Global Banks in National Markets
A Theory of Post-Crisis Reform as Democracies Under Constraint

Thesis submitted in partial fulfilment of the requirements of the degree of

DPhil in Public Policy

Blavatnik School of Government, University of Oxford

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St Cross College, Trinity Term 2023

Word count: 99,105



Acknowledgements

A DPhil is a long journey during which many debts are accrued. Thanks to a European Research Council-funded scholarship (Advanced Grant agreement 787887), these are fortunately not of the monetary kind. It has been a great privilege to be part of the innovative Banklash Project, which has provided a prime intellectual environment in which to ask big questions about capitalism and democracy.

I hope in trying to answer such questions that I have done justice to the time and wisdom that many people have given. This project would not have been possible without my supervisor, Pepper Culpepper. Pepper shares a fascination with the political economy of finance, but is also a formidable academic sparring partner who has kept me on my toes and made me a far better social scientist. I cannot wait to see the corpus of Banklash research take shape.

It would be no exaggeration to say that I am indebted to every single faculty member of the Blavatnik School for their input. In particular, I thank Julien Labonne, Karthik Ramanna and Ngaire Woods for some inspired conversations, which helped me to clarify my thoughts and better structure the project. Emily Jones has examined this work at each of the three key DPhil milestones. I am very lucky to have had her intellectual engagement throughout the process.

The Blavatnik DPhil community has been academically rewarding and made for some lifelong friendships. Fellow "Pepper people" on this journey – Clemence, Lorenzo and Robin – made it a happier and more enriching one. I am grateful to fellow Bank-lasher Mika-Erik Moeser for assistance with interview transcriptions, and to Maxime Kern for German translations.

Outside the department, my list of acknowledgements becomes only longer. At various stages of this project, I am thankful for professional and personal advice from: Joe Ganderson, David Howarth, Scott James, Sheila Jasanoff, John Kay, Ranjit Lall, Daniel Kinderman, Elsa Massoc, Colin Mayer, Meghan O'Sullivan, Konstantin Oppolzer, Stefano Pagliari, Paul Pierson, Paul Tucker, Stewart Wood, Steve Vogel, Kevin Young, Nick Ziegler, and others whom I may have missed.

I am also profoundly grateful to Jacquie Rawes, my tutor since I was writing about *Hamlet* at Corpus Christi College aged 20. As well as numerous stays in her beautiful home, she has been enormously patient identifying dyslexia-induced mistakes in my writing these past months.

This kind of research relies on the willingness of a significant number of professionals to give up their time and offer their critical insights on the policy process. Many interviewees are cited in this dissertation. But I would in particular like to thank David Murphy, Brian Polk and Sir John Vickers for taking a sustained interest in this work as it developed.

Finally, to my friends and family. Olivia has been a partner in crime for the last 30 years, and a pandemic-era DPhil was made so much better for her company. To my partner Max, thank you for bearing with many months of antisocial work routines. Exploring Italy – and less talk about designing tables – are exciting prospects. My brother Alex has also been a rock of support. The final word I will give to my parents, Carol and Andrew, whose support and lifelong commitment to education gave me the tools and wherewithal to write this thesis.

Abstract

Why have global banks been subject to such varying regulatory reform since the Global Financial Crisis? Despite a far-reaching global regulatory regime, many states supplemented these multilateral efforts with their own unilateral interventions, a process that has led the Financial Stability Board to warn of a "global fragmentation of the financial system". This thesis argues that these unilateral reforms of global banks are the outcome of *democracy under constraint*. In the wake of the Global Financial Crisis policymakers faced unprecedented popular outrage over the activities of large financial institutions. The increasing salience of this issue forced them to respond to the democratic pressure for reform. In many cases, this response was constrained not by elite capture, but by economic pressure. Many advanced democracies are highly dependent on the value that financial institutions create in global markets, which they extract as fiscal revenue. Therefore, the degree of reform they can impose is constrained by its potential negative effect on the global firms that are intertwined with their national economies. The higher the state's dependency on global banks, the more constrained will be the democratic response. This theory of post-crisis reform as *democracy under constraint* is tested on regulatory outcomes in three democracies which in 2011 were home to just under half of the world's global banks: Switzerland, the United Kingdom and the United States. Australia – which did not experience bank bailouts in 2008 – is incorporated as a shadow case. This theory of post-crisis reform challenges established models. These have focused mainly on relationships among institutional elites and have failed to provide a comprehensive explanation for varying national responses to the GFC. By identifying the democratic drivers behind the most significant post-GFC reforms of global banks, this thesis offers a new and plausible explanation for the diverse regulatory outcomes. If it can be ascertained that democracy is able to reform global finance even under powerful economic constraints, this broadens the policy terrain in which the rules of advanced capitalism can be contested.

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List of Acronyms

ACD	Advanced Capitalist Democracy
ATS	Alternative Trading System
BCBS	Basel Committee on Banking Standards
CCP	Central Clearing Party
CET1	Common Equity – Tier 1
CFTC	Commodity Futures Trading Commission (USA)
D-SIB	Domestic-Systemically Important Bank
DVC	Double Volume Cap
EMIR	European Market Infrastructure Regulation
ESMA	European Securities and Markets Authority
FDIC	Federal Deposit Insurance Corporation (USA)
Finma	Swiss Financial Market Supervisory Authority
FAT	Financial Activities Tax
FMI	Financial Market Infrastructure
FCA	Financial Conduct Authority (UK)
FSA	Financial Services Authority (UK)
FSB	Financial Stability Board
FSC	Financial Stability Contribution
FSI	Financial System ("Murray") Inquiry (Australia)
FTT	Financial Transactions Tax
G20	Group of Twenty
GFC	Global Financial Crisis of 2007-9
G-SIB	Global-Systemically Important Bank
G-SIFI	Global-Systemically Important Financial Institution
ICB	Independent Commission on Banking (UK)
IMF	International Monetary Fund
IRB	Internal Risk-Based model
LCH	London Clearing House
MFI	Markets in Financial Instruments
MIFID 1	Markets in Financial Instruments Directive I (EU)
MIFID 2	Markets in Financial Instruments Directive II (EU)
Nesta	National Endowment for Science, Technology and the Arts (UK)
OCC	Office of the Comptroller of the Currency (USA)
ONS	Office for National Statistics (UK)
OTCD	Over-the-Counter Derivative
PRA	Prudential Regulation Authority (UK)
RBA	Reserve Bank of Australia
RBS	Royal Bank of Scotland (UK)
PCBS	Parliamentary Commission on Banking Standards (UK)
SEC	Securities & Exchange Commission (USA)
SRC	CFA Institute Systemic Risk Council
SNB	Swiss National Bank
TBTF	Too-Big-To-Fail
UK MIFIR	UK Markets in Financial Instruments Regulation

