising and professional regulation, at least to some extent.

- 171.** The binding nature of the commitment to comply with the standard by the regulated entity should not be considered as a limitation to voluntariness when the regulated entity has opted into the regime or has firmly committed to abide by those rules. Mandatory compliance reinforces the voluntary nature of the standard and it conforms with the general principle of *pacta sunt servanda*.

- 172. Incorporation in commercial contracts of regulatory instruments.** In some instances, their legal enforceability is indirectly ensured by incorporation into contracts that make references to the standards (see for example art. 26 ICC

Consolidated Code in relation to advertising). In the latter case third parties may be bound or be granted rights by the Code. The provision of enforcement mechanisms is associated with rules defining the enforcement power, due process guarantees, principles concerning sanctioning and the enforcement of sanctions.

### ***Multiple enforcement mechanisms and their coordination***

**173. Binding standards require enforceability.** Private standards are today enforced via multiple mechanisms: within the ordinary courts and administrative enforcement structures, in the private domain private dispute resolution bodies and through arbitration. Many regimes are now equipped with their own enforcement mechanisms shifting towards an approach that mirrors the conventional regulatory pattern in public regulation. The enforceability via private enforcers or via administrative or judicial domestic enforcement not only makes compliance mandatory but increases effectiveness of regimes by providing additional incentives. The increase and strengthening of legal instruments has not reduced the importance of non-legal mechanisms in particular those market-related.

Table 6. Internal and external enforcement mechanisms

<b><i>No monitoring</i></b>	6
<b><i>Yes - Internal</i></b>	5
<b><i>Yes - External</i></b>	9
<b><i>Yes – both</i></b>	4

**174. Multiplicity of enforcement mechanisms require coordination:** both temporal and functional. Temporal coordination might require the definition of sequences whereby one enforcement mechanism is given temporal priority over the others. Functional coordination may require distinctions concerning the type of dispute, the procedure, the content and nature of sanctions (e.g. the combination between legal and non-legal). The problem of coordination is not limited by the necessity to integrate private dispute resolution bodies with public enforcers because it is exacerbated by lack of coordination between public national enforcers. Regulatory cooperation operates rather well for standard setting much less so for enforcement when independent regulatory agencies exercise enforcement powers including those related to transnational private regimes. To make things even harder at times coordination between administrative and judicial enforcement related to the enforcement of private regime is lacking even at national level. Cases concerning

financial systems, accounting, food safety show that at national level administrative enforcement generally comes first and it is followed by judicial enforcement. Coordination with private enforcers differs depending on whether it is centralized (as the majority of instances) or decentralized, as for example in the sector of advertising where EASA maintains only a function in cross-border complaints.

- 175.** In many instances the private regimes include enforcement mechanisms and sanctions legally enforceable directly by the private regulator, by third parties or by the courts at domestic level. In some instance the regulator delegates enforcement policies to individually regulated entities obliging them to adopt grievance mechanisms available for third parties (see art 12 of the ICoC Charter in private service company, binding corporate rules in data protection). The regulator defines in its statute, charters or in the codes of conduct the general principles while firms have to adopt specific grievance procedures generally for the protection of third party rights. It receives claims from third parties about the adequacy of grievance procedures, it collects best practices among different grievance procedures. When adopting these procedures they have to define criteria to discriminate between substantiated and frivolous claims and provide claimants a forum if they claim that the procedure does not meet minimum due process requirements and provides effective remedies.
- 176.** The allocation of tasks between public and private enforcers was based on the idea that internal disputes between regulator and members and among the latter would be decided by the enforcer whereas disputes involving third parties were left to public enforcement with some significant exceptions (advertising). These arrangements are changing to some degree. The model outlined above suggests that in the private sphere third party disputes are also resolved privately but at the level of individual regulated entities. The enforcement aspect of the regulatory regime decides disputes with regulated entities and between them. Individual firms decide disputes with third parties according to the rules drafted by the regulator. In the case of data protection the rules by individual firms have to be drafted according to principles outlined in public legislation or soft law.
- 177. Collective redress.** A second important factor concerns collective harm and collective redress. Despite the collective nature of the harm caused by many infringements of regulatory provisions, collective redress is generally not regulated in TPR. When a standard's violation causes harm to many victims claimants have to act individually and no private collective redress procedures have emerged.

### ***Sanctions and enforcement by private bodies***

- 178.** Private dispute resolution bodies use their sanctioning system. Often it is inspired by general principles including proportionality and effectiveness of remedies. Sanctioning by private enforcers is based on two different interacting

logics: deterring unlawful conduct and regulating membership. Sanctions may at the same time prevent (injunctions, pre-clearance) or react to violations (warning, corrective action, private fines) and affect membership. The latter is often based on an escalating system that starts with alarm or warning, continues with temporal suspension of membership and ends with expulsion and termination ( see GLOBALG.A.P. general regulations part. I art. 6.4 describing the sequence warning, suspension, cancellation). The two types of sanctions often interact ( see for example art. 11.2.7 Charter of oversight mechanisms of ICOC where the board can first ask for corrective actions and in case of inaction suspend or terminate membership). Escalating sanctions is associated with the gravity and seriousness of the infringement and its frequency. One of the most significant difference between private and public enforcement is the relevance of repeat violations and the ability to

- 179.** Private regulatory instruments like codes of conducts or guidelines are usually legally binding tools, albeit heavily relying upon non legal mechanisms to ensure compliance, to monitor behavior and to sanction violations. Naming and shaming and more broadly the use of reputational sanctions that trigger the business and social communities' reactions are commonly used. Food safety and advertising constitute good examples of the high relevance of non-legal sanctions. Reliance on market mechanisms to enforce standards clearly emerges in advertising where deception once detected is severely punished by consumer transactional choices. Similarly, in food safety the discovery of food hazards has relevant effects on the marketability of the individual product with serious effects on similar products when the consumer cannot differentiate safe from dangerous products ( see the recent horse meat case where reputational sanctions were used much earlier than legal ones). Such discoveries also affect the potential for trade in food products and may extend beyond the particular product to adversely impact food exports from particular countries. Less distinct effects of market control emerge in financial markets where the role of financial intermediaries may mitigate investors' reactions to failures of private regulatory instruments. Yet, the relevance of market mechanisms to ensure compliance and detect failures cannot be neglected.
- 180.** Incentives to comply are produced not only by the threat of legal sanctions but also by market and social mechanisms that penalize those in breach. Reliance on social mechanisms, especially media and community pressures, is of utmost importance in the area of private regimes designed to protect fundamental rights but play also a significant role in advertising, food safety and corporate social responsibility. They range from reputational to membership sanctions based on peer monitoring or third party intervention. Making violations known can have economic repercussions ranging from consumer boycott to refusal to invest or provide credit. Social mechanisms operate also in professional regulation where reputation is distinctly valuable through naming and shaming triggering market sanctions.

- 181. What is thus the relationship between legal and non-legal sanctions? Are they alternative or mutually reinforcing?** We have not detected relevant forms of crowding out where effectiveness of legal sanctions has been reduced by the use of non-legal mechanisms. On the contrary we have, in some instances, observed a **mutually reinforcing interaction between different sanctioning regimes**. This reliance suggests that both legitimacy and effectiveness, in particular compliance, are based on the complex interaction between legal, market and social mechanisms. However the institutional design that should maximize such mutually reinforcing effect is often weak. Functional coordination lacks producing at times under deterrence and at times over deterrence.
- 182.** Hence, the binding nature of TPR is ensured by the concurrent operation of multiple enforcement mechanisms based on different sanctions and sanctioning policies. The research shows that enforcers using legal sanctions are aware of the potential effects on market and communities and use quite deliberately an escalating strategy that internalize social and market effects.
- 183.** One of the most relevant weaknesses of private enforcement mechanisms is represented by **non-compliance with sanctions issued by private enforcers**. When parties, regulated entities, have been sanctioned and do not comply with the sanction it is hard for the enforcer to ensure compliance. Clearly the entity can be expelled from the regime and its membership terminated. This effect would not however compensate the victim. Often the enforcement of sanctions administered by a private regime needs the intervention of courts. If lack of compliance constitutes a breach of contract domestic courts can enforce the sanction as a remedy for breaching the contract between the regulator and regulated entity.

### ***Complementarity between public and private actors in transnational regulation***

- 184.** In this section the relationship between transnational public and private regulation is addressed to analyse the function of the distinction in light of the increasing cooperation between international organizations, states and private regulators. In particular is TPR an alternative or a complement to international public regulation? **The research shows that public and private regulators are mainly complementary rather than alternatives**. TPR regimes operate within institutional frameworks where domestic private law and courts are active. The complementarity takes different forms. It is primarily characterized by informality, but the roles of public and private institutions are very context dependent. The existence of strong and effective IOs is often combined with multiple private institutions whereas lack of IOs or multiplicity of public bodies, as in financial markets, generates consolidation in the private sphere. In some instances, as in the case of civil aviation, there is

institutional concentration of power on both sides and a significant degree of cooperation.

**185.** Complementarity may be evident not only in standard setting but with multiple regulatory functions including monitoring and enforcement. We find interaction between public and private regulation at the international level translating either in forms of coordinated standard setting, with formal or informal features, or forms of delegation to private actors concerning rule-making, monitoring and enforcement. Such coordination emerges for different reasons: complementing competences, improving effectiveness and compliance and enhancing legitimacy.

**186. Complementarity does not coincide with hybridization. Hybridization does not cancel the public-private distinction.** There is an ongoing debate over the differences between public and private regulators at the international level. Many believe that hybrids have become the predominant feature of transnational regimes and that the distinction public/private does not play a heuristic function. Whereas it is clear that there is a consistent trend towards new forms of collaborative regulatory governance where public and private actors cooperate, many of the investigated regimes preserve distinctive characteristics. The findings show that TPR enshrines specific features from those deployed by international organizations and by treaty based regimes. The nature of the standard (voluntariness), the relationship between regulators and regulated, the governance through private law forms ( association, foundations, non profit corporations), the lack of immunity from liability, the use of regulatory contracts, and the limitations of judicial review represent distinctive features of TPR. As showed TPR is still primarily regulated by domestic private law whereas IOs are governed by international law which is not directly applicable to transnational private bodies. **We therefore conclude that complementarity does not eliminate, rather it transforms the public-private distinction.**

**187. The distinction between the public and private concerns actors, instruments and effects.** Oversimplifying : within private regimes the main actors are industry and CSO while in the public regimes it is IOs and transnational networks. In respect of instruments in the private sector we find codes of conduct, guidelines, regulations; in the public sector we find hard law instruments such as treaties, conventions, legislation; in relation to effects in the public sector we have binding effects on citizens, whereas in the private sector effects are limited by the privity principles to the members of the signatory organizations. These distinctions become much more nuanced and trickier when the comparison moves to soft law. Whilst the differences between actors remain those concerning instruments and effects blur. Nominally public organizations enact codes of conduct and guidelines as private actors do. Soft law subscribes to the voluntary approach similar in character to private standards. The open issue is whether they have the same legal nature, e.g. private law instruments or they are subject to public international rules.



