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# **A Human Rights Based Approach to International Financial Regulatory Standards**

By Daniel D. Bradlow

Globalization and information and communication technologies pushed national financial regulators to establish international standard setting bodies (SSBs) which promote non-binding international financial regulatory standards. However, finance inevitably has social and human rights impacts and the SSBs and their members are not meeting their responsibility to account for these impacts in their international standards. This failure means that financial regulators and institutions may underestimate the risks associated with their operations leading to misallocations of credit, less safe financial institutions and less efficient and transparent financial markets. To avoid this problem, SSBs should adopt a human rights approach to standard setting. The benefits of doing so will exceed the costs.

*La mondialisation et les technologies de l'information et de la communication ont incité les autorités nationales de réglementation financière à créer des organismes internationaux de normalisation qui établissent des normes internationales de réglementation financière non contraignantes. Or, la finance a inévitablement des répercussions sociales et des répercussions sur les droits humains et ni les organismes de normalisation ni leurs membres ne les prennent en compte quand ils élaborent les normes internationales. Les organismes de réglementation financière et les institutions financières peuvent donc sous-estimer les risques associés à leurs activités ; il en résulte une mauvaise attribution des crédits, des institutions financières moins sûres et des marchés financiers moins efficaces et moins transparents. Pour y remédier, les organismes de normalisation devraient prendre en compte la dimension des droits humains dans l'élaboration des normes. Les avantages à en retirer seront plus importants que les coûts.*

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***La mundialización y las tecnologías de la información y las comunicaciones han inducido a las autoridades nacionales de reglamentación a crear órganos normativos internacionales que establezcan normas de reglamentación internacionales no vinculantes en el ámbito financiero. Sin embargo, el sistema financiero afecta inevitablemente a las esferas sociales y de derechos humanos y ni los órganos normativos internacionales ni sus miembros están asumiendo la responsabilidad de tomar en cuenta estos efectos en sus normas internacionales. Esta omisión implica que las autoridades de reglamentación y las instituciones financieras pueden subestimar los riesgos asociados con sus operaciones lo que da lugar al otorgamiento desafortunado de créditos y hace las instituciones financieras menos seguras y los mercados financieros menos eficaces y transparentes. Para evitar ese problema los órganos normativos deben adoptar un enfoque basado en los derechos humanos en la elaboración de las normas. Los beneficios de hacerlo serán mayores que los costos.***

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Historically, finance was essentially a domestic economic activity and financial regulation was viewed as the prerogative of a sovereign state. This situation had two important policy implications. First, governments could regulate their financial sectors so that it supported their domestic policy objectives. This meant, for example, that they could decide what types of activities banks and other financial institutions could undertake, how they should allocate credit and how much risk they should assume.

Second, governments decided how financial institutions should account for the social, and human rights impacts of the projects and programs that they funded.<sup>[1]</sup> They could either socialize these costs or compel financial institutions and their clients to account for them in the planning and budgeting of their transactions.

Over time, globalization and information and communications technologies have undermined national financial regulation. They have pushed financial regulators to create international standard setting bodies (SSBs) to discuss and agree on non-binding international financial regulatory standards that facilitate coordination between national regulators. These standards deal with such issues as the safety and soundness of financial institutions, the operation of efficient and fair financial markets, and the structure and functions of financial regulatory authorities.

These forces have also exacerbated concerns about the efficacy of the financial sector. A well-functioning financial sector promotes savings and investments that create jobs and produce the goods and services that people need, thereby contributing to a society's wealth, resilience, sustainability and welfare. However, the financial sector has been misallocating funds and failing to deliver the expected benefits. For example, about 85% of

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the business of banking in the US consists of buying and selling existing assets, rather than funding the development of new assets. In addition, unemployment, poverty and inequality are increasing around the world and many societies are showing symptoms of social fragility, such as substance abuse, breakdown of families and intolerance.<sup>[2]</sup> Financial institutions are also funding projects around the world that are having profoundly adverse impacts on people, communities and the environment.<sup>[3]</sup>

The fact that the operations of financial institutions, financial markets and financial regulators inevitably affect people means that they cannot avoid having human rights impacts. Consequently, it is noteworthy that the SSBs have not developed standards for dealing with these human rights impacts. Their failure to do so increases the chances that the financial sector will under-estimate the risks and over-estimate the benefits of its activities. This in turn increases the risk that it misallocates credit and overestimates the safety and soundness of financial institutions, the efficiency of financial markets and the stability of the financial system.