1. Introduction: The National Contests of Global Banking Reform

When the record-breaking tennis champion Novak Djokovic was deported from Australia in January 2022, it was not only sports fans who followed the news with rapt attention. After a successful visa application, the star had entered the country to compete in the Australian Open, but eventually the immigration minister barred Djokovic from entering for not having been vaccinated against Covid-19. Many fellow tennis stars thought Australia's treatment of Djokovic a scandal, with conflicting decisions by officials and detention in an immigration facility. Most articulated the ordeal as a bad outcome for professional tennis. Polls nonetheless showed that the Australian public was far more resolute than its indecisive government: 71% thought it right that Djokovic be barred entry, with just 14% wanting him to be allowed to compete (Crowe 2022). For Australians, the real scandal was that Djokovic had ever been allowed to board his flight. Given the strictness of Australia's Covid-19 rules, it was seen as unfair that a celebrity had seemingly been able to bypass the rules when the government first granted him a visa.

This dissertation is about how rules of the game were contested in a rather different area of policymaking, but one which led policymakers to experience similar, albeit more globally consequential decisions. In 2008, when governments stepped in to prevent global economic meltdown, many soon reached the conclusion that the financial system had been governed such that big banks could reap the rewards of global capital mobility, but in that process much of the associated risk had been passed onto taxpayers. Each of the three countries studied in this thesis – Switzerland, the United Kingdom and the United States – experienced some of the worst effects of the Global Financial Crisis (GFC). Their financial centres in Zurich, London and New York respectively are home to a roster of financial institutions, many of which came close to collapse. Saved only through extraordinary government interventions, including the notorious bailouts, the fight to save these financial centres from ruin was for many policymakers existential.

These industrial agglomerations can be thought of as akin to the world's famed tennis tournaments that take place annually, notably Wimbledon and the US, French and Australian Opens. There are elite players, or firms, who compete. In the tennis world, these include decorated sportspeople such as Djokovic. In banking, firms such as JP Morgan and HSBC dominate various rankings and usually outcompete smaller banks. In tennis tournaments, there are umpires and linesmen who referee individual matches; as well as authorities that coordinate and police the global rules of the sport. Global financial centres, meanwhile, require scores of professional regulators, who supervise banks to ensure compliance with what is today an enormous body of rules and standards. A tournament is brought to life not just by those who play, but also those who pay to watch matches live. They cheer on their favourite players, and even occasionally boo those whom they like less. These people are like bank shareholders financially vested in the success of individual firms. Together, these actors create a whole that is greater than the sum of individual parts: world-famous sports events attract millions of people each year, just as there are globally important urban agglomerations into which an army of skilled and often handsomely paid workers arrive each morning.

This sporting metaphor can be usefully extended to demonstrate the core theoretical contributions of this dissertation. When Djokovic was deported from Australia, decisions made by actors involved in the Australian Open counted for very little. Indeed, Tennis Australia was hotly criticised for supporting Djokovic's attempt to enter the country. What became far more important to Djokovic's fate were the decisions made by the federal and state government. Rather than honour the decision to allow Djokovic into the country with a medical exemption, Australian politicians were faced with a democratic public incensed at what appeared the privileged treatment of a celebrity. Politicians responded to this scandal by barring Djokovic entry. They were criticised by some for backtracking on earlier decisions, but broadly speaking this was a popular decision which Australia as a whole supported. It is unlikely that the tournament could have gone smoothly had Djokovic been allowed to compete, given the scale of public resentment.

Analogous dynamics played out in global banking after 2008. The bank bailouts suspended the rules of the capitalist game, preventing the bankruptcy of firms which had made what turned out to be catastrophic investment decisions. Rather than allowing banks to return to business-as-usual, democracies demanded that rules seen to unfairly benefit wealthy elites be changed. Many thought big banks should only be allowed to re-enter the game of global finance if they abided by a fair and transparent set of rules. The number of spectators who took a keen interest in how the new rules should be designed dramatically increased. It was what took place outside the normally closed world of financial regulation – the ticketed barriers to the tennis stadium, if you will – that became the key site in which reforms were now contested.

The sizeable existing literature on the political economy of finance has rarely focused on this democratic dimension of financial regulation. Instead, as Chapter 2 elaborates, the focus of most studies of post-2008 reform has been on how policy elites interact, implying that the role of mass democracy in this domain of public policy remains at best marginal. Leveraging ongoing inconsistencies found between explanations of elite politics and the regulatory outcomes observed in Switzerland, the UK and US, as well as Australia, the theory set out herein challenges that core assumption. It shows how, in these three democracies each home to globally important financial centres, the normally closed elite world of financial regulation was prized open and subject to democratic scrutiny. Just as most people watching Wimbledon do so from their home televisions, so too, for a limited period after 2008, did financial regulation become a topic that animated often acrimonious national political debate. After 2008, banking reform became an issue that elicited strong public reaction, in much the same way that Novak Djokovic's interactions with the Australian government did during the Covid-19 pandemic. This study examines how policymakers go about incorporating democratic pressure on different policy issues. On the whole voters did not necessarily want the contest to stop; but they wanted players to abide by fair rules.

The second key contribution of this thesis is the explanation it offers for what holds policymakers back from delivering on these democratic pressures. In line with their assumption that financial regulation remains the remit of a closed network of policy elites, studies to date have generally looked to "undemocratic" factors as the main constraint on more significant financial reform. Captured regulators and politicians as well as highly resourced lobbyists are the main actors in these accounts. The scale of elite capture may differ

by country, but the weakness of the public interest is generally seen as a constant. It is assumed that financial sector interests will be especially strong in countries with global financial centres.