- 188.** Even when public and private actors participate, differences in instruments and effects make the public/private distinction relevant at transnational level. Clearly the challenges to the conventional partition are represented by new instruments not easy to reconcile with conventional domestic private law tools like contracts and property rights (see above). A clear example of such challenge is provided by **memoranda of understanding** used to define framework rules between international organizations (OECD and ILO) between international organization and private organization (OECD and ISO, IOSCO and IASB, ICAO and IATA) and between private regulators (GFSI and GLOBALG.A.P.). Memoranda constitute instruments of regulatory cooperation (see OECD 2013). Their content differs but the main features recur regardless of the status of the signatories. Similarly challenges come from the growing use of codes of conduct and guidelines by International organizations.
- 189.** More specifically the differences between public and private regimes concern governance and regulatory processes. In relation to governance, for example the often overlooked distinction between trans-governmental networks and private associations composed of national federations remains. Networks of national public regulators like IOSCO may use the associational form but their decision making process and the implementation of their rules is grounded on national administrative laws. When financial domestic public regulators have to implement IOSCO guidelines they will have to follow their domestic laws. The national regulatory agencies, members of the networks are not deemed to have undertaken a legally enforceable obligation to implement the network guidelines. On the contrary, when private regulators organized via federal associations like CCBE or IBA in the legal profession have to implement their decisions at national level, they use the law of association of both the country where the federal association is incorporated and those of the national associations where implementation takes place.
- 190. Private standards are voluntary whilst public standards are usually mandatory.** Private standards are *de jure* voluntary while public international law standards are usually mandatory. This is generally true for hard law. Moving from hard to soft law changes the pictures. Soft law standards are usually not mandatory and States are in principle free to adopt them. The effectiveness of soft law and informal law has proven to be at times higher than hard law but the relationship with private standards differs. Private standards are not necessarily stricter than soft law standards and when states decide not implement soft law private bodies are not legally bound. When public standards are incorporated in soft rather than hard law instruments, private standards may not necessarily be bound by soft law, although in many instances they do not make a difference between hard and soft law instruments. The dynamics between hard law and soft law with TPR cannot be captured in single pattern as it is the case for hard law and TPR.
- 191.** The voluntary nature formally characterizes transnational private standard setting with the significant caveats emerging from empirical evidence. The non-



binding features of soft law imply that states are generally not legally bound by these recommendations. Increasingly, however, there is recognition that they produce relevant legal effects. However, there is an important difference when it comes to compliance. In general, compliance is mandatory in TPR, while it remains voluntary in relation to soft law. We therefore believe that important differences exist between public international soft law and private transnational regulation. As we shall see, the interplay between TPR and public international law changes depending on the legal instrument used in the public sphere.

- 192. What are the main differences between public (hard) and private in relation to regulatory processes? Transnational private standards are usually stricter than public standards.** Public hard law international regimes are considered minimum mandatory standards; private regimes often adopt stricter standards or focus on implementation and compliance monitoring. Such a relationship implies that the public standard, where it exists, constitutes the common basis, which may lead to regulatory competition between private actors proposing stricter standards as it has been the case in food safety regimes. Public standards define a floor and private standards go beyond adding requirements or calling for more rigorous compliance programs. Codes of conduct and guidelines often explicitly include rules that impose compliance with international and domestic laws ( example in food safety, data protection, ). The relationship between public and private might change when international public rules are issued via recommendations or guidelines with no binding effects on the states ( soft law). When specific references are made in the codes of conduct that private standards shall not limit or alter the applicability of international law both hard and soft law are meant to be included.
- 193.** A second difference concerns the content of the standard rather than its strictness. In several instances the private regulator is responsible for providing technical standards that specify the principles defined by the public organization. This is nowadays the case between ICAO and IATA in civil aviation. Similarly, in financial market regulation there is cooperation between IOSCO and IFRS in relation to financial reporting. In this collaboration the role of the ISO varies. In some circumstances the private regulator builds on ISO standards, in other instances it develops autonomous technical standards, like in the derivatives market and the development of the Master Agreement and the Model Netting Law which many public regulators adopted.
- 194.** The differences constitute the basis for complementarity. **We have identified different patterns of complementarity: cooperation and competition, vertical and horizontal, formal and informal.** The first concerns primarily the relationship between actors, the second the geographical and jurisdictional scope and the third the instruments deployed. There is increasing interaction between public and private actors and, within the private sphere, between private actors regulating conducts at transnational level. **These forms of interaction are often characterized**

**by cooperation, sometimes by competition.** They are dynamic and the position of players changes over time: sometimes private actors lead and public follow, other times it is the opposite. The research shows that transfers of power or different combinations have taken place over time especially in the financial markets but also to a significant extent in food safety and in corporate social responsibility.

- 195.** The examples of civil aviation in the past, and food safety in the current situation show that member states, or at least a relevant group, has been skeptical towards private standard setting stimulating IOs to produce their own standards or to exercise direct or indirect control over standard setting. Cooperation was reached in civil aviation after a relatively long period of competition and some degree of mutual uneasiness. But even after the MOU between IATA and ICAO competition continued and coordination has not always been smooth as the relationship between USOAP (1999) and IOSA (2001) standards shows. Similarly in other areas like derivatives, accounting or food safety private standard setting, especially when it is exclusively industry driven is seen with skepticism. Cooperation is the outcome of a process which is often not linear and includes some degree of competition.
- 196.** Variations of public/private interactions occur depending on whether private standards emerge on the basis of existing international public standards or where legislation is purely domestic and no public international law is in place. In the first instance private regulation specifies or increase the strictness of an existing harmonized standard. In the latter case TPRE contributes to harmonization and may be stricter than some domestic regime and laxer than others. With the multiplication of soft law standards, which are in principle not mandatory, the relationship between public and private has become more complex. TPR often implements public soft law standards thereby increasing their effectiveness or supplies the detail required to make principles-based regulation effective. For example, FAO sustainability standards in SAFA (2013) or other guidelines are implemented via commercial contracts. The Ruggie principles (2011) are simultaneously implemented by states, private regulators and gatekeepers, see for example the strategic plan in the UK read in conjunction to the more recent law society endorsement of the principles. The principles are directly implemented through incorporation by reference via contracts between the lead firms and its suppliers. Similarly the ICOC principles are implemented in procurement contracts regulated by domestic legislation.
- 197.** As mentioned TPR operates more often as a complement rather than as an alternative to public international regulation, including both hard and soft law. But for the reasons just outlined complementarity changes depending on whether public international law is hard or soft. Unlike in the domestic realm, where self and co-regulation have been in the past characterized as an alternative to public regulation, this is unusual in the transnational setting. But what form does complementarity take? We have identified two main patterns of complementarity related to the jurisdictional scope of the regulators. **Complementarity operates at horizontal**

**levels between transnational private regulators and international organizations, and at the vertical level primarily between transnational private actors and nation states.**

- 198. Horizontal complementarity** occurs when regulators complement each other at the same jurisdictional 'level' by coordinating their activities implicitly or explicitly, formally or informally. Examples can be found in civil aviation between IATA, IFALPA and ICAO, in accounting between IOSCO and IASB, in food safety between FAO and GFSi, FAO and ISEAL, and in project finance between the Equator Principles Association and the International Finance Corporation (IFC); at the regional level between the EU Commission or EU Agencies like (1) in the case of advertising between EASA and the EU Commission, (2) in the case of payment systems between EPC, SEPA, the EU Commission and the ECB, (3) in the area of food safety between certification schemes and the EU Commission.
- 199. Vertical complementarity** operates when, for example, transnational regulators set standards at the global level which are subsequently implemented by public legislation or by administrative agencies at domestic or regional level. There are numerous examples of EU legislation incorporating in different ways transnational private regulation. This is the case in accounting, derivatives, food safety, private services. In the field of financial reporting the endorsement procedure of accounting standards by EU constitutes a clear example where the EU Commission prepares a draft endorsement regulation on the basis of EFRAG advice and SARG opinion; at the global level divergent implementation by financial market authorities of IFRS standards has stimulated a recent agreement, where the transnational financial network IOSCO ensures cooperation by its members in addressing divergent implementations and ensuring uniformity of international financial reporting standards (IFRS). Whenever ISO technical standards are integrated into these regimes there are clear cases of vertical complementarity with adoption by domestic legislation. Symmetrically, there is vertical complementarity when compliance by regulated entities with international public standards is monitored at the local level by private organizations like certification schemes. Another form of complementarity occurs when national courts enforce international private standards at domestic level.
- 200.** Private standards develop differently depending upon the degree of harmonization of mandatory standards in the public domain. When, for instance, public standards are uniform there is some degree of uniformity at the international level (food safety regulated by Codex Alimentarius Commission (CAC), financial standards regulated by IOSCO). However uniform standards are often implemented differently creating regulatory fragmentation. At the regional level private standards often differ, giving rise to some degree of regulatory competition ( accounting, food safety in the early stages, data protection). When public standards diverge at the national or the regional level (data protection, security, accounting, payment systems, derivatives, professional services, advertising), private standards tend to be

more homogenous, promote harmonization and reduce transaction costs determined by legal differences in the public local domain. TPR tries to have institutions devoted to uniform interpretation that can address and possibly correct divergences. This is not to say that local practices implementing private regulation do not diverge. We can then identify a pattern of complementarity where there is a combination between factors that push towards harmonization and factors that stimulate differentiation.

- 201. Forms of complementarity.** Complementarity can result in explicit coordination. Coordination between public and private regulators in standard setting may take different forms; it can translate into a set of principles steering the activities of each private regulator, the definition of a strategic plan for cooperation, a joint standard and/or coordination of monitoring and auditing techniques. It can be also the outcome of a new public-private partnership or the result of an agreement between two or more organizations. Cooperation is a form of coordination between public and private that can take contractual or organizational forms. There are multi-stakeholder organizations including public and private actors that jointly set standards as is the case for the Biofuel Round tables or the Sustainable Soy Round Tables (SSRT) the ICoC private security service providers' association, the Council for globalized aircraft de-icing standards (composed by ICAO, IATA, SAE in civil aviation). There are forms of contractual' cooperation in the financial markets where under the IOSCO umbrella public and private regulators define common standards or when IOSCO and IFRS on the basis of the MoU cooperate to improve international financial reporting standards (Statements of protocols for cooperation on international financial reporting standards, September 2013). Similarly forms of cooperation occur in civil aviation between ICAO and IATA as in the case of sharing information about safety. Other forms are used in the area of food safety between FAO or IFAD and private organizations including both MNCs and civil society organizations. We have modes of cooperation in many areas outside the scope of the case studies in technical standards (ISO and OECD, ISO and ILO) and in respect of the environment and in the area of corporate social responsibility.
- 202. Instruments of cooperation.** Cooperation can occur by having joint standard setting or by having one actor designing the standard and the other endorsing it or incorporating it. Interestingly we observe both: Legislation incorporating private standards and codes of conducts and guidelines and contracts incorporating public standards by reference. In relation to public activities there are different forms ranging from ex post legislative approval (Model Netting Law in derivatives), ex post administrative approval, incorporation by reference and policy alignment. But we also have examples of ex ante authorization as in the case of data protection related to BRC.
- 203. Formal cooperation is not the only form of collaboration.** There are informal sequential cooperative forms where the private organization sets standards on the basis of a process open to stakeholder consultation and participation of both public

and private actors and the public actor approves it and/or incorporates it into legislation or into an administrative act. The reference points are certainly the ISO Guide 59:1994, Code of good practice for standardization (1994); WTO TBT Annex 3 code of good practice for the preparation, adoption and application of standards, and the ISEAL standard setting code (v. 5.0). Many of the standard setting procedures adopted by individual private regulators draw from the principles defined in these codes. In the financial markets area, accounting standards set privately by the IASB have been widely adopted in public legislation either as permitted or mandatory (many stock exchanges around the world require use of IFRS for public listed companies). In respect of OTC derivatives many governments have been 'persuaded' to adopt legislation which gives the intended effects to model netting rules. In private service company ICoC makes explicit references to the Montreux document and to the Protect, respect, remedy framework designed by the UN rapporteur John Ruggie. The Equator Principles III makes reference to the IFC standards on environmental and social sustainability and to the World Bank Group environmental, health and safety guidelines.