This paper argues that the SSBs and their members can mitigate this risk by adopting a human rights based approach to financial regulation. In order to make this case, the paper is divided into three sections. The first provides an overview of the international financial regulatory standards. The second discusses how human rights can contribute to the work of the SSBs. The third is a conclusion.

### **The SSBs and the International Financial Regulatory Standards**

There are fifteen SSBs.<sup>[4]</sup> They have developed the regulatory standards that are included in the compendium of international economic and financial standards (the Compendium) maintained by the Financial Stability Board (FSB), which operates as a coordinating body for the SSBs<sup>[5]</sup>.

Space does not permit a full discussion of all the SSBs. Consequently, the paper focuses on the three most prominent SSBs. They are the forums in which the regulators of the banking, securities and the insurance industries meet.

The Basel Committee on Banking Supervision (BCBS) is the “primary global standard-setter for the prudential regulation of banks”.<sup>[6]</sup> Its members are representatives of independent supervisory agencies or central banks from 28 countries. They are expected to incorporate the standards that they have developed in the BCBS into their national laws

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and regulations. In addition, despite its limited membership, the BCBS's mandate is to “strengthen the regulation, supervision and practices of banks worldwide”.<sup>[7]</sup>

The BCBS has two prominent international standards. The first establishes a framework to promote the resilience of banks.<sup>[8]</sup> The most recent version of this standard, Basel III, uses three tests—a risk-weighted capital to assets ratio, a liquidity coverage ratio and a net stable funding ratio—to assess the adequacy of a bank's capital.<sup>[9]</sup> It also establishes three criteria—capital adequacy, governance and risk management practices and the quality of public disclosures--that investors and regulators can use to assess the robustness of financial institutions.

The Core Principles for Effective Banking Supervision<sup>[10]</sup> stipulates 29 principles with which banking supervisory authorities should conform to if they are to effectively oversee the safety and soundness of their banks. The principles deal with the powers and functions of banking supervisors and their supervisory responsibilities.

The second SSB is the International Organization of Securities Commissions (IOSCO) whose members are the regulators of securities markets in 115 jurisdictions.<sup>[11]</sup> It “develops, implements, and promotes adherence to internationally recognized standards for securities regulation” and facilitates cooperation among securities regulators.<sup>[12]</sup> Its most prominent standard is the IOSCO Objectives and Principles of Securities Regulation.<sup>[13]</sup> These 38 principles deal with the powers and functions of the regulators of securities markets, protection of investors, ensuring that securities markets are “fair, efficient and transparent” and managing systemic risk in financial markets.

The third SSB is the International Association of Insurance Supervisors (IAIS) whose members are “insurance regulators and supervisors of more than 200 jurisdictions”.<sup>[14]</sup> Its goal is to promote consistent and effective regulation of the insurance industry so that insurance markets are fair, safe and stable. The Insurance Core Principles stipulate 26 principles to promote an insurance supervisory authority that is independent, accountable and transparent and that can oversee a fair, safe and stable insurance industry.<sup>[15]</sup>

Although none of the international financial regulatory standards are legally binding, there are some *de facto* means for enforcing them.<sup>[16]</sup> For example, the International Monetary Fund (IMF) and World Bank use them in preparing their individual country Reports on Standards and Codes (ROSCs).<sup>[17]</sup> These reports assess how well the country is complying with the provisions of these standards and codes. The IMF may use this

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information in its policy discussions with the member state and it may influence the technical assistance the IMF and World Bank offer the member state. In principle, the IMF and/or the World Bank can also use this information in developing the conditions that they attach to any financing that they offer to the member state.

Financial markets offer another mechanism for *de facto* enforcement. A state's failure to comply with the standards may adversely affect its access to financing and its cost of funds.<sup>[18]</sup>

Given their limited memberships, it is ironic that the SSBs' standards may, because of the ROSCs and market forces, become more enforceable in countries that do not participate in their formulation than in some of those that do.