This theory instead offers a model of financial reform as *democracy under constraint*. It explains the scope of a national democratic response by reference to how global financial sector agglomerations create economic value within a national political economy. On one hand, the same group of global banks dominates the competitive landscape in the City of London and Wall Street, and to a lesser extent Zurich. Equally, global firms have a home country in which they have their headquarters, certain financial activities in which they are market leaders, and locales in which they have especially sizeable commercial interests. It is at this point that 'global' banking starts to mean something rather different depending on where the term is used. The UK, for example, has had a globally significant financial centre since the Industrial Revolution, but after World War II the biggest British banks have struggled to compete with American, European and Asian firms even on their 'home turf' in the City of London. This trend has been referred to as the "Wimbledonisation" of the City, an apropos idiom alluding to the fact that, just as it is rare that a British player wins Wimbledon, so too the UK has been far more successful in providing a competitive market environment than it has market-leading firms. This has allowed the UK financial centre to grow even as its national economy has shrunk relative to other countries. To this extent, the UK trajectory contrasts with that of the US, where both Wall Street and the national economy continue to loom similarly large in the global economy. American global banks are above all American banks.

When the rules governing such firms become highly salient, such as after a major crisis, it is no longer just a small group of global elites whose views on regulatory governance matter, but also voters of the democracy in which the financial centre sits. After a crisis, the place of the centre in the national political economy becomes crucial to the overall trajectory of reform that takes shape. For the UK and Switzerland, these large financial centres sit in countries which are relatively small. In some cases, the balance sheets of individual global banks competing in them are larger than their entire national economy. As a result, the plurality of financial activity conducted by these firms relates not to underlying national economic, but rather global market activity. These are global banks which also happen to be national economic actors. This dramatically changes the rulemaking environment compared to a country in which the domestic economy remains the main source of commercial activity, as is the case in the United States.

The tennis tournament can again serve as a useful metaphor. To recall the opening vignette of Novak Djokovic being banned from Australia, these events shocked other professional tennis players not because they thought the rules Australia had made were inherently unfair, but because they thought that Djokovic had been treated poorly. The rules Australia had in place were in fact very similar to those in the United States, where Djokovic was similarly barred from entering to play in the 2022 US Open. Yet in contrast to the debacle involving the Australian Open, there was effectively no controversy around Djokovic being banned from the US. While of course much of the tennis world would have preferred that Djokovic play in both tournaments, US authorities did a far better job policing a set of rules that were collectively judged fair. Despite similar rules being applied in Australia and the US, they were the subject of controversy in the first but not the second instance. (Two months prior to the

US Open, Djokovic had been allowed to play at Wimbledon despite his vaccination status. He went onto win for the tournament for the seventh time.)

While there are of course differences, a similar observation can be made of post-crisis banking reform. As the following empirical chapters show, when American policymakers introduced certain post-crisis reforms, global banks had little choice but to abide by the new rules of the game. Even if they saw the rules as poorly designed or executed, the US is simply too important a market, and its government too powerful a global actor, for even the world's biggest banks to refuse to internalise regulatory costs. Aware of that singular position in the global economy, American policymakers can in principle design rules with limited regard to how they compare to those in place in other financial centres. To extend the metaphor, even if the prize money available in New York is less, players have little option but to show up and compete. To not do so would jeopardise their prized global ranking. Where democratic pressures facing US politicians to pass reforms are strong and cross-partisan, this allows for a strong policy response to those demands. These conditions may have coalesced only periodically, but where they did, the democratic response can largely ignore the preferences of policy elites, such as career bureaucrats and well-resourced lobbyists.

Despite also having globally important financial centres, Swiss and British policymakers do not enjoy such a free hand to reform banks constituent in Zurich and London. While each country has sizeable national markets, global banks are far less motivated by the investment opportunities they offer than they are by access to the market infrastructure and other benefits of clustering in a financial centre such as London or Zurich. Of course, firms have some immoveable investments in these centres, such as human capital, real estate, and technology. Given their global imprint, however, they will invariably weigh up the loss of immoveable investment against regulatory costs if they do not relocate activities elsewhere. These firms assess regulatory costs through comparing the different regimes available across similar global financial centres. The prize money given new regulatory costs may simply not worth it; and firms may decide to move certain functions.

The regulatory costs of these disinvestment decisions can tally up not just for a financial centre, but also for a state. Global banks serve an important role in overall tax revenues and high-wage employment in countries such as Switzerland and the UK. Policymakers experience the resulting fallout if industry generates lower revenues. Swiss and British policymakers are cut less slack by industry than are US policymakers, but the costs of disinvestment also run deeper. Where the reforms demanded by democratic publics outpace what can be reasonably achieved without the financial centre losing competitiveness, it is often in the interests of smaller countries to encourage the trading-up of international rules and standards. That way, policymakers can achieve some of the reforms that are democratically demanded, while the regulatory costs are distributed across financial centres.

Given the incompleteness of global regulation, gaps nonetheless emerge between what is demanded by democratic publics and what is achieved by policymakers. In theory, policymakers have the option of regulating more and bearing the resulting costs of becoming a less competitive centre for global finance, and are more likely to do so where the democratic incentives they experience are especially strong. However, if global finance is an especially important industry, those costs quickly stack up. Some voters may be willing to accept those

costs, especially if the benefits they enjoy from the sector are few relative to the high costs of a major crisis. With an eye to the next election, however, politicians are far more cautious about agreeing to costly reforms if that risks jeopardising economic growth. As a result, policy decisions have distributive effects from which some gain more than others. Where global finance is an especially important component of the national economy, the cumulative effect of decisions that distributionally favour finance may make it seem that democracy is wired to bypass voter preferences. In a country such as the UK, which has notably high regional inequalities, such distributional effects may be compounded.