- 204.** We distinguish these forms of cooperation in standard setting from participation where one of the players has ownership of the standards and leads the process and the other(s) participate in the standard setting but has no final decision making power. In relation to participation we observe participation of private actors into the rule making process of IOs and of transnational networks and symmetrically participation of public actors into the standard setting process of transnational private regulators. Clearly, the distinction represents a continuum rather than discrete domains since strong forms of participation may border co-design.
- 205. Cooperation can also occur vertically between transnational private actors and regional public institutions.** Increasingly there are forms of private transnational standard setting incorporated or endorsed by regional (EU) and domestic legislators (vertical complementarity). There are numerous examples from accounting (IFRS standards) to civil aviation (IATA), from data protection (BRC) to food safety certification (GLOBALG.A.P. general requirements, EU recommendation on food safety certification), payment systems (EPC rulebooks). We consider these forms as complementary since the subsequent endorsement or incorporation of private standards by the public is the end result of an informal dialogue between private and public organizations. Clearly, the research shows that private actors while setting the standard take into account the requirements that the public needs/wants to include when approving or incorporating the standard in legislation ex post.
- 206. Vertical cooperation operates also symmetrically to the case above when international public standards, primarily designed through soft law, are implemented by private actors.** This is often the case for codes of conduct which make references to soft law principles (ICOC, IFRS standards in accounting, codes of conduct in professional services, ICC code and EASA best practices in contracts between media and advertisers, certification scheme in supply chain contracts

between producers and retailers) but it is often referred to contracts used as vehicles of implementation of international public standards. This process provides international public standards both with legitimacy and effectiveness. Unlike mandatory public standards here the relationship is not necessarily public minimum/private stricter since the use of soft law may reflect the inability to reach a political decision on mandatory public standards and define general principles to be specified by transnational private regulation in contractual relationships.

- 207.** The form of public/private regulatory interaction with greatest potential concerns monitoring compliance. The costs of monitoring compliance of multinational regulated entities have proven high and the results often unsatisfactory, especially when applied to multinational corporations acting simultaneously in many jurisdictions. In many areas the combination of high costs and poor results has shifted the responsibility of monitoring to the regulatees and/or to third parties increasing the role of certification and audit. In the area of PSC the newly created association has taken up the burden of monitoring compliance with ICoC which implies also compliance with the Protect, Respect, Remedy framework adopted by the Ruggie principles. In relation to sustainable finance the Equator principle financial institutions (EPFI) have taken up the costs of monitoring compliance by the borrowers. Similarly in the area of food safety the use of certification schemes has transferred compliance costs onto to the supply chain and in particular onto suppliers. It is unclear whether some of these costs have been passed on the end-consumers. There is a double objective in implementing this kind of complementarity: to shift regulatory costs from tax payers to private regulated entities, and to improve effectiveness of regulatory standards by ensuring systematic control.
- 208.** However, the shift towards ensuring compliance via private law instruments has not replaced the role of domestic public actors. In the field of data protection, financial reporting and accounting, civil aviation and food safety, administrative agencies and governmental entities play a major role and often operate as crisis management entities. Here, we see the symmetrical phenomenon of transnational private standards implemented and enforced by local public enforcers. Especially in the area of financial markets there has been a growing concern about compliance after the GFC and monitoring by public actors has been subject to major governance reforms towards a high degree of coordination and to a limited extent centralization.
- 209.** Domestic legislation has increasingly relied on due diligence to control compliance with international standards including those private standards the regulated have voluntarily committed to. The effects of these controls over sanctioning are still unclear. In particular the link between findings of non-compliance and public action varies from legal system to legal system, from sector to sector and from international to domestic level. The necessity of coordination among public enforcers at the national level remains even when the costs of control are partly mitigated by the use of third party monitoring.



- 210.** The main open question concerns the legal effects of third party monitoring on liability. Compliance with certification requirements does not exclude liability of regulated entities in many legal systems. Hence it might be that public standards for evaluating compliance, in particular when civil or criminal liability is at stake, may differ from those deployed by private certifiers. Regulatory and Judicial cooperation directed at reaching a common view on compliance would certainly increase legal certainty. Hence the costs of compliance with international standards have only been mitigated by the use of third party monitoring.
- 211.** Relevant, but not as significant as in compliance, is the complementarity in enforcement policies. Such complementarity occurs when domestic courts enforce transnational standards and when private dispute resolution bodies, including institutional and, to a limited extent, commercial arbitration, adjudicate with national courts identical disputes applying different sanctions which have to be coordinated.

### ***The role of public actors when there are conflicts in the private sphere***

- 212.** Institutional complementarity translates into different forms depending on who is part of the public and private sphere and on a wide range of factors concerning the differences and the conflicts within private sphere. International organizations have differentiated strategies and instruments for cooperation with industry and with CSOs.
- 213.** The public approach differs depending on various factors featuring the relevant private sphere among which should be highlighted: (1) the structure of the regulated market, (2) the heterogeneity of regulated entities, (3) the existence of conflict among regulatory objectives correlated to the heterogeneity, (4) the level of fragmentation and competition among private regulators and, (5) the degree of technical expertise required by the regulatory needs.
- 214. Structure of regulatory space: concentration versus dispersion.** When there is a high concentration of regulatory power (monopoly or oligopoly of private regulators) as in the case of accounting or derivatives, the public exercises direct control over private regulation either *ex ante* or, more often, *ex post*, when private standards have been enacted. Many forms of *ex ante* informal control and participation have been promoted within the regulatory process so as to ensure participation of both public and private actors in the process. When instead there is competition between private regulators the function of the public is that of avoiding race to the bottom and ensure compliance. Competition occurs in the field of accounting between FASB (US GAAP) and IFSR standards (applied in Europe, Latin American countries and some of the Asian countries) has been in place for some time. Despite the Norwalk agreement (2002) and the memorandum of



understanding (2006 updated in 2008 and 2010) cooperation has not seriously advanced towards harmonization; unlike in other contexts here the network of public regulators IOSCO has made a specific choice in favor of IFRS. Despite this choice the dual system persists in relation to several issues from the definition of financial instruments to the methodology used to account for losses. The case of accounting is quite telling both in relation to concentration and the role of the public regulator.

- 215.** When concentration is low, the regulatory landscape is fragmented, and competition is high, the public acts more as a mediator or orchestrator of different private interests often represented by competing regimes. This is the case in food safety, data protection, professional regulation and it has been the case in payments until the public, at least in the European context, decided to take a more significant role than pure steering.
- 216. The structure of the regulated market.** When the regulated market is local as it is the case for advertising, public control operates locally at the state or regional level and legislation and enforcement often complement the role of private actors. Similarly in professional regulation where only a small, relative to the total, number of professionals, is engaged with the global market for services, private regulation in the form of self or co-regulation is local and international public institutions play a very limited function compared to nation states. When the market is global as the case of financial regulation public control operates at the transnational level (IOSCO) and at the local level via regulatory authorities and central banks.
- 217.** There are a few cases where there is clearly a misalignment between the public and the private regulatory objectives as in payment systems and the professional services regulation. Divergences primarily refer to the level and instrument of regulatory harmonization. In payment (SEPA) the EU has a clear interest in harmonization whereas many private actors especially in the banking system have an interest in maintaining local rules; here harmonization has prevailed over mutual recognition (EU regulation 260/2012 amended by Reg .../2014). In professional services instead mutual recognition has prevailed over harmonization. National professional bodies have insisted to maintain local rules and promoted a mutual recognition regime (Bolkenstein). Professional regulation however presents a higher level of complexity since there are conflicting objectives depending on whether the markets are predominantly local or if a reasonable size market for transnational professional services is available. Here, private regulators are driving the process of increasing trade and promoting market growth while public actors still focus primarily on domestic regulation or limit themselves to promoting mutual recognition.
- 218.** The roles played by public actors depend not only on the features of the private sphere but also on the structure of the public sphere, in particular:

- a. the presence of international organizations or transnational networks and their degree of internal cohesiveness (food safety (FAO), civil aviation (ICAO) derivatives (IOSCO) accounting (IOSCO));
  - b. the role of regional players and their alignment or misalignment (data protection), the relevance of nation states in devising public policy (consumer protection in advertising, security and public procurement in relation to private security companies).
- 219.** Potential conflicts exist also within the public sphere and the development of transnational regulation depends on the willingness of nation states to delegate policy making to the international level. There is an increasing parallel growth of the European and to a much more limited extent of the global level in some of the investigated areas like in advertising, payment systems and professional regulation where global public institutions are absent or have very limited reach.
- 220.** The relationship between private and public is not static. Many case studies show that the tasks shift over time between public and private. The drivers of these transfers differ. As mentioned earlier fragmentation within one sphere might stimulate harmonization by the other sphere. But fragmentation is not the only determinant of shifting. Regulatory failures have determined important shifts or readjustment. In the field of financial markets private regulatory failures or partial success as in the case of payment systems (2012) and to a more limited extent in accounting (2002) and derivatives (2008) have shifted power from public to private. Thirdly, cost reduction and re-distribution represent another powerful driver of regulatory power transfer from public to private.
- 221.** Furthermore, when disentangling both the private and the public sphere it becomes clear that many changes within spheres determine other changes between spheres. The reallocation of regulatory power within the private sphere in food safety (from suppliers to retailers) has brought about new activism within the public sphere. International organizations like FAO, WHO, CAC have reacted to the proliferation of private standards by changing their regulatory strategy related to standard setting and compliance monitoring.
- 222.** TPR is often implemented by States or regional public entities according to the specific rules. The research shows that the EU does not have a unitary approach to integrating TPR. A large number of transnational private standards make their way into European legislation and administrative activities, but each sector or even single instruments define the way in which the standards are integrated. The differences between financial regulation, civil aviation and food safety are remarkable. But even within financial market regulation there seems to be wide variation across individual areas. For example, accounting and derivatives provide examples of very different approaches to integration of private standards into the EU. Whereas it appears quite clear that sector specificity might require different modes of adaptation in to the EU

legal framework a set of general principles would be useful for the purpose of common requirements related to legitimacy and accountability of transnational private regulators.