### **Human Rights and the SSBs**

The preamble to the Universal Declaration of Human Rights states that "every organ of society ...shall strive...to promote respect" for human rights and to secure their "universal and effective recognition and observance".<sup>[19]</sup> The SSBs, their member regulatory authorities and all financial institutions qualify as "organs of society". They therefore, have a responsibility to respect human rights. This means that their actions should be consistent with human rights principles. In addition, they should not do anything that undermines efforts by other actors to meet their own human rights obligations and responsibilities.

The national financial regulatory authorities that participate in the SSBs are agencies or instrumentalities of sovereign states that have signed human rights treaties and that are bound by applicable customary international law principles. Consequently, they are bound by the commitments of their home states. This includes protecting, respecting and working to fulfil human rights both in their national regulatory work and in their participation in the SSBs.

Despite their human rights responsibilities and obligations, the SSBs and their participating national regulatory authorities have not addressed the human rights impacts of the financial sector. Their failure to do so is implicitly a decision to externalize the human rights impacts of their standards and the transactions entered into pursuant to them. This in turn risks exacerbating the adverse human rights impacts of any particular standard.

It is important to note that while finance can impact all human rights, there are some human

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rights that are implicated in almost all financial activity. These are:

- *The right of non-discrimination*<sup>[20]</sup>. This applies to questions of access to financial services, the range of products that financial institutions offer and their suitability for the needs of their consumers, and to the inclusiveness of the financial system.
- *The right of access to information*<sup>[21]</sup>. In order for the financial system to function effectively, all its participants need sufficient information to make informed decisions.
- *The right to privacy*<sup>[22]</sup>. Since information plays such a critical role in financial decision making there is a risk that financial institutions may ask for inappropriate information or will mismanage<sup>[23]</sup> or misuse the information that they receive.
- *The right to an effective remedy*<sup>[24]</sup>. This right becomes relevant when other human rights are infringed. This can happen, for example, when individuals are deemed to be undesirable customers by financial institutions, when they are accused of engaging in unlawful conduct in financial markets or of using the financial system for unlawful purposes.
- *Economic, social and cultural rights*: Article 2 of the International Covenant on Economic, Social and Cultural Rights (ICESCR) stipulates that signatory states must use “maximum available resources” to progressively realize economic social and cultural rights. This article, thus, acknowledges that, based on local conditions, not all signatories may be in a position to provide all ESC rights to all their citizens at the time they become parties to the ICESCR. As a result, they are obliged to work “progressively” towards the goal of full realization of these rights. It also stipulates that states must use the “maximum” and not necessarily “all” available resources for this purpose. It is important to note, however, that “maximum available resources” include human, regulatory and supervisory resources, as well as financial resources. The way in which finance is allocated will also have implications for the realization of such economic and social rights as the rights to education, access to health and to work.

### **The Costs and Benefits of a Human Rights Based Approach**

A human rights based approach can benefit financial regulation by contributing to a more accurate assessment of the true costs and benefits of proposed international standards. However, by adding additional tasks to the standard-making process, a human rights approach will increase the costs of making and implementing international regulatory standards.

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### ***The Benefits of a Human Rights Approach***

Human rights can add value to international financial standard setting in a number of different ways.

First, a human rights approach by making transparent the impacts of proposed standards on individual savers, investors and consumers of financial services helps the SSBs and their members develop a disaggregated understanding of the positive and negative impacts of any standard on the different groups of stakeholders in the standard. This should help them formulate standards that optimize the positive and mitigate the negative impacts of the standard on the stakeholders in the financial sector. This information should enable them to more accurately assess how well the financial system is performing all its functions, the safety and soundness of individual financial institutions, the efficiency and fairness of financial markets and the sustainability and stability of the system. Such an approach, for example, will ensure that the regulators capture the impact of the Basel standards on the ICESCR requirement that states and their agencies allocate maximum available resources to the progressive realization of ESCR. This information can only be garnered from an explicit human rights analysis.