This can sometimes leave policymakers with uncomfortable, even fraught, trade-offs. In the Djokovic case, Australia's response may have seemed especially surprising because the country is known as a nation of sports fans. Yet moral norms that had developed during the pandemic years weighed more heavily than any cultural instinct to welcome a sporting superstar. With that shift in preferences, politicians were unfazed by the reputational costs of deporting a tennis star and chose to deliver a resolution to an Australian public frustrated with prior government decisions. When scaled up to the level of a global financial centre and its role in the national economy, deciding between voter and industry demands can weigh more heavily. Salient voter issues have their own moral economy, which is often different from the cost-benefit estimations made by regulatory policymakers. While ideally a reform could yield both democratic and economic wins, it is often difficult for public policy to achieve such an equilibrium. If it is the job of politicians to seek it, the following pages show how they grappled with such trade-offs. Indeed, much of the time, policy outcomes show *democracies under constraint*, whereby responding to voter demands conflicts with the policies required to sustain a global financial centre. Overall, the constraints on democracy will be bound tighter where voters' demands are stronger and the competitiveness costs associated with reform higher.

This dissertation seeks to establish both the locus and process that led to some of the most significant regulatory change of the post-2008 era. That is an important step to assessing the reach of democracy in a domain of economic governance widely perceived as captured by elite interests. For those motivated to expand that reach, this study shows when there is the highest potential to achieve this. Voters can become not just bystanders, but winning players in contests where the umpire adheres to a clear set of rules. For those seeking to improve regulatory policy, the study identifies where substantive debates play out, the interests that different actors will seek to defend, and alternative pathways to reform that may be possible. Where today there is a tendency to sling mud at elected officials for some combination of capture or ineptitude, this study offers grounds for optimism that mechanisms of responsiveness and accountability exist in advanced capitalist democracy to improve future outcomes. If it is true that the most notable reforms were ushered in through democratic contest, this finding offers scope for future episodes of global economic reform to make a champion of both the economy and democracy.

2. A Theory of Financial Reform as Democracy Under Constraint

2.1 The Post-2008 Reform of Global Banking: Democracy Denied?

Despite the vibrancy and volume of the literature on global financial regulation since 2008, surprisingly limited attention has been paid to the electoral connection between policymakers and voters. Instead, explanations for divergent reform outcomes have focused on varying behaviours and interests of policy elites and special interests, especially pre-existing levels of cooperation and cohesion among policymakers and industry executives (Carpenter and Moss 2014; Ganderson 2020a, 2020b; Grossman and Woll 2014; Howarth and James 2023; Jabko and Massoc 2012; James 2016, 2018; James and Quaglia 2020; Massoc 2018, 2020; Quaglia and Spendzharova 2017; Woll 2014).

In bald terms, these accounts claim that the realities of regulating global finance trump democratic mandates that might exist in favour of more sweeping reform. A stylised depiction of the causal mechanism underlying many of these accounts is shown in Table 2.1. It shows that a policy process is stimulated by a market event – in this case, the banking crisis that occurred during the GFC. This event leads to a diagnosis of the specific policy problem to be solved, for example the widely observed "Too-Big-To-Fail" (TBTF) phenomenon in global finance. Elites – elected officials, regulators, industry executives – enter a negotiation to find a policy solution. The rules of the game are shaped by certain institutional features in the political economy, such as special interest access or autonomous bureaucracies. Actors respond to the market event according to preestablished norms and incentives occurring in the elite network. The outcome from that negotiation is a reform. Since regulatory contestation occurs among elites behaving according to habituated norms, this causal account elides not only the content of voter demands, but even the force that democratic demands for change can produce.

Table 2.1: Causal Mechanism Underlying a "Democracy Denied" Crisis-to-Reform Process

(1) Policy Stimulus	(2) Policy Process		(3) Policy Outcomes
Market **Event** →	Problem **Diagnosis** →	Elite **Negotiation** →	Reform **Output**

The alternative argument, advanced in this dissertation, is that democracy has not been denied in post-crisis reform, but has in fact been the driving force behind diverse national reform processes. The model advanced is that variation in reform across countries is the result not of differences in institutionally preordained elite behaviour, but of the scope of democratic response delivered in each regulatory outcome. Lawmaking bodies are the crucial locus of the reform process, but unlike many existing accounts which focus on the "capture" of these institutions to special interests, in this story the primary interface of concern is that between elected officials and their voters. This section summarises the existing scholarly debate, using this discussion as an opportunity to establish key alternative explanations of post-crisis reform to that proposed by this thesis.

There are two key strands of literature advancing the case that the realities of global finance have narrowed opportunities for the exercise of voter interests. The first of these looks to the increasingly technical and resource-intensive realm of regulatory bureaucracy. The complexity of global financial markets has required increasing technical expertise among the regulatory community. From the black letter detail of regulation to the lag period of bureaucratic implementation after legislation, some scholars have characterised the politics of expertise and bureaucratic behaviour as creating a fault-line between public policy and mass politics.

In the area of financial regulation, this literature has explored, for example, how regulators seek to exploit either a national and divided, or international and "multi-level", regulatory architecture to secure agency preferences (Carpenter 2010a; Jacobs and King 2016; James and Quaglia 2019b, 2020); the process by which legislative reform is undermined through the regulatory capture of bureaucrats (Carpenter and Moss 2014; Coffee 2011); and the strategies industry uses to exert its influence over regulators (Carpenter et al. n.d.;[1] Mankad, Michailidis, and Kirilenko 2019). The former British central banker Paul Tucker diagnoses the lack of accountability in the modern administrative state as constituting "unelected power". In this model of governance, it is proposed that without adequate checks and balances democracies risk sliding into "undemocratic liberalism" where "too little of government is decided at the ballot box" (Tucker 2018, 3). While operationalising bureaucratic power differently, this body of literature has moved the locus of policy contestation away from legislatures and other political institutions. With that shift, this research deemphasises the role that voter interests have on reform outcomes. Democracy is denied at some stage of policymaking prior to implementation.