### ***Evaluation of TPR***

- 223.** Evaluation of the regulatory process, its legitimacy, quality, effectiveness and enforcement has become a strategic element. It should be considered as part of the regulatory process since it can provide regulators, regulated entities and beneficiaries with information about strengths and weaknesses of the process and promote innovation to improve instruments and objectives' definition. We look at it from the perspective of the entire regulatory cycle including the standard setting, the monitoring and the enforcement stage. In relation to the cycle we posit that evaluation should consider the *ex ante* stage when the standard is designed and *ex post*, i.e. after implementation of the standard has taken place. The two dimensions, *ex ante* and *ex post*, are strongly correlated although they might also have independent functions. We also suggest that evaluation should not stop at the single entity when multiple entities concur to the regulatory process as it is the case when standard setting is performed by a different entity from monitoring and performance.
- 224.** Evaluation of regulatory performance can focus on different aspects: the geographical and numerical scope of a regime, the number of participants and their compliance. Evaluation can look at regulatory objectives and the targets that have been set. Evaluation can look at the consequences of standard adoption and implementation; that is to say the impact of standard implementation over economic, social and environmental conditions. Evaluation can also focus on the adequacy and effectiveness of the governance structure of the regulator and its correlation with the regulatory process. The research reveals a strong correlation between governance and regulatory process, hence in the evaluation process indicators related to governance should be linked with those of regulatory performance.
- 225.** The research shows that *ex ante* impact analysis related to regulatory choices is very rare and not rigorous. More specifically: Evaluation of alternative regulatory options does not occur. Nor do we find rigorous comparative analysis of alternative regulatory instruments like principles, guidelines, codes of conduct. For example, it is very rare that private regulators compare *ex ante* command and control regulatory tools with more responsive styles concerning the relationship between regulators and regulated before engaging in a standard setting process. Cost-benefit analysis of the regulatory instruments is generally not performed, though in some cases the potential impact over third parties is taken into account. Some indications concerning a regulatory model and the instruments can be found in EASA Best Practice self-regulatory model where the main characteristics of the regulatory

process are identified and have been specified in other Best Practices recommendations. A similar approach can be found in the Global Aviation Safety Roadmap (GASR) where IATA has defined a strategy and an implementation program.

- 226.** While a comprehensive *ex ante* assessment is generally missing there is increasingly *ex ante* definition of procedural requirements concerning consultation, stakeholder selection, transparency and duty to give reason. The reference points for standard setting principles include the ISO Guide 59:1994, Code of good practice for standardization (1994) WTO TBT Annex 3 code of good practice for the preparation, adoption and application of standard, and the ISEAL standard setting code (v. 5.0). More recently the Due Process Handbook issued by IASB provides a set of general rules related to standard setting.
- 227.** Such procedural requirements are defined in standard setting procedures that include some degree of evaluation as is the case for demand assessment when the standard setting committee, before engaging in the process, has to show that there is a clear case for a new standard or for standards revisions. There are clear indications that standard setting procedures have introduced limited elements of evaluation of the regulatory process. For instance, the Code Development Procedure in *UTZ Certified* provides that in case a request for the development of a new product code of conduct is received, a 'demand assessment' is done which also includes an analysis of who needs and will use the standard, a description of how the demand can be met. Similarly, the IASB Due Process Handbook provides that when deciding whether a new IFRS is proposed, a preliminary analysis includes the needs of users across different jurisdictions, taking into account the changes in the financial reporting and regulatory environment; the pervasiveness of the issue to be tackled by the new standard; the level of urgency; and the potential consequences, i.e. if the absence of an IFRS might cause users to make suboptimal decisions. However, no specific indications concerning *ex ante* impact analysis are included in the standard. These requirements clearly affect the quality and legitimacy of the process but no data prove that they have significantly influenced the content of regulatory products: e.g. the content of codes of conducts or guidelines. In some instances we have traced the effects of standard setting procedures over the content of the code. For example in the case of the ICC paper on code drafting (2010) and the consolidated Code on advertising and marketing (2011). Another example is the procedure for the setting and revision of the GLOBALG.A.P. (2007). Structural and content modifications become apparent when comparing the General regulations integrated farm assurance (EUREPG.A.P. 2007) with GLOBALG.A.P. General regulations (2012). More research is needed to verify whether the introduction of these standard setting requirements has really improved the quality of regulatory instruments (codes and guidelines) and in particular whether stakeholder inputs have influenced their effectiveness.

- 228.** Some meta-regulators (for example ISEAL in the Impact Code) require the identification of economic, social and environmental impact, but the real distributional consequences, especially those concerning regulatory power and institutional capacities are not integrated into the *ex ante* analysis to inform the standard setting activity and the overall definition of the governance infrastructure. Given the findings that confirm the remarkable effects of private standard setting and implementation over the distribution of power and wealth between private and public actors there is a clear mismatch between the scope of the evaluation and the effects produced by the standards. The current mechanisms of evaluation do not capture the real effects of transnational private regimes in terms of wealth, power and capabilities effects.
- 229.** *Ex post* evaluation is more diffused., in particular in the form of reporting, though in some cases this is not in the form of periodic report. Organizations either evaluate themselves or more frequently ask third parties to evaluate their regulatory performance. The link between governance and the regulatory process and how the governance of the organization (the structure of interest representation, its single or multi-stakeholder identity) affects performance is usually not part of the analysis. The focus is primarily on compliance. The primary goal is to verify compliance by regulated entities whereas less attention is devoted to scrutinize if and to what extent regulatory objectives have been achieved. This partly depends on the opaqueness about their definition and the failure to state them in a measurable fashion.
- 230.** Regulators often produce annual reports about their own activities and that of regulated entities. Self-reporting is sometimes based on indicators adopted by each regulator to evaluate its own regulatory performance. For example, UTZ Certified annual reports show the progress (or lack thereof) made in relation to environmental and social performance by the codes of conduct and the linked certification schemes. In other instances, reporting is less structured and not based on indicators that measure progress in the regulatory process. The focus often tends to be on the number of regulated entities that subscribe to the scheme. As mentioned, the expansion of the scheme measured by the number of new members is a clear indicator of the popularity of the scheme, but does not tell much about the real impact. In order to measure impact, the rate of compliance needs to be measured and that has to be correlated with the achievement of the regulatory objectives.
- 231.** The evaluation of regulatory performance in relation to the objectives is very limited. Objectives, when stated, are very general and difficult to measure. There are some instances where more specific objectives are defined and their achievement can be measured. For example, within EASA commitments included in the Charter the definition of jury composition with lay people by 2010 was a clear objective whose achievement could be clearly measured. Some regulators have engaged into *ex post* impact assessment evaluation to measure the effects on costs, practices,

environmental protection and working conditions. According to UTZ Certified self-report they have measured regionally the impact of their codes on the costs for smallholders, the improvement of farming practices and working conditions. Moreover, additional analysis is committed to third parties selected for their expertise on sustainability issues, and include the Committee on Sustainability Assessment, the Dutch Agricultural University of Wageningen, KPMG Advisory B.V. In the ISDA case, the regulator carries out periodic surveys addressing overall market activity through Market surveys and the annual Benchmarking survey, the latter being interpreted as a review of the regime as a whole, including the efficiency of processing transactions.

- 232.** We have looked at indicators deployed by private regulators operating in different sectors in relation to economic, environmental and social impact. We tried to investigate whether sectorial differences and distinct objectives might change the specific indicators used to measure environmental and social changes. Preliminary findings show that sectors' variations matter for indicators concerning environmental impact whereas there is more homogeneity in relation to indicators related to social and working conditions.
- 233.** While evaluation of the performance by regulators is very limited and rudimentary, much more sophisticated is the toolbox deployed by private regulators to evaluate the compliance by regulated entities. Regulated entities are asked to report and ever more frequently they have to integrate their supply chain in the reporting activities. The latest version of the Guidance by GRI (4.0) clearly shows a stronger emphasis on the necessity to look at the entire supply chain rather than focusing on individual regulated entities. The Equator Principles require each EPFI to report on their compliance (principle 10). The certification schemes in food safety require the certifiers to report on their own activities. When operating within benchmarking the reporting chain is even longer: the benchmarking organization requires the scheme owner to impose reporting on the individual certifiers (this is the case of GLOBALG.A.P.).
- 234.** Even when *ex post* evaluation is carried out there is insufficient evidence to prove that it produces changes and innovation in regulatory practices. There are no clear obligations to act upon the findings and to make changes when evaluation reveals shortcomings on both governance and process. However there is evidence that changes concerning evaluation mechanisms have brought about changes in the standard. In the case of the Equator Principles the change of IFC indicators occurred in 2012 have stimulated significant changes between version II (2006) and version III (2013). For example, in relation to performance standard Principle 7 of IFC concerning indigenous people the changes have modified the Equator principles on the role of prior free and informed consent. The example shows that evaluation can affect the regulatory process in different ways. It clearly demonstrates the strategic function of indicators as governance devices.

- 235.** In some instances private meta-regulators carry *ex post* evaluation of the regulatory performance of their members. They might do it in relation to individual performance of the participants (GFSI) or collectively (EASA). In the former case reporting concern of the regulatory performances of each scheme owners that is part of the benchmarking process. In the latter, the meta-regulator reports the progress that individual regulators have made in relation to specific commitments that EASA had made. EASA made public commitments concerning advertising self-regulation and committed to report about its progress. With the Charter Validation Report, EASA measures via a set of indicators progress that has been made in relation to each commitment. As mentioned these commitments are not legally binding and were stimulated by the Round tables but have proven to be a powerful driver of change.
- 236.** The link between *ex ante* impact analysis, when it exists, and *ex post* evaluation is not yet well designed. Given the necessity to consider the entire policy cycle of regulatory instruments the coordination and comparison between *ex ante* impact analysis and *ex post* evaluation of regulatory performance should become part of the ordinary process that accompanies the choice to introduce, use and terminate a regulatory instrument. We might expect to see regimes compete for adherents on the basis of the quality of their processes and evaluation.

### ***Core Findings and Policy recommendations***

- 237.** The four dimensions considered in the research - legitimacy, quality, effectiveness and enforcement - are strictly related. The correlation may vary across sectors but clearly effectiveness and legitimacy play a very significant role in shaping the success or the failure of standard setting, monitoring and enforcement. TPR operates in a regulatory space populated by many institutions. It interacts with public international and domestic regimes. This interaction is characterized mainly by complementarity, sometimes by competition. In either instance the interactions between public and private play a role in the definition of legitimacy and effectiveness. In the case studies we have seen the more traditional 'exchange' where public provides legitimacy and private effectiveness but in some circumstances, primarily linked to the use of soft law, we have also observed the private providing legitimacy to principles and recommendations enacted by public international organizations. The latter occurs when legitimacy is primarily related to providing binding effects rather than authority. A third type of interaction is illustrated by the accounting case where transnational private standards are implemented by domestic public regulators. Here the model would suggest that the legitimacy of the transnational private, based primarily on technical expertise, is complemented by the effectiveness of the national public which adapt the standards to the local needs.