Second, a human rights based approach will require regulators and the SSBs to more actively engage with all the stakeholders who may be affected by a proposed standard and exchange views with them about the content of the standard and their possible responses to the standard. This increased engagement should provide the SSBs with new information that makes it easier for them to identify and address any unintended consequences of the proposed standard. It should also promote standards that are as responsive as possible to the needs of the regulators, the regulated entities and their customers.

Third, in order to conduct an effective human rights analysis, the formulators of the standards will need to be transparent and open to participation by all stakeholders. This in turn should increase confidence that the international standards are serving the needs of all stakeholders in the financial value chain. It should also enhance their legitimacy and credibility, thereby making the standards more robust.

### ***The Costs of the Human Rights Approach***

A human rights based approach to regulation has two significant downsides. First, it is inevitable that the cost of developing international standards will increase if the SSBs and

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national regulatory authorities need to undertake a human rights risk assessment for each proposed and adopted standard. Furthermore, the costs of monitoring and evaluating the implementation and effectiveness of these standards will rise.

Second, there is a risk that requiring financial regulators to incorporate human rights related tasks into their work could potentially compromise their independence. Given that human rights impacts are hard to quantify, the regulators and supervisors will need to exercise some discretion in deciding how to manage these impacts. The way in which they exercise their discretion may subject them to increased scrutiny and political pressure, possibly leading to calls for them to be subjected to more oversight and to having less independence.

### ***The Benefits Outweigh the Costs***

As indicated above, the negative human rights impacts will occur regardless of whether financial regulatory standards account for them. This means that currently the SSBs, their members and their regulated entities are incorrectly calculating the costs and benefits of their actions. This leads to distortions in the allocation of finance and imposes opportunity costs, measured in economic, financial, and human rights terms, on society.

Making the human rights costs more transparent will help reduce these distortions and costs. This, in turn, will have beneficial effects on the safety of financial institutions, the efficiency of financial markets and the stability of the financial system. It will also have a positive effect on the allocation of financial resources and on financial inclusion, thereby promoting a financial system that helps make societies wealthier and contributes to their resilience, stability and welfare.

It is important to note in this regard, that the SSBs can mitigate the costs of adopting a human rights based approach by learning from the experience that financial institutions have gained from their use of some of the most relevant international standards namely the UN Guiding Principles on Business and Human Rights (UNGPs)[\[25\]](#) and the Equator Principles (EPs).[\[26\]](#)

The UNGPs consists of 31 non-binding principles that were unanimously adopted by the state representatives on the United Nations Human Rights Council in 2011. The UNGPs have three pillars, dealing with the human rights obligations of states, the human rights responsibilities of companies and the need to offer remedies to affected parties. The

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responsibility of companies to respect human rights means that they should avoid infringing human rights and should address the adverse human rights impacts of their own operations and those in which they are directly involved. The principles also stipulate that businesses should have human rights policies that are approved at a high level in the company and are publicly available. The UNGPs clearly state that companies should have in place due diligence procedures to identify, prevent, mitigate and account for the human rights impacts of their operations.

A small group of banks have formed the Thun Group to encourage the incorporation of the UNGPs into the operations of banks.<sup>[27]</sup> Although most financial institutions are not participants in this group, many of the major international financial institutions, in fact, have adopted human rights policies and/or express support for human rights in their public reports. These include, for example, thirty of the thirty-eight financial institutions represented on the Board of Trustees of the Institute for International Finance.

The EPs were developed by representatives of financial institutions working with the International Finance Corporation and some civil society groups. They are intended to guide the conduct of signatory banks engaged in financing projects whose total capital value exceeds \$10 million. They have been adopted by 94 financial institutions in 37 countries covering the majority of projects being financed around the world. The EPs are based on the International Finance Corporation's (IFC) Sustainability Framework.<sup>[28]</sup> There have been three iterations of the EPs since 2003 and a fourth is currently under consideration. In each case, the changes have been stimulated by changes in the IFC's Sustainability Framework. Currently the EPs consist of a set of performance standards dealing with environmental, social and labor issues.