A distinctive approach has been taken by those scholars who position politicians as active and witting participants. Rather than seeing post-crisis reform as subject to a slow but predictable erosion by bureaucratic agents, the participation of politicians in these accounts brings to the fore faster-placed opportunism and power-play among elected officials. Here, it is activity taking place in the political realm that determines whether a reform will sink or swim. Various mechanisms are proposed for how this process takes place. A US-centric literature cites the "undemocratic" factors eroding responsiveness to voter interests. In this reading, the scale of lobbying and campaign contributions today mean that politicians will reliably choose industry over voter interests for political and financial self-gain (Hacker and Pierson 2010; Igan, Mishra, and Tressel 2009). In this account, more substantial reform is not possible so long as industry can outspend and outmanoeuvre less resourceful interests.

On the other hand, a literature mainly focusing on European political economy has offered a more institutionalist account of how coordination between elected officials and industry impacts outcomes. This literature has theoretical affinity with, although it represents a significant departure from, foundational comparative capitalisms literature (e.g. Hall and Soskice 2001; Zysman 1983). In these accounts, it is the substantial variation in policy responses among political elites, not their predictable co-option by industry, that explains divergent policymaking. Studying several European economies, Elsa Massoc argues that

[1] Unpublished manuscript cited by kind permission of the authors.

differences in how elite networks of elected officials, bureaucrats and industry behave leads to varying policy (Massoc 2018, 2020). Habitually adversarial interaction among elites – as in the UK – makes for weaker state-industry coordination, and in turn outcomes less favourable to firms when industry reform drives the policy agenda. More structured, coordinative policy networks – as in France and Germany – produce outcomes more favourable to industry. This explanation of policy variation is underpinned by sociological relationships sustained among elites; and their electoral connection with voters remains in the background of the model.

Joseph Ganderson opens the door to democratically responsive public policy by foregrounding this electoral dimension to regulatory politics. Aligned with Massoc, Ganderson argues that relations among policymakers and industry are symptomatic of outcomes, but that the underlying reason for elites interacting as they do is the different electoral systems they operate in (Ganderson 2020b, 2020a). Where Massoc operationalises elite interactions through a primarily sociological lens, for Ganderson incentives produced through electoral institutions dictate policy decision-making. On one hand, consensus-driven politics characterised by broad coalitional government – a product of proportional representation – forges links between the plurality of the political class and the policy status quo. This creates what Ganderson refers to as a "politics of association", producing a status quo bias even after a major crisis. The prototypical case here is the Netherlands, although politics of association is also observable in Germany.

Meanwhile, in this model adversarial politics produced through majoritarian voting systems, such as in the UK, incentivises higher party competition over regulation. There is not a "politics of association" reputationally linking opposition parties to the regulatory status quo. A crisis therefore presents an opportunity for the opposition to build a platform which can serve to discredit status quo policies associated with the party of government. Where for Massoc the crucial interface is between policy institutions and industry, for Ganderson industry effectively becomes collateral to the incentives that electoral institutions create to deliver anti-business outcomes. Importantly, party competition is induced through what Ganderson calls a "salience window", which acts as a constant across his cases, in which voters are more likely to be paying attention to the political debate in the otherwise technical and low salience policy area of financial regulation. The content of the demands made by the public of policymakers remains immaterial to the theory; and the policy contest that takes place is chiefly the result of time-invariant electoral behaviour. In Ganderson as well as Massoc's work, in more country cases than not democratic demands are quashed and the content of those demands is mostly overlooked. Nonetheless, this work has shown that important regulatory contests can and do play out in legislatures and originate from voter interests.

These institutionalist accounts offer a serious challenge to the bureaucratic literature, where the implication is that, even if politicians compete vociferously over legislation, the real contest for industry is how this legislation is brought to life via policy implementation (cf. Romano 2014). Nonetheless, even in political institutionalist accounts, although the political sphere may be where the action happens, policy elites secure or disrupt the status quo not because of the actual content of voter preferences, but as a result of how established rules of the political game determine elite behaviour. Even if these two theoretical approaches have vastly different implications, both paint a somewhat deflating picture of

contemporary democracy. Yet these accounts of post-crisis reform have also left unresolved some thorny questions about the causes of different – and theoretically challenging – regulatory outcomes.

Assessing the predictions of these accounts alongside the observed outcomes of bank structural reform, which was a policy issue widely debated in ACDs in the post-crisis period, can help demonstrate some of these gaps. Bank structural reform refers to regulation of the type and range of different activities that can be conducted in a bank. Historically, the most well-known version of this was the Glass-Steagall Act in the United States, passed in the aftermath of the Great Depression before its substantial repeal in 1999. Glass-Steagall enforced full separation between commercial and investment banking activities. After 2008, bank structural reform was either considered or undertaken across many ACDs, mainly as a response to concerns about the mixing of "core" financial services with investment banking/trading in large cross-border banking groups. This mixing, many observers argued, had created a "Too-Big-To-Fail" phenomenon during the GFC, which meant that many states were compelled to bail out large universal banks due to the crucial role that they played in core financial services, such as in retail banking and the payments system.[2] In this way, the TBTF problem manifested as states bailed out the speculative trading activities that many saw as an underlying cause of the GFC and representative of financial sector excesses. Bank structural reform was passed or debated by many ACDs to prevent a recurrence of this sub-optimal outcome.

Table 2.2 sets out several stylised arguments made in the political economy literature and applies them to five countries which as of 2012 were home to the majority of global banks.[3] A typical argument of the business lobbying literature, for example, is that the best-resourced firms are the most successful in attaining their preferences. In the United States, despite banks' consistently high lobbying expenditure that grants supposedly unparalleled access to policy elites, politicians voted for a reform (the Volcker Rule) that continues to frustrate its largest banks. Bureaucrats have persevered with most of these reforms despite herculean implementation challenges and a sustained lobbying effort over the past decade-plus (Allahrakha et al. 2019; Cassidy 2010; Duffie 2012). In contrast, despite their comparatively cash-poor lobbying operations, large French and Dutch banks achieved outcomes widely characterised as favourable to their interests. The dominant explanation in American political science literature that "money talks" in politics clearly fails to explain the European outcomes (cf. Woolley and Ziegler 2011). In fact, it is deeply puzzling that as well-funded an operation as the US bank lobby failed so spectacularly to secure its interests in policymaking institutions.

[2] Universal banks are institutions which combine commercial banking, such as lending and payment services, with other financial services such as wholesale and investment banking (Morrison 2012).