- 238.** The findings of this project reveal a working notion of legitimacy which integrates legal, economic and social institutions in the definition of the relationship between regulators and regulated entities. Clearly, there is an interaction between the three dimensions which most of the time seem to be positively correlated e.g. high legal legitimacy corresponds to high social and market outcomes with some exceptions. For example, higher inclusiveness ensured by a legal requirement will generally increase social legitimacy by empowering communities to express their voice and, possibly, their dissent. The combination between the three forms of legitimacy vary across sectors, according to the structure of the regulatory framework (whether monopolistic or pluralistic), the proximity of the standard to the final destination market and the role of media.
- 239. How are effectiveness and legitimacy correlated?** Effectiveness and legitimacy can correlate positively, when increasing effectiveness positively affects legitimacy, or negatively, when there are trade-offs between the two: the increase of legitimacy reduces effectiveness or viceversa. The most conventional approach is efficiency related and underlines the trade-off. Increasing legitimacy via inclusiveness and participation raises the costs thereby reducing efficiency. Low inclusiveness excludes relevant stakeholders and permits externalizing some of the costs increasing the benefits of members and the effectiveness of the regime from their perspective.
- 240. The relationship between the legitimacy and effectiveness may depend on the extent of political contestation.** Where there is a high degree of political contestation input-based legitimacy is increasingly important, but with the potential for effects on substantive outcomes shaped more by interests than technical requirements. Normative standards are particularly liable to bargaining, and more so where many stakeholders are involved. Absence of political contestation does not mean that interests are not affected, but may rather indicate that those whose interests are adversely affected have not been incorporated into the regulatory process. As it was said the at the beginning of the Report we have included contestability in the definition of legitimacy. The type of correlation will *ex ante* affect the institutional design and the structure of the regulatory process, in particular the role of affected stakeholders along the decision making process and the final impact.
- 241. Legitimacy.** Which dimensions of the regulatory process are involved with legitimacy? Both process and governance. The 'how' question is strongly correlated to 'who' question. The legitimacy of the regulatory process is linked to that of governance of the organization. Whereas voluntariness is often described as the characterizing features of private standards and more broadly private regulation many weaknesses make this claim partial and problematic. Voluntariness is limited in relation to entry and exit. Consent is often formal and it does not provide space for deliberation. The majority of regulated entities are only given a take it or leave it option. If voluntariness is reduced in relation to regulated it is even more problematic as to those who are affected by the standard. Participatory rights to the

process often require knowledge, expertise, resources that are not available. The research reveals that significant governance and procedural reforms are needed to ground legitimacy of private standards on voluntariness and consent.

**242.** Meta-regulation. The analysis shows that an increasing number of regimes have followed predefined (meta-) rules to set standards, implement, monitor and enforce them. Some of them require consensus others are approved by majority voting. These meta-rules, when followed, have been either defined by the regulator itself or by other entities such as meta-regulators. Clearly, a lack of meta-rules corresponds to limited legal legitimacy. When they are missing, private regulators enjoy discretion in the definition of the regulatory process without being bound by any pre-defined standard. When meta-rules are in place we have asked whether they are adequate and meet the minimum threshold of procedural legitimacy. These thresholds refer to transparency, inclusiveness, adequate interest representation, duty to give reason and indirectly to contestability. They vary from sector to sector, but they show significant limitations with respect to the voluntariness by the regulated and the expression of consent by the potential beneficiaries. This being said, it is clear that the increasing number and quality of standard setting procedures has improved both the procedural and substantive legitimacy of transnational private regulators

**243. The investigated regimes show an overall pattern of increased procedural legitimacy but they differ across dimensions.** Some regimes have improved on transparency, others on inclusiveness. Differences about inclusiveness are still rather significant. The financial market regimes show very limited inclusion of consumers and investors and even when they present multistakeholder features. Similar conclusions concern professional regulation and civil aviation. Human rights and food safety show a higher degree of inclusiveness but still very limited transparency. Are these differences justifiable? Sector specificity can only provide limited justifications but in many instances they seem more the outcome of choices made by the originators and the existing allocation of regulatory power at time of birth. To what extent are they compatible with domestic constitutional principles? Especially when they pursue public interest limited transparency and representation may be questionable. Judicial control appears limited and uneven. We lack a good evidentiary basis of comparative analysis but domestic courts seem to operate on assumptions which do not cut across sectors when reviewing them.

**244. The adoption of procedural requirements have often translated into different forms of inclusion related to both governance and regulatory process.** In relation to governance there is a move from single to multi-stakeholder organizations although in many instances, within the examined sectors, single stakeholder organizations remain popular (primarily, if not exclusively, these are industry driven). **The research shows that procedural requirements in the regulatory process differ between single and multi-stakeholder regulators. Multi-stakeholder organizations tend to have stricter and broader procedural requirements than single stakeholder**

**organisations especially those related to inclusiveness and transparency.** We strongly recommend proceeding towards a higher level of inclusiveness and suggest a combined strategy between governance and regulatory process e.g. to balance inclusion in the organization and in the regulatory process. The pursuit of the instrument to promote inclusiveness may depend on the legal form of the regulator. Differences between associations, non profit corporations and foundations may require stronger procedural requirements in the latter case given the strong managerial features of the foundational model whereas governance may ensure inclusiveness in relation to the former.

**245. Linking governance and the regulatory process.** Legitimacy of the regulatory process is determined by both choices concerning governance and choices related to the structure of the regulatory process, its procedural requirements, and the composition of the competent committees in charge of setting standards, monitoring and enforcement. The findings show that there is a correlation albeit not a linear causal one between governance models and regulatory processes. At times there are trade-offs: Lower organizational accountability, which is a characteristic of the foundational model, is often compensated by stronger inclusiveness and participatory requirements in the standard setting process designed by regulators that have adopted that legal form (for example IASB in the accounting, UTZ Certified in food safety). Wider participation featured in associational models may instead translate into less burdensome procedural requirements. More importance should be attributed to the choice of the governance model, from the selection of the legal form to the identification of applicable law in case of the need to fill gaps. Hence we suggest regulators working in a coordinated fashion on both standard setting procedures and governance structures to pursue inclusiveness. In particular we recommend the adoption of transparent and easy to monitor practices for stakeholder inclusion by regulators that are formally or informally delegated by public entities..

**246. Functional separation as a governance pillar to ensure legitimacy.** Functional separation within the regulatory process between standard setting, monitoring and enforcement is crucial to increase legitimacy and to avoid conflicts of interests. Sometimes it translates into structural separation between different legal entities, sometimes it results in distinction within the same entity. The research has showed that improvements have been made towards **higher process accountability** by externalizing some of the functions to separate legal entities performing each function albeit with a different degree of independence. In particular the separation of standard setting, monitoring and enforcement is perceived as a necessary requirement to minimize conflicts of interests between regulators and regulated at the expense of regulatory beneficiaries. The higher the separation the lower the risk that monitoring and enforcement strategies will be biased in favor of regulated entities, promoting private benefits at the expenses of social welfare. Especially as the weaknesses of enforcement have often been associated with the lack of

independence of the enforcer from regulated entities and its positive bias towards them. Symmetrically functional separation implies that enforcers are ever less agents of the regulated entities and more agents of the regulator and trustee of the beneficiaries' interests.

**247. The governance dimension of functional separation.** When does functional separation translate into structural separation? Changes favoring structural separation within the governance of transnational private regulators have occurred for various reasons. In some instances because of external pressure by public institutions, in other instances for competitive pressures coming from new entrants, and in other instances on the basis of influence by the media and social groups directed at enhancing participation and social control. In a limited number of cases structural changes have been promoted by domestic courts exercising judicial review. Structural separation between entities exercising standard setting, monitoring and enforcement is a necessary yet not sufficient condition to ensure accountability. **We recommend introducing functional separation across the board and to the extent possible combining it with structural separation by ensuring that monitors and enforcers are independent from standard setters.**

**248.** In relation to process there has been **an increasing degree of formalization** mainly aimed at ensuring stakeholders' effective participation and transparency. Higher formalization increases legitimacy at times at the expenses of effectiveness. Formal involvement in the regulatory process of external stakeholders takes place in two **different** ways: (1) the creation of standard setting or drafting committees that include nonmembers, representatives of stakeholders' organizations; (2) participation in the consultation by external organizations, once the standard has been drafted but before it comes into force. While the overall result of enhancing participation is increased accountability, the selection of relevant stakeholders may be biased towards organizations with higher expertise not necessarily combined with greater representativeness of the affected interests. Mapping stakeholders and seeking their concrete participation has proven to be very limited. More transparency about stakeholders' selection criteria is needed. **We recommend that criteria to define stakeholder mapping, selection and participation are defined ex ante and regulators be made accountable for compliance with these rules. We recommend that standard setting procedures be drafted by incorporating the variable concerning organizational models e.g. different rules for associations, foundations and nonprofit corporations.**

**249.** In relation to internal accountability towards regulated entities the level and quality of change and innovation has been less significant. **Seen from the perspective of legal innovation, reforms of organizational constitutions have occurred much less frequently than modifications of standards and the procedures to enact them.** We often have 3 or 4 versions of the standard whereas no reform of the charter and bylaws take place over the same period. Governance of TPR is not always transparent and information about the charters and bylaws are often not

publicly available. Compared with process requirements governance features are much less transparent and open to public deliberation. But even within the same area there is no consistency! We observe different patterns within financial markets: accounting and payment systems are areas where governance has represented a turning point in opposite directions. The reform of IASB in the late 90s/early 2000s has included both the institutional framework and the regulatory process with the approval of the due process handbook. Derivatives with ISDA, Equator principles in the human rights/environmental area have showed resistance to governance changes while there has been an intense review process of the standards. However, the recent creation of the association by EPFI in the Equator Principles shows that governance reform may go parallel to the reform of the standard. The payment system represents the most problematic area since the claimed inability to self-reform the process by EPC prompted a EU legislative intervention with implications for the SEPA Council and the overall governance still under review.

- 250. Legitimacy's evaluation requires a different metric for regulated entities and regulatory beneficiaries.** To a certain extent one could infer from the findings that - in relation to the regulated entities - input legitimacy is more relevant than output legitimacy, whereas in relation to the beneficiaries output legitimacy acquires prominence. Regulated entities pay more attention to the process and the opportunities to influence standard setting and implementation of the standards. Regulatory beneficiaries focus more on output and impact, e.g. on whether the regime delivers the promised results and achieve the outcomes. The different perspectives should be captured by evaluation schemes breaking down legitimacy of the governance and the regulatory process and emphasizing the different weights depending on whose perspective is adopted.
- 251. Integrating legal, social and market legitimacy.** The research shows that the level of legitimacy depends on the interplay between legal, market and social mechanisms. We have proposed an integrated notion of legitimacy able to capture how the legal mechanisms are influenced by social and economic institutions. But their combination differs. Across sectors the accountability mechanisms ensuring legal legitimacy seem to be rather homogeneous whereas the weight and instruments of market and social legitimacy varies significantly. CSOs and their primary control instruments like certification schemes have a higher impact in human rights and consumer protection than in the areas of financial markets. In the latter market legitimacy seems to play a more relevant role than social legitimacy. Further research is needed to investigate comparatively and across sectors the reasons of different power and influence of CSOs in Transnational private regulation and the regulatory tools used to earn regulatory power.
- 252. We strongly recommend the development of a set of general principles concerning both governance and process, including transparency, inclusiveness, adequate interest representation, functional separation, self-evaluation and**

**reporting.** These principles have to be stricter for private regulators that specifically pursue public interest and cooperate with public organizations at the transnational and domestic level. **We recommend that public regulators subject incorporation and endorsement of policies enacted by transnational private regulators to verification procedures for compliance with these requirements. We suggest that they should give recognition to standards produced in violation of these principles.** The signal that legislators and judges could send by scrutinizing the process together with the content may have significant spillover effects over private standards not endorsed or subject to approval by public entities.