## **Conclusion**

Financial systems are complex and changing fast. In response, the SSBs must develop international standards that respond to the evolution of the financial system and its changing impact on social welfare, job creation, and social and economic resilience. However, these standards will have human rights consequences regardless of whether or not the standards account for them. Such costs are particularly high when they fall on those who cannot easily bear them. Consequently, it is preferable that the SSBs incorporate a human rights approach into their standard making process. This will not only make the costs and benefits of the proposed standard more transparent but will also increase the capacity of the SSBs and their members to ensure that the standards do not impose

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disproportionate burdens on some of the more vulnerable stakeholders in their work.

There are precedents for expanding financial sector rulemaking to include non-financial factors. This has been done in regard to promoting financial inclusion in financial systems across all continents. The Financial Stability Board has also encouraged the SSBs to reflect on their specific roles and responsibilities in relation to climate change. While these are both welcome developments, they should not be viewed as obviating the need for a human rights approach to financial regulation.

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[1] It should be noted that a similar point can be made about environmental impacts. This paper, because it is focused on human rights, does not develop this issue.

[2] See, for example, Thomas Piketty, *Capital in the Twenty-First Century* (Harvard University Press, 2014); Branko Milanovic, *Global Inequality - A New Approach for the Age of Globalization* (Belknap Press, 2016); Anne Case and Angus Deaton, '[Suicide, Age, and Wellbeing: an Empirical Investigation](#)', *NBER Working Paper* 21279, June 2015, in David A. Wise (ed.), *Insights in the Economics of Aging* (Chicago: University of Chicago Press, 2017), Chapter 10, 307-34; and Anne Case and Angus Deaton, '[Mortality and Morbidity in the 21st Century](#)', *Brookings Papers on Economic Activity*, Spring 2017, 48(1): 397-476.

[3] See, for example, OUR COMMON FUTURE, Report of the World Commission on Environment and Development (1987); DAMS AND DEVELOPMENT: A NEW FRAMEWORK FOR DECISION MAKING, Report of the World Commission on Dams (2000).

[4] The fifteen SSBs are: Basel Committee on Banking Supervision (BCBS), Committee on the Global Financial System (CGFS), Committee on Payments and Market Infrastructures (CPMI), Financial Action Task Force on Money Laundering (FATF), Financial Stability Board (FSB), International Association of Deposit Insurers (IADI), International Association of Insurance Supervisors (IAIS), International Accounting Standards Board (IASB), International Auditing and Assurance Standards Board (IAASB), International Monetary Fund (IMF), International Organisation of Pension Supervisors (IOPS), International Organisation of Securities Commissions (IOSCO), Joint Forum (JF), Organisation for Economic Co-operation and Development (OECD), World Bank (WB); see FSB, 'Standard-Setting Bodies in the Compendium', available at: <http://www.fsb.org/what-we-do/about-the-compendium-of-standards/wssb/> (accessed March 2018).

[5] See <http://www.fsb.org/>.

[6] See 'About Basel Committee,' <https://www.bis.org/bcbs/about.htm?m=3%7C14%7C573>.

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[7] See 'About Basel Committee,' <https://www.bis.org/bcbs/about.htm?m=3%7C14%7C573>.

[8] See Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 available at [http://www.bis.org/publ/bcbs189\\_dec2010.htm](http://www.bis.org/publ/bcbs189_dec2010.htm).

[9] See Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010, available at [http://www.bis.org/publ/bcbs189\\_dec2010.htm](http://www.bis.org/publ/bcbs189_dec2010.htm).

[10] See Basel Committee on Banking Supervision: Core principles for effective banking supervision (2012), available at <http://www.bis.org/publ/bcbs230.htm>.

[11] See 'About International Organization of Securities Commissions (IOSCO)' at [https://www.iosco.org/about/?subsection=about\\_iosco](https://www.iosco.org/about/?subsection=about_iosco) (last visited on 23 August 2018).

[12] See, for example, IOSCO Multilateral Memorandum of Understanding available at: [http://www.fsb.org/2012/05/cos\\_020501/](http://www.fsb.org/2012/05/cos_020501/).

[13] See 'IOSCO Objectives and Principles of Securities Regulation' available at <https://www.iosco.org/about/pdf/IOSCO-Fact-Sheet.pdf>.