[3] Australia, which is deployed as a shadow case in this study, is not included in Table 2.2 given the absence of bank bailouts and thus the lower drive for bank structural reform after 2008. This case is discussed at length in Chapter 6.

Table 2.2: Competing Explanations for Bank Structural Reform Outcomes Across Cases

	Evidence Base for Competing Explanations of Policy Outcome						
Country	**Bureaucratic Autonomy**	Evidence	**Financial Resource of Bank Lobby**	Evidence	**Political Institutionalist**	Evidence	**Actual Policy Outcome**
France	Highly centralised bureaucracy leads reform	✓	Limited lobbying expenditure reduces financial sector influence over reform	✗	Closed policy elite network coordinates reform	✓✓	Limited reform[4] with broad policy elite consensus
Netherlands	Centralised bureaucracy leads reform	✗	Limited lobbying expenditure reduces financial sector influence over reform	✗	Closed policy elite network coordinates reform	✓✓	No reform with broad policy elite consensus
Switzerland	Federal bureaucracy leads reform	✗	Some lobbying expenditure; some challenges to financial sector interests	✗	Closed policy elite network coordinates reform	✗	Significant reform with limited elite consensus
United Kingdom	Centralised bureaucracy leads reform	✗	Some lobbying expenditure; some challenges to financial sector interests	✗	Adversarial politics leads to political conflict over reform	✗	Significant reform with broad political consensus
United States	Divided bureaucracy yields weak reform	✓	High lobbying expenditure; weak/no reform	✗	Adversarial politics leads to political conflict over reform	✓✓	Significant reform with low political consensus

Key: ✓✓ evidence in support; ✓ limited evidence in support; ✗ evidence against

[4] For detail of the nuanced outcome in France, in which limited reform was used to deter an EU-led reform of broader scope, see Hardie and Macartney (2016).

As for the scholarship arguing that state bureaucracies dictate regulatory outcomes, their general thrust yields the stylised hypothesis that industry is more successful in attaining preferential outcomes when it successfully infiltrates regulatory agencies. Political institutionalist arguments, on the other hand, might explain bank structural reform outcomes with reference to whether political elites in these countries reached a common consensus to deliver policy supportive of or against industry. Yet neither the bureaucratic nor the institutionalist explanations successfully predict outcomes. In the Dutch case, it was politicians (not bureaucrats) who actively blocked reform (Ganderson 2020a), while in France a broad consensus was achieved among politicians and bureaucrats alike to deliver a weak reform which mostly protected the regulatory status quo (Massoc 2018). Meanwhile in the US, despite lower political and bureaucratic support for the chosen policies in a system characterised by its high number of veto players, tough new regulations were implemented. Overall, Table 2.2 shows that none of these explanatory frameworks applies well across cases. Notably, none of these synthetic accounts explains either the UK or Swiss outcomes at all convincingly.

Seeking to explain reforms on both sides of the Atlantic, Scott James and David Howarth recently constructed a hybrid model, coming down somewhere in the middle of these competing political and bureaucratic explanations. They call their theory a "comparative financial power" approach, and focus on the differing ways that banks' instrumental power is exerted (cf. Grossman and Woll 2014; Woll 2012). They propose that the immense lobbying operation of US banks failed to deter costly reform post-GFC because firms compete, rather than cooperate, to achieve political influence. This, they argue, has created a "fragmented [response] subject to challenge by multiple countervailing groups" (Howarth and James 2023, 62). While a contested atmosphere has allowed the US bank lobby to erode reforms over time (what they call "contested reform"), the authors argue that the most "durable" reform occurs when decision-making is taken out of the hands of politicians through venue-shifting to non-majoritarian institutions (ad hoc committees, expert groups, etc.), and where industry is competitive. These venues, they suggest, are less influenced by partisan behaviour and capture by special interests than either legislatures or government bureaucracies. While British industry engages in the same competitive behaviour as occurs in the US, in the UK an ad-hoc expert committee (the Independent Commission on Banking) could overcome special interests and deliver durable reform due to lack of political interference and insulation from special interests. This combination of variables, they argue, explains why the UK achieved the strongest bank structural reform. Meanwhile, less reform was achieved in the two continental European cases they deploy – France and the Netherlands – because, they argue, industry presented a united front of "cooperative" financial power, leading them to successfully counter political appetite for bank structural reform. Table 2.3 provides a summary of this novel contribution.

Table 2.3: Howarth and James' (2023) Comparative Financial Power Approach

		Interest group lobbying	
		Competitive financial power	*Cooperative financial power*
Venue shifting	*Yes*	Durable reform	No reform
	No	Contested reform	Symbolic reform

This hybrid explanation seeks to resolve the difficulties to date of building a theory that can explain reform outcomes across both European economies and the United States. Its predictions are not however borne out in further within-case and cross-case testing. The authors place considerable emphasis on the causal role of delegation and venue-shifting. They thus argue that the strongest reforms occur when the role of political institutions is effectively neutered. Their model does not, however, identify why politicians choose to delegate or proceed with reforms recommended by expert groups regardless of their own preferences. Other recent literature in the political economy of regulation has characterised these principal-agent-type problems as far more determinative (Abbott et al. 2020). If ad-hoc committees are so crucial, it is surprising, and from a theoretical perspective frustrating, that their creation is left essentially contingent.

Indeed, looking more closely at UK bank structural reform (a case study Howarth and James also deploy), it seems remarkable not only that politicians in an adversarial majoritarian system decided to delegate to an expert group, but moreover that there was subsequently almost complete cross-partisan consensus that its recommendations should be accepted. In a world of policy reform replete with expert reviews whose recommendations have negligible impact on politics or policy, a theory that offers no explanation for what allows an ad-hoc institution to become so authoritative remains incomplete.