- 253. Effectiveness.** The effectiveness of transnational private regimes is the key determinant of their failure or success. Whether the regimes define accurately their objectives and the solution of conflicts therein, whether and how they achieve the expected outcomes, how costs and benefits are distributed among regulated, whether there is proportionality between means and ends, are all strategic questions influencing the legitimacy of the regulatory process and the overall performance.
- 254.** Effectiveness calls for the definition of clear and measurable objectives. Such an approach not only requires a combination of ex ante impact assessment and ex post evaluation but it also needs flexibility and modularity addressing incomplete information about the standards implementation's effects. Information about standards' impact is often unavailable at reasonable costs at the standard setting stage but organizations do not properly address the issue of incomplete information of distributional impact in the design of regulation. When incomplete information about the potential impact of standards prevents from clearly stating trade-offs ex ante, the design of the regulatory process should permit not only ongoing integration of the standard's content as soon as information becomes available but also adjustment of compliance and sanctioning policies to ensure their effectiveness. The regulator may be unaware of the incentives to depart or violate the standard and establish a sanctioning policy which does not target the most relevant infringements. As in the case of incomplete contract in general, incomplete regulatory contracts require mechanisms to incorporate changes based on the availability of new information concerning regulatees' incentives without waiting for ex post evaluation.
- 255. Effectiveness also requires incorporating the impact of distributional consequences into the definition of the standard and its objectives. It not only about whether but also how objectives are achieved: namely who bears the costs and who gains the benefits.** Costs imposed by private standards over certain categories of regulated entities translate into wealth transfers which may have remarkable consequences for entire communities and economies. Decisions about costs allocation, often implicitly, are made at the standard setting stage but no public information is available for evaluation on distribution of costs among classes of regulated. Lack of analysis by the regulator should be justified by incomplete



information which has to be addressed in designing the process. Incomplete information demands ex post adjustment. Accordingly the regulatory process should include compensatory mechanisms that can redistribute costs ex post among regulated entities and between them and third parties when information becomes available. Wealth transfers also concerns the distribution of **benefits** arising from the implementation of the standard and the identification of priorities among regulatory objectives. The expected beneficiaries of the regulatory process should be clearly identified. When standard's implementation has both positive impact on some classes of beneficiaries (for example consumers) and negative impact on others (indigenous communities) conflicts should be internalized. If information about them is not ex ante available room for ex post adjustment should be granted. This implies that **interest representation in the regulatory process should translate into transparent and defined trade-offs among regulatory objectives openly addressed in the ex ante impact analysis, during the implementation process and ex post.**

**256. Monitoring compliance.** Monitoring compliance with standards reflects the strong complementarity between public and private. There have been new actors and new instruments to monitor compliance with transnational private standards. Monitors include national administrative authorities, national courts, third party verification bodies, local private regulators. It is generally decentralized but for multinational enterprises where compliance offices tend to combine a global and a local dimension. Increasingly monitoring has been transferred onto the private sphere. This transfer has created a market for private entities engaged into third party verification. The role of gatekeepers has increased but in many instances with a plethora of overlapping bodies. **Often higher monitoring costs have not reflected proportionate effects on compliance.**

**257. The role of gatekeepers.** Third party verification has grown. Expertise and costs reallocation of compliance monitoring have been major drivers of this development. Gatekeepers differ across sectors but one open issue is cross-cutting: the balance between independence required to professionals in order to preserve the public interest and the contractual relationship with the monitored entity. Most of the gatekeepers including certifiers, auditors, financial reporters are paid by the monitored entity undermining the level of independence that third party verification systems should have. However many non-profit independent organizations are developing. They engage in comparison, looking at best practices of regulatory performances. The role of these CSOs may usefully complement that of professional gatekeepers in exercising monitoring functions but clearer rules are needed to ensure that monitoring enjoys the right level of confidence by the final beneficiaries.

**258.** Serious shortcomings exist in relation to at least six dimensions of effectiveness and its evaluation in relation to the performance of private regulators. The following do not apply *sic et simpliciter* to the evaluation of regulated entities performances.



- a. Failure by private regulators to engage into rigorous *ex ante* impact analysis concerning the incremental benefits of the new regimes *vis-à-vis* existing ones and their interaction with potentially conflicting international regimes.
  - b. Failure to define a regulatory matrix that permits an informed choice between regulatory alternatives within the new regime, accountable towards members and relevant stakeholders.
  - c. Failure to clearly and precisely state the regulatory objectives and their potential conflicts to enable an accurate evaluation of the regulatory performance and their adaptation over time as information about compliance become available.
  - d. Failure to evaluate the potential social and economic direct and indirect impacts of the standard and its implementation including the distributional consequences over individuals, communities and states.
  - e. Failure to evaluate the political impact of TPR and the effects on regulatory power shifting between public and private and within the private sphere.
  - f. Failure to define one or multiple metrics with correlated indicators to evaluate regulatory performances by comparing the *ex ante* impact assessment with *ex post* regulatory performance
- 259.** We recommend these 6 dimensions be duly taken into account in the design, implementation and revision of regulatory policy by individual private regulators and by private meta-regulators when defining common principles related to evaluation of regulatory performance. **For the purpose of evaluation we propose a modular solution with (1) general principles valid for all private regulators, (2) intermediate principles distinguishing evaluation by meta-regulators, by public organizations and by third party independent evaluators, and (3) sector specific principles that would tailor indicators to the precise regulatory objectives.** This approach will combine uniformity and diversity in a constitutionalized model of TPR which should nevertheless provide sufficient scope to practice and explain variations where they are justified.
- 260.** In relation to the introduction of new regimes or new standards **we suggest that its enactment is desirable only when the incremental benefits outweigh the systemic costs measured in terms of higher search and transaction costs for regulated entities and direct and indirect impact for affected communities in terms of regulatory capabilities.** Comparison should be made with the best available standard. We recommend that, before introducing new standards, private regulators engage in impact analysis to show that new standards produce regulatory innovation and a higher degree of effective regulatory competition between existing and new regimes. That potential beneficiaries should gain not only in terms of wealth but also choice and institutional capacities whereas negatively affected communities should be adequately compensated (not only or even primarily in pecuniary terms).

- 261.** In relation to the desirability of examining ex ante a set of alternative regulatory options openly and transparently **we suggest that transnational regulators should produce more structured and rigorous proposals describing advantages and disadvantages of alternative regulatory options**, indicating the objectives, the likelihood of the achievement, the potential conflicts among them and for each one the social and economic impact that they may bring along when regulation is implemented. This impact analysis should be publicly available and subject to the scrutiny of the potentially affected stakeholders.
- 262.** In relation to regulatory objectives **we recommend that they are clearly stated and the provisions include forms of standards' revision and correction that permit taking into account unforeseen circumstances or governance changes that may urge their redefinition or adjustment**. The definition of objectives should be combined with the identification of the necessary resources to achieve them and a feasibility plan that indicates the likely time frame. Clear definition of objectives makes performance evaluation possible thereby permitting measuring effectiveness of the regulator.
- 263.** **We recommend the use of periodic reporting deploying indicators that permit evaluating the progress and shortcomings of the regimes correlated to those used for ex ante impact assessment**. Data related to the number of participants, their compliance, the achievement of targets should be made available to the public. In particular **we recommend ex post impact analysis** providing information about the social, economic and political impact of standard's implementation. Such analysis should be performed periodically and used to revise policies about standard setting and monitoring.
- 264.** In relation to the impact analysis **we encourage the definition of indicators coordinating social, economic and political impact associated with the implementation of a new private standard with specific reference to structural changes of local economies and displacement of communities**. We encourage the reference to capabilities indicators by linking both procedural and substantive requirements to the communities of regulated entities and those of the regulatory beneficiaries.
- 265.** With specific reference to the political impact we suggest that a specific metric concerning effects of TPR on (1) the relationships among states (2) the relationship between different powers within nation states is taken into account. The research shows that TPR has produced huge effects on the distribution of regulatory power between private actors and states with effects on the policies towards private standards adopted by several international organizations. Many of them (FAO, IFAD, ILO, OECD, UN Globalcompact, for example) have redesigned their policies for collaboration with private actors and civil society organizations but have not yet designed evaluation tools but for due diligence.

- 266.** In relation to indicators **we further suggest distinguishing between governance and regulatory instrument indicators. If the legitimacy and effectiveness of a process is to be evaluated according to the interaction between governance and process then separate yet coordinated indicators are needed.** In relation to the regulatory process we recommend distinguishing between procedural and substantive indicators. The former will ensure that the objectives concerning the process are met. For example that effective inclusiveness and stakeholder participation is achieved. The latter should be separately examined in order to consider the objectives and the impact e.g. positive and negative external effects associated with the pursuit of the specific objective. Particular attention should be devoted to indicators related to the indirect impact or more precisely the distributional consequences produced by the implementation of the standard over regulated and affected communities.
- 267.** **We specifically suggest looking at redistribution of market opportunities between regulated entities and regional economic growth generated by private regulation especially in the light of the significant increase of retailers' market power in many sectors.** Ex post evaluation should consider both procedural and substantive outcomes and direct and indirect impact taking into account the effects on market concentration and market competition by the standard.
- 268.** Evaluation provides meaningful information to the regulators and to the regulated about collective performance. But even more importantly, it should clearly document whether social benefits have accrued and the public interest has been correctly pursued. It is relevant that this information is translated into changes and innovation that improve regulatory performances and compliance with procedural requirements. Both internal use by the members and external use by gatekeepers and public organizations should be devised. **We recommend the adoption by the regulator of evaluation procedures and the obligations to take them duly into account.** Such obligations should not bind the regulators to the objectives set out in the *ex ante* impact assessment since flexibility and discretion in implementation are needed. Rather **they will oblige the organization to explain why changes have taken place between ex ante analysis and implementation and the consistency between the new solutions and the original rationales.**
- 269.** The findings suggest that often the regulatory process is organized within a multilevel structure composed of several separated legal entities across institutional layers. These layers may be closely or loosely coordinated. **To evaluate process' effectiveness it is therefore necessary to consider the entire regulatory chain and not each individual node independently.** We therefore advocate, when possible, to move to the regulatory chain as the unit of analysis evaluating each entity's operation and their coordination mechanisms. The relevance of local implementation requires taking into account interdependencies and, to a limited extent, adjusting the standards to specific institutional environments. **We advocate**