[14] See <http://www.iaisweb.org/home>.

[15] See <http://www.iaisweb.org/page/supervisory-material/insurance-core-principles/file/58067/insurance-core-principles-updated-november-2015>.

[16] There are other peer review mechanisms that also give these standards some de facto enforcement. They are the reviews by the Financial Stability Board, see <http://www.fsb.org/about/>, and the Regulatory Consistency Assessment Program (RCAP) of the Basel Committee. See <http://www.fsb.org/what-we-do/implementation-monitoring/monitoring-of-priority-areas/basel-iii/>; <http://www.bis.org/bcbs/implementation.htm?m=3%7C14%7C587>.

[17] IMF's 'Standards and Codes—Implementing the Fund's Medium-Term Strategy and the Recommendations of the 2005 Review of the Initiative' available at <http://www.imf.org/external/np/pp/eng/2006/062906.pdf>.

[18] See generally the OICV-IOSCO Final Report (2008) 'The Role of Credit Agencies in Structured Finance Markets', <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD270.pdf> on the use of ROSCs by credit rating agencies and investors.

[19] Office of the High Commissioner for Human Rights (OHCHR), 'Universal Declaration of Human Rights (UDHR)', entered into force 1948, General Assembly Resolution 217, available at: [www.ohchr.org/EN/UDHR/Documents/UDHR\\_Translations/eng.pdf](http://www.ohchr.org/EN/UDHR/Documents/UDHR_Translations/eng.pdf) (accessed March 2018).

[20] International Covenant on Economic, Social and Cultural Rights (ICESCR, 1966), Arts. (2)2 and 3.

[21] International Covenant on Civil and Political Rights (ICCPR, 1966), Art. 19.

[22] UDHR, Art. 12 and ICCPR, Art. 17

[23] The risk of mismanagement of information has become more important as the issue of

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cyber-security becomes a more significant risk for the financial sector. See for example, Equifax, 'Equifax Cyber-Security Incident Involving Consumer Information', 7 September 2017, available at: [www.equifaxsecurity2017.com/2017/09/07/equifax-announces-cybersecurity-incident-involving-consumer-information/](http://www.equifaxsecurity2017.com/2017/09/07/equifax-announces-cybersecurity-incident-involving-consumer-information/) (accessed March 2018).

[24] UDHR, Art. 8 and ICCPR, Art. 2(3).

[25] United Nations Office of the High Commissioner for Human Rights, Guiding Principles on Business and Human Rights, U.N. Doc. HR/PUB/11/04, [http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf).

Another prominent international standard in this category is the OECD, Guidelines for Multinational Enterprises (May 25, 2011), <http://www.oecd.org/daf/inv/mne/48004323.pdf>.

[26] See [http://equator-principles.com/wp-content/uploads/2017/03/equator\\_principles\\_III.pdf](http://equator-principles.com/wp-content/uploads/2017/03/equator_principles_III.pdf), <http://www.equator-principles.com/>.

[27] The Thun Group members include Barclays; BBVA; Credit Suisse AG; ING Bank N.V.; RBS Group; UBS AG; and UniCredit. See [https://www.ubs.com/global/en/about\\_ubs/ubs-and-society/how-we-do-business/sustainability/thun-group.html](https://www.ubs.com/global/en/about_ubs/ubs-and-society/how-we-do-business/sustainability/thun-group.html).

[28] [http://www.ifc.org/wps/wcm/connect/Topics\\_Ext\\_Content/IFC\\_External\\_Corporate\\_site/Sustainability+and+Disclosure/Environmental-Social-Governance/Sustainability+Framework](http://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_site/Sustainability+and+Disclosure/Environmental-Social-Governance/Sustainability+Framework)

**Author: Daniel D. Bradlow is South African Research Chairs Initiative (SARChI) Professor of International Development Law and African Economic Relations at the University of Pretoria. Email: [danny.bradlow@up.ac.za](mailto:danny.bradlow@up.ac.za).**

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**For more information, please contact Anna Bernardo of the South Centre: Email [bernardo@southcentre.int](mailto:bernardo@southcentre.int), or telephone +41 22 791 80 50.**

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