For his part, Ganderson (2020a) elaborates on why the UK government chose to delegate this highly consequential policy to experts. To recap, Ganderson's core claim is that a party's prior association with the regulatory status quo is the crucial predictor of its stance on reform. In his model, delegation occurs because of the highly unlikely scenario of a coalition government in 2010-15, where politicians who would have otherwise acted in adversarial competition instead sought to defuse one of the most salient political issues of the day. While the decision to delegate does appear to have been a result of these electoral contingencies, that hypothesis struggles to explain why some (backbench/non-government) Labour politicians, being from the party *most closely* associated with the pre-crisis regulatory regime, were crucial players in helping to instigate an expert-led process even while their party remained in government. Ganderson also does not speak to why the outcome of the venue shift – ringfencing retail banking from investment banking – attained seemingly unanimous support among politicians. If political action is determined by association with the pre-crisis regulatory status quo, we should surely be able to observe Labour politicians defending that regime, rather than lending their support on the UK's most significant post-crisis regulatory innovation. In Ganderson's account, evidence of such competition is lacking. Moreover, in the research conducted for this dissertation, interviewees overwhelmingly pointed to the broad political consensus in favour of the ringfencing outcome. This problematises the quite widespread explanation in the literature that UK reforms have been a product of political adversarialism.

To return to the hybrid account of "comparative financial power" (Howarth and James 2023), this model also struggles to explain cases outside the study which should present relatively low hurdles. In the case of Swiss bank structural reform, a similar outcome to the UK was achieved despite its own expert committee explicitly rejecting the policy (Swiss Commission of Experts 2010, 22; see Chapter 4). In this instance, politicians went out of their way to challenge the recommendations of the body they had chosen to delegate to. This is despite

Switzerland possessing cooperative institutions of political economy that a considerable body of theory would expect to produce consensus-based outcomes broadly favourable to big business (Campbell and Hall 2017; Katzenstein 1985). Over time, an outcome rejected by the ad-hoc institution and resisted by the two dominant and "cooperative" (to use their term) Swiss banks, was achieved. According to Howarth and James' theory, ad-hoc institutions combined with cooperative industry behaviour should have created *no reform* in Switzerland, which is what they argue led the Netherlands to reject structural reform. Instead, Switzerland achieved reform that resembles the UK outcome despite the countries diverging on one of their two independent variables. All in all, assessing the various US and European structural reform outcomes in parallel presents challenges that neither the bureaucratic nor institutionalist accounts, nor the novel hybrid offered by Howarth and James, can explain.

This thesis takes up Howarth and James' call to study policy reform across geographies and political economy traditions. On the one hand, the UK and the US are mainstay cases in the comparative capitalisms literature, traditionally categorised as Liberal Market Economies (Hall and Soskice 2001) which before the crisis were known for financial regulation variously known as "light-touch" or "market-making" (Quaglia 2010). Assessing Switzerland – known for its more "coordinated" institutions of political economy – alongside these cases reveals an intriguing feature these three countries share. Each possesses a globally significant financial centre, in New York, London, and Zurich/Geneva. When the FSB and BCBS first published its list of globally systemically important banks (G-SIBs) in 2011, these three countries were home to just under half of these very large firms (see Table 2.14).

According to a bureaucratic account, policymaking in these three countries should be shaped by the highly developed regulatory institutions which are required to govern global financial centres. Yet to date no literature has found that these countries' bureaucrats were instrumental in decisions on the crucial case of bank structural reform. In a lobbying account, meanwhile, it would be assumed that the world's biggest banks would be especially capable of defending their interests on home turf. Yet given the palpable failures of these bank lobbies, such an account is clearly unsatisfactory. Since the UK, US and Switzerland do not share a common set of electoral and political institutions, it cannot be that incentives created by such institutions are doing the causal work. Indeed, it is very surprising that these three countries structurally reformed global banks through unilateral regulatory policymaking, while other ACDs in which these firms are less dominant players did not.

A core proposition of the theory of reform as *democracies under constraint* is that it is difficult to explain these surprising and diverse outcomes without giving a causal role to how high issue salience can work to disrupt preestablished modes of interaction among elites (cf. Culpepper 2011). In this respect, while surveying the literature one could conclude that post-crisis reform across a range of ACDs is a story of "democracy denied", *democracies under constraint* widens that avenue of causal influence. It proposes that voter interests can sometimes upend the established policy process and produce outcomes that may appear discordant with established rules of the game in a political economy. The proposed mechanism underlying a crisis-to-reform process is set out in Table 2.4. As in the "democracy denied" mechanism (Table 2.1), it shows that a policy process is stimulated after a market event such as the GFC. That event leads to voters making (or not making) certain demands of policymakers, the content of which shapes and galvanises the policy process. Policymakers

evaluate the costs of incorporating these voter demands given the presence (absence) of economic constraints that are experienced in the political economy. In the case of post-GFC reform, these constraints come from the costs to a country of passing reforms that would deplete the competitiveness of global banks, which are both important domestic and global economic actors. Policy outcomes are a product of the economic constraints that policymakers face when responding to voter demands.

Table 2.4: Causal Mechanism Underlying the 'Democracy Under Constraint' Crisis-to-Reform Process

(1) Policy Stimulus	(2) Policy Process		(3) Policy Outcomes
Market **Event** →	Democratic **Drivers** →	Economic **Constraints** →	Reform **Output**

For some, the claim that democracy drove post-crisis reform may be a challenging one, given the established narrative that 2008 was "the status quo crisis" (Helleiner 2014). Indeed, ample survey data, as well as the overall climate of populist backlash in many ACDs since 2008, make it clear that many felt that democracy did not deliver a satisfactory response to the GFC (Culpepper, Jung, and Lee 2023). This legacy of democratic discontent raises an additional puzzle: if voter interests did come to matter in the countries under study, an account needs to be offered as to why a policy response originating in democratic demands has failed to quell public antipathy towards finance. From the perspective of many voters, the project of financial sector reform remains unfinished business. The conclusion to this dissertation returns to this puzzle in light of the evidence presented in the empirical chapters.

The following pages endeavour to explain the pattern of post-crisis reform in three ACDs, while paying attention to how that argument can explain outcomes across a broader range of political economies. In particular, the shadow case of Australia is used as a useful counterpoint to the cases of Switzerland, the UK and US, it being a country which avoided the salience shock associated with bailouts and which does not possess global banks.