**a wider use of modular standard setting that can adapt to local specificities and take into account protection of local communities' interests and customs.**

- 270.** Evaluation of regimes' effectiveness is a complex task because different perspectives should be combined: that of regulated entities and that of affected stakeholders. As the Report shows their preferences concerning objectives and instruments are often not aligned and many times in conflict. These conflicts may translate into different perceptions about the regimes' effectiveness. Against this background the instruments to collect information about regulatory performance should be differentiated. In addition to general instruments like auditing and reporting we recommend specific instruments to collect information about effectiveness by using feedback mechanisms, especially from third parties (consumers, employees and civil society organizations).
- 271.** As to **quality of the regulatory process** remarkable progress has been made on the procedural side by many private regulators over the last decade. The standard setting process in particular has improved from the procedural perspective with the adoption of meta-rules that define *ex ante* standard setting procedures the regulator has to abide by and is accountable for. However in many instances quality requirements are not adequate to ensure legitimacy and effectiveness and the metric to evaluate their compliance is at most poor if non-existent. The extent to which complied with procedural requirements translate into better standards is hard to determine. The differences related to the degree of technical standardization make it hard to engage in a simple across sector comparison. The quality of regulation is dependent on the clear definition of the premises upon which choices are made. From a substantive stand point there is a need for higher specificity in the definition of outcomes and outputs and their measurability. **We recommend a full policy cycle approach that combines *ex ante* with *ex post* evaluation. In principle we suggest that different entities should perform *ex ante* impact assessment and *ex post* evaluation in order to avoid unnecessary biases.**
- 272.** Main information gaps are related to impact rather than to the incentives of regulated entities which in principle participate actively to the standard setting process. Even when they adopt a multi-stakeholder model, the information about standards' impact is, at most, incomplete. Lack of *ex ante* impact assessment worsens the quality of the process, which is only partially compensated by increasing openness and participation. The quality of information partly depends on the inclusiveness of the process and partly depends on the real ability of affected stakeholders to contribute to the definition of the impacts. Quality of the process is hence conditional upon quality of participation, which may in turn depend on the organizational capacities of affected communities to evaluate the potential impact of the standard on their members, as in the food sector for example. Often poor and not well organized communities located in the producers' countries might be unable to evaluate and participate in the standard setting process that private organizations located in the northern hemisphere set up. But quality of participation is a general

problem: ensuring rights and defining procedural avenues is the premise but legitimacy is only granted by effective participation that cannot stop at the drafting stage. Only when the standard is implemented affected stakeholders acquire a full perception of its effects. Clearly, impact evaluation has to take into account the quality of stakeholders' participation and their ability to identify and calculate ex ante the impact but they should be given an opportunity to negotiate the consequences of implementation when they materialize. Ex post impact assessment may ameliorate the biased self-selection of stakeholders at the ex ante stage but requires more flexibility.

- 273.** In relation to **quality and effectiveness of enforcement policies** the degree of variation across sectors is very high. There are (1) regimes that introduce their own dispute resolution mechanisms (EASA, ICoC), (2) regimes that rely on external private enforcers, (3) regimes that do not even mention enforcement, implicitly delegating dispute resolution to domestic judicial systems. Enforcement and monitoring are mainly decentralized both when using private enforcers and when deploying courts or administrative authorities. Decentralization permits cheaper and more effective enforcement but increases coordination costs and the risk of inconsistencies. The latter could be addressed by coordination both within the same enforcement system and across various mechanisms. Some regimes impose on regulated entities the adoption of a grievance procedure to solve disputes with third parties (BCR, ICoC). In the case of ICoC the association has oversight power over the fairness and accessibility of the grievance procedures (see art. 13.2.3 of the ICoC Association charter).
- 274. Independent enforcers.** The analysis suggests that enforcement mechanisms characterized by independence from the standard setting organization are becoming much more common as a result of the general process of structural separation between bodies participating to the same regime. Many governance charters require the mandatory creation of an independent enforcement mechanism. **We recommend the definition of principles concerning enforcement regardless of the identity of the enforcer as part of the necessary elements of a transnational private regulatory regime.** These principles should guide every enforcer in the resolution of dispute, the definition of remedies and the determination of their effects. Certainly among them due process and enforcer's independence should stand out. Principles can then be specified and articulated depending on the type of enforcement mechanism and its relationship with compliance monitoring techniques in relation to the regulatory choices and the specificity of the regulatory domain(s).
- 275. Combining direct enforcement with audit and certification.** There is an increasing trend towards the use of mechanisms assessing compliance like quality assurance, certification and audit that at times replace and at times complement direct enforcement by the private regulator and domestic courts. When the

regulatory scheme includes enforcement there are two main models: direct enforcement ( professional regulation, SRO in the field of advertisement) delegation to auditors, certifiers and quality assurers. In some instances the regulator 'delegates' monitoring and compliance assessment to third parties (in food safety GLOBALGap, in civil aviation IATA in relation to IOSA, ...). Within this subset of cases some retain the sanctioning power (as does GFSI in the benchmarking scheme) others delegate not only monitoring but also sanctioning to a third party. There is also a subset that combines the two modes of enforcement: delegation is primarily focused on the regulated entities compliance whereas direct enforcement focuses on disputes among regulated and disputes between regulated and third parties. A good illustration is the model recently adopted in PSC by the ICoC association that distinguishes between certification (art.11), reporting, monitoring and assessing performance (art.12), Complaints process (art. 13). The Rules define a certification scheme that will ensure compliance with the code and then procedures through which violations are addressed and remedied.

**276.** Private actors assessing compliance with private standards have been also delegated similar functions by public organizations especially in relation to soft law and informal law making. This phenomenon occurs for many reasons. The difficulties and costs of coordination among domestic public enforcers ( courts and/or administrative authorities) that include monitoring and enforcement tasks. In some areas there is overlap between public and private without a clear allocation of tasks. Private enforcement has worked in the area of advertising, food safety and human rights, less in that of financial market where the role of domestic regulators remains highly relevant.

**277. Multiplicity of functions in private enforcement mechanisms.** When private regimes set up their own enforcement mechanism they combine functions that remain distinct in the public domain. Private enforcers operate as dispute solving instruments between regulators and regulated, among regulated and between regulated and third parties. In relation to the first type of dispute their activity mirrors judicial review and to some extent that of a constitutional tribunal that interprets the general principles of the regime. In relation to the other sets of disputes the enforcer reflects more the function of a commercial or criminal judge depending on the violations and the correlated sanctions. The distinction between civil and criminal enforcement, so relevant in the public domain, loses traction in the private domain where often the two dimensions interplay. Clearly there are or should be limits to this overlap when due process rules are applied depending on whether fundamental rights are involved in the litigation.

**278. Hierarchical versus cooperative enforcement.** Within private regimes there is a consistent trend towards the adoption of cooperative enforcement and that of escalating sanctioning policies. This trend concerns both direct enforcement on the one hand and certification and auditing on the other hand. In cooperative enforcement cooperation between enforcer and infringer is the strategy aimed at



detering violations or repairing the consequences caused by the infringement. Practices even more than formal regulation suggest that the private enforcer tries inducing the infringing party to comply and fix the compliance problems, before moving to stronger punitive sanctions (see for example ISEAL Code of ASSURANCE, 6.4.10 remediations and sanctions, ICoCA art. 12). In many instances the rules prescribe that once the infringement has been identified regulated entities submit a corrective action plan subject to the approval of the enforcer. Only if the action plan is not submitted or fails, can the enforcer proceed to issue sanctions which may have a punitive component. The emphasis on cooperative enforcement is consistent with the goal of ensuring regulatory compliance and assumes that violations are non-intentional. The motivations of violations are mainly related to incorrect interpretation of the rules or to inability to cope with the implementation of the standard. Cooperative enforcement facilitates joint problem solving which often involves a plurality of regulated entities as in the case of supply chains. It assumes the necessity to protect collective goods like the reputation of the regime that increase overall effectiveness.

**279. Sanctioning policies** are defined in codes of conduct or regulations and the level of the enforcer's discretion is limited by due process requirements. Sanctions by private enforcers are generally non pecuniary; they differ depending on the membership or non-membership based nature of the organization and they follow an escalating structure correlated to the seriousness of the breach and its repeat nature. The use of injunctions and fines is limited but does occur. Given the contractual nature of private regimes in a case of non-compliance with sanctions it is necessary to refer to the competent judicial system. Often the non executory nature of the sanction administered by private enforcers may cause under-deterrence. These regimes are complemented by administrative and judicial domestic enforcers whose array of remedies permit to expand the scope and the effectiveness (number of claimants, types of remedies) of enforcement for violations of private standards.

**280. Combining legal and non-legal sanctions.** Enforcement policies by private dispute resolution bodies reveal a significant use of reputational sanctions, with a relevant role of media-induced negative publicity. While often formal sanctions are defined in codes of conduct or similar regulatory instruments, informal social and market sanctions operate next to them and provide legal sanctions with a much stronger degree of effectiveness. Market and social sanctions differ across sectors and depend on the culture of the business community within which regulated operate. Even if there are differences in kind and effectiveness non legal sanctions have relevant impact on regulated entities' incentives to comply or deviate from the rules. **The reference to non legal mechanisms should be made explicit and taken into account when effectiveness of the sanctioning policies is evaluated.**

**281. The shifting boundaries between monitoring compliance and enforcement.** The increasing use of cooperative enforcement, the diversification of sanctioning policies, the relevance of non-legal sanctions contribute to **modify the factors**



**determining the distinction between monitoring and enforcement.** On the one hand there is an increasing use and call for non binding ex ante advisory opinions that can direct the choices of regulated entities before the fact. This model has been adopted in the field of advertising (copy advice) but it is likely to spread in other sectors. Ex ante opinions do not legally bind the enforcer but it is very rare that a conduct that has received ex ante approval by the regulator would be later 'disapproved' by the enforcer. On the other hand the increasing use of cooperative enforcement moves the cooperation with regulated entities well within the area of sanctioning, breaking the divide between the area of compliance and that of infringement. **Whilst we believe that distinction between monitoring compliance and enforcement still holds we encourage to rethink its functional boundaries in the light of an enforcement policies that are not limited to a purely reactive mode but uses a proactive approach.**

**282.** The role of public domestic enforcers. Many transnational private regimes are enforced locally by domestic courts and administrative authorities. In some instances because they are incorporated into legislation in other instances as regulatory contracts that identify one legal system as the applicable law. Domestic courts play multiple roles. When private enforcers are missing they represent the primary enforcement mechanisms to solve the different disputes; secondly they interpret private rules and distil general principles whose application may have effects beyond the individual regime; thirdly they operate as gap fillers by applying international law and domestic private law when the regulatory framework is incomplete. Often multiple public enforcers have jurisdiction; conflicting interpretations among domestic courts do emerge as the case of derivatives (ISDA), that of advertising and food safety show. Divergent interpretations about the same rules by local enforcers may endanger uniformity and legal certainty and undermine the ability to pursue regulatory objectives.

**283.** Coordination of enforcement mechanisms about what? There is uncertainty about the functional complementarity between judicial and administrative enforcement and, when in place, between them and forms of enforcement by private bodies. Sometimes they operate as complements, sometimes they overlap. Often they are designed separately and with little foresight about their modes of interaction. Especially given the decentralized nature of enforcement, coordination may become a key variable. In particular we recommend a higher degree of coordination between judicial, administrative and private enforcers in relation to sanctions for the same infringement. Such coordination should reflect the objectives of efficient and effective enforcement combining, if necessary, sequentially different enforcement mechanisms. **We recommend stronger explicit coordination between sanctioning policies related to the various enforcement mechanisms in place in order to maximize compliance and reduce the number of repeat infringements.** We also recommend **specific reporting concerning enforcement that contributes in**

**identifying which infringements are commonly detected and which ones are less observable and less punished.**

- 284.** The use of commercial arbitration is limited also on the basis of obstacles related to the (in)applicability of non-state law. The Hague principles of private international law (November 2012) and some indications stemming from the practice suggest that some changes are taking place as for example the application of IBA rules on evidence and conflict of interest to arbitration (field of professional regulation). **We recommend more radical changes in the law of arbitration both commercial and non-commercial to permit the applicability of transnational private regulation in dispute resolution. More broadly we encourage the creation of professional institutions specialized in dispute resolution,** characterized by independence that can offer different mechanisms for solving disputes within and between private regimes. Hence we recommend the creation of sector specific institutions that can promote the formation of professional enforcers but also ad hoc mechanisms that can solve conflicts among regimes and require different types of skills
- 285.** TPR clearly represents a form of transnational private law (TPL) making primarily created by private actors. Unlike other forms of TPL operating via conventions and model laws which follow territorial patterns, TPR is based on functional regimes whose geographic scope may or may not be coincident with territorial jurisdictions. Hence TPL is formed by several components: legislation, judge made law, private regulation that have different forms of legitimacy and effectiveness, using various forms of enforcement. The interaction between them is limited because TPR has a strong sectoral component, whereas TPL is built around instruments (contracts, property, torts) rather than sectors. In comparison with some of the more conventional instruments TPR shows a higher level of innovation partly due to its hybrid nature and partly due to its flexibility and adaptability.
- 286.** These recommendations acknowledge the deficits both in effectiveness and in the democratic credentials of transnational private regulatory regimes and offer a means to address these through demonstrating performance against stated criteria and simultaneously creating a form of transparency which supports the potential for monitory democracy, in which mutual and overlapping oversight by competitors, CSOs and public actors may hold TPR actors within an acceptable equilibrium.

## **Appendix 1**

### ***The Eleven Project Case Study Sectors***

#### **EUI - Consumer Protection**

Coordinator – Fabrizio Cafaggi

Advertising – Paul Verbruggen

Food Safety A. GLOBALG.A.P. – Donal Casey

Food Safety B. Global Food Safety Initiative and UTZ Certified – Elena Fagotto and Federica Casarosa

#### **Utrecht – Human Rights**

Coordinator – Linda Senden

Data Privacy – Binding Corporate Rules – Lokke Moerel

Private Security Industry - Willem Van Genugten, Nicola Jägers, and Evgeni Moyakine

Aviation Security and Safety – Fiona de Londras

#### **UCD – Financial Markets**

Coordinator – Colin Scott

OTC Derivatives – International Swaps and Derivatives Association – John Biggins

Accounting Standards – International Accounting Standards Board – Burkard Eberlein

Fabrizio Cafaggi - Preliminary version

Project Finance – Equator Principles Association – John Conley and Cynthia Williams

Professional Services – Panagiotis Delimatsis

Bank Payments – European Payments Council – Agnieszka Janczuk

## Appendix 2

### ***Case study Template***

#### **PART (I) – Introduction. General overview**

**I.A. Brief introduction on the key-elements of the study** (e.g.: relevance of the sector within the national and international industry; main changes occurred in recent years; development and relative importance of (trans)national private regulation for the sector).

#### **I.B. Brief historical description of the sector**

The birth of the industry (type, dimension), the role of enterprises and other main actors (NGOs, public bodies, associations, etc.).

- What is their roles?
- What is their legal forms?
- What are their main activities?
- Which type of relationship is set among the different actors?

In this part their critical aspects concerning functioning and the evolutionary perspective should be presented.

#### **I.C. General overview of sector regulation at national and international level:**

- What is regulated?
  - Economic regulation (regulation aimed at addressing the impediments to competition)
  - Social regulation
    - Health and safety
    - Environmental protection
    - Consumer protection
    - Human rights protection
    - Financial stability
    - Others

- Why is the sector regulated? what is the rationale for regulation?
  - Economic / market failure justification for regulation:
    - Impediments to competition (e.g. monopolies)
    - Asymmetrical information
    - Externalities
    - Coordination problems
    - Others
  - Distributive justice
  - Paternalism
- How is the sector regulated?
  - Regulatory instruments for economic regulation:
    - Public ownership
    - Price and quality regulation
    - Competitive public franchising
  - Regulatory instruments for social regulation:
    - Private law
    - Administrative instruments:
      - Prior approval
      - Mandatory standards (output or input standards)
      - Information disclosure
      - Economic instruments
- Is the sector highly or poorly regulated?
  - Is it possible to define a benchmark to assess the intensity or complexity of regulation?
- What is the level of regulation? Who are the competent institutions (national v. international level, public v. private actors, etc.)?
- Are there private organisations (e.g. enterprises, associations) involved in the regulatory process and how?
  - At what level of the regulatory process are private organisations present?
    - Standard-setting
    - Monitoring

- Enforcement
  - Are private organisations the only actors responsible for a given level of regulation or rather is the responsibility shared among private and public actors?
  - Is there a private actor that has a monopoly over a given regulatory level or is there a competitive structure?
- What is the underlying regulatory model?

#### **I.D. International dimension**

Given the previous background information, highlight the international dimension of the sector, e.g.

- Relationships among enterprises at international level
  - Do enterprises at international level cooperate and/or compete with each other?
  - Are there formal relationships among enterprises at international level and of what type are they?
    - E.g. joint-ventures; research and development cooperation agreements etc.
  - Is the relationship horizontal or vertical?
- Existence of associations to which members from different countries participate
- International organizations regulating the sector (with coordinated or overlapping competences), etc
- Formal or informal international cooperation through for example the creation of networks...
- Cross-border characteristics of the sector: Do the goods and services provided by the sector easily move across the borders of national jurisdictions?
  - Is there a cross-border (as opposed to national or local) market for goods or services in a given sector?
  - Is there a potential for a cross-border market ?
  - Is there international public regulation or are national regulations harmonised (in either intended or non-intended way), or are national regulations diversified?

### **PART (II) – The emergence of transnational private regulatory regimes**

#### **II.A. Existing TPRERs**



This part will describe the existing TPRERs in the sector focusing on

- Conditions that lead to the emergence of transnational regulation (e.g. lack of national regulation; existence of international regulation (will not necessarily act as enhancing); international dimension of the sector; level of competition in the sector; etc.)
  
- What are the incentives for the industry to set up TPRERs? (Intrinsic: promotion of integrity and safety of the industry, absence of public regulation, rent-seeking, not realised gains from cross-border activity, etc. or External: pressure by public actors, fear of public intervention, etc)
  
- National, international or global dimension
  
- Main actors that participate to the TPRER?
  - At which stage? creation/implementation/enforcement/monitoring
  - With which function? standard-setting, monitoring, enforcement
  
- What is its relationship with national or international regulation? (given that its pre-existed)
  - None
  - Private regulation fills the gaps left by public regulation
  - Public regulation fills the gaps left by private regulation
  - Public regulation requires private regulation
  - Delegation by public regulation
  - Ex-post approval of private regulation by public acts
    - By public regulation or by judges (centralised vs. decentralised recognition)
  - Contract
  
- Source of financing
  - Public vs. private
  - Internal (industry) vs. external

- Membership fees / selling regulatory outputs etc.
  
- Mechanisms of standard-setting
  
- Internal or external monitoring concerning application of the TPRER
  - External – by whom? Public vs private actors, centralized or decentralized, atomistic or sustained monitoring, etc.,
  - Internal: sustained or atomistic? Centralised or decentralised?
  
- Internal or external enforcement (dispute settlement)?
  - Internal: are all the stakeholders represented? Constant or ad hoc mechanism?
  - External: public or private?
  
- Participation of legal/financial/technical consultants in the elaboration of the TPRER
  
- Existence of sanctions and if so what type: compliance v. deterrence / contract v. statute? It is also important to survey whether these sanctions are established and administered by a private body itself on the basis of privately established standards (i.e. the TPRERs) or whether the body evaluates the behaviour of private actors against public law standards.
  - Public or private sanctions?
  - Types of sanctions: formal or informal; financial (paying a certain fee to TPRER or another body or compensation to the party harmed), naming and shaming, expelling from TPRER etc.
  - Possibility to impose public means to enforce sanctions
  
- Types of TPRERs
  - Technical vs. interest-based TPRERs
    - International business organisations; international NGOs;
  - Legal form
    - Contractual or organisational model
      - Types of contractual relationships
      - Organisational forms: association, foundation, cooperative, company
  - Type of members

- Meta-organisations
- Individual market players
- Public actors

## **II.B. Failed TPRERs**

- Weaknesses of the TPRERs
  - low quality standards
  - insufficient monitoring and/or sanctions
  - too many actors
  - diversified interests
  - opacity
- Conditions that drive to the dissolution of the TPRERs if any (e.g. changed market conditions, national or international regulatory intervention (regulatory intervention might also be sign of success of a TPRER; its effectiveness convinced the statutory regulator to codify the TPRER))

## **Part (III) – Conclusions**

In this last part each of the following elements should be autonomously evaluated to provide a useful framework. Common parameters should be chosen to facilitate the comparison between sectors.

### **III.A. Legitimacy**

- Procedural transparency
- Inclusion (are all those affected by a norm represented in the creation process?)
- Accountability of private regulators?

It may be useful to differentiate among the regulatory levels: standard-setting, monitoring and enforcement

### **III.B. Effectiveness**

- What are the means used to render the regulation effective in practice?

### **III.C. Enforcement**

- Mechanisms

- o Formal vs. informal (Specify in more detail)
  - o Centralised vs. decentralised
  - o Costly vs. not costly
  - o Public vs. private
- 
- Do they depend upon the source of the norms? Are various norms considered in the enforcement process (e.g. private and public, private from different sources)?
  - Perception of enforcement by (1) regulatees; (2) third parties

### **III. D. Quality**

- Certainty, predictability,
- unambiguity, coherence
- accessibility
- Adaptability, flexibility
- Efficacy
- Costs of standard-setting, monitoring and enforcement
- Conformity with public rules

What are the differences in terms of relationship between regulators and regulated and third parties when an organization has or does not have legal personality? What are the differences when an organization has the non profit constraint or regulate for profit? How does the profit motive change the relationship between regulators and regulated? One of the main question is whether regulated and shareholders coincide ( hence profit goes to the regulated) or do not coincide ( hence the profit goes to shareholders but not to the regulated). In the case of ISDA there is a double dimension

- a) It is non profit
- b) Members do not coincide with regulators