In this account, the exercise of democratic interests in the contemporary era of global finance has not been rendered impotent. Many of these countries have grown dependent on extracting and distributing the value that global finance creates within their respective national political economies. This growing dependency has meant that elected policymakers face starker trade-offs when voters demand reform. Nevertheless, the empirical chapters show that lawmakers will continue to attempt to reform global banking despite this dependency. In turn, it is the democratic institutions to which they are elected which remain the crucial vehicles for institutional change.

2.2 Theorising Financial Reform as Democracy Under Constraint

The theory can be summarised as follows. As Table 2.5 shows, states exist on a spectrum of dependence on global banks, which the framework terms *State-Banking Sector Dependency*. States that derive high value from the global market operations of the sector, mainly through taxation and employment, are more dependent on global firms than states whose financial

sectors are primarily domestic in orientation. Countries with highly internationalised financial sectors are motivated to regulate the sector so that it can remain globally competitive, especially given the equivalent regulatory regime that exists in other ACDs. To do so, policymakers seek to maximise sector revenues, and to minimise firm exit. High dependency occurs when there is a strong policy drive to sustain a competitive market environment for global banks because the state needs to extract the value the industry creates. Meanwhile, where states derive relatively less value from an internationalised financial sector, and where the exit options available to firms conducting these international activities are weak, state dependency on global banks is correspondingly lower.

State-banking sector dependencies underpin regulatory regimes, but their effects become observable when the rules governing finance become subject to contestation. Outside of crisis periods, and when regulatory issues associated with the governance of these global firms are not salient to voters, policymakers in ACDs experience low democratic pressure to impose financial regulation against industry interests. In ACDs where state dependency on banks is lower, nonetheless, firms must compete with other interest groups to maintain influence over the policy process. They do so through lobbying operations and other non-commercial activities which grant them instrumental power over the policy process. Where dependency increases, banks have less need to compete with other interests also vying for influence. Instead, higher state-bank dependency creates a symbiosis between policymakers and banks, meaning that in a low salience equilibrium banks possess a privileged position vis-à-vis other interests in the political economy.

When certain regulatory issues become salient to voters, for example during a major financial crisis or corporate governance scandal, the policymaking environment which privileges industry's interests can destabilise. Banks' instrumental power becomes more liable to erosion. In the three main cases deployed in this study – Switzerland, the UK and the US – institutional mechanisms which at the low salience equilibrium give industry substantial influence over policymaking broke down after 2008. Such breakdown will occur in any political economy setting in which democratic demands are particularly strong; however, in countries that possess institutions which cultivate sustained elite cooperation, as occurs in many European countries, it takes an especially strong surge in democratic pressure for established state-industry relations to fray (Massoc 2020). The mechanism that disrupts industry interests is nonetheless a common one: policymakers experience high pressure to undertake reform when there exist strong democratic drivers to do so after a major crisis or scandal.

Table 2.5: Democracies Under Constraint –
Varying Democratic Responsiveness Under Different State-Bank Dependency and Democratic Pressure

State-Bank Dependency *Ex. Country*	Democratic Pressure to Policymaking	
	High Democratic Pressure varying democratic responsiveness	**Low Democratic Pressure** low democratic responsiveness
Asymmetric Dependence	Constrained Responsiveness	State-Bank Symbiosis/Alliance
Symmetric Interdependence	Mitigated Responsiveness	*Range of State-Bank Cooperation*
Strategic Independence	Unconstrained Responsiveness	Interest Group Politics

After the instrumental mechanism of bank power is severed, policymakers' ability to deliver a democratic response to highly salient issues varies according to state-banking sector dependency. Those states which exist in what the theory calls *Asymmetric Dependence* can offer only *Constrained Responsiveness* to strong democratic pressures. Those that exist in *Symmetric Interdependence* – where finance is less internationalised and/or where banks' exit options are weaker – can deliver *Mitigated Responsiveness*. In such environments, policymakers can deliver a stronger democratic response relative to political economies that exist in asymmetric dependence. Finally, where finance is mostly domestic in its orientation and where firm exit options are correspondingly weak, the state exists in *Strategic Independence* from big banks. Policymakers operating in such a context can deliver *Unconstrained Responsiveness* when responding to high democratic pressure. This last policymaking environment presents an unlikely scenario, given that the financial sectors of most ACDs have become highly internationalised in orientation in recent decades. Indeed, among the ACDs only the US possesses the unique confluence of a global industry that is constituted by firms that remain highly domestic in orientation.

Table 2.5 further visualises the varying democratic responsiveness that occurs given the covariance in state-banking sector dependency and democratic pressure among a sample of six states, three of which are included in this study as cases (Switzerland, the United Kingdom and the United States) and one as a shadow case (Australia). France and the Netherlands are included for demonstrative purposes as two ACDs which also possess global banks. Different policymaking outcomes will occur under low (right-side of table) compared to high (left-side of table) democratic pressure due to the varying constraints imposed by state-bank dependency in high pressure scenarios.

When policymakers act in response to low democratic pressure, the right-hand side of Table 2.5 shows that the higher the level of state-bank dependence, the closer the symbiosis that characterises the relationship between policymakers and big banks. That variation is labelled *Range of State-Bank Cooperation*. Over time, high dependence creates an alliance-type mode of interaction between policymakers and big banks in business governance. In lower dependency settings, on the other hand, firms must engage in interest group politics to ensure that politicians will continue to prioritise their interests over other groups. This is usually achieved through richly resourcing their lobbying operation.

Meanwhile, in scenarios of high democratic pressure (shown in the middle three rows of Table 2.5), which occur as policymakers seek to respond to strong democratic demands on high salience issues, policymakers will similarly arrive at different responses according to the level of state-banking sector dependency in the political economy. The higher the dependence of the state on big banks, the more constrained the response that policymakers can make to democratic demands.

Table 2.6 shows the underlying variables of state-bank dependency for these same six countries. Countries are listed in descending order from high to low dependency, and each country assigned to a broader category of dependency (Asymmetric Dependence; Symmetric Interdependence; or Strategic Independence). These relationships of dependency are a product of two structural business power variables: the internationalisation of a country's

financial sector, and whether the largest firms possess strong exit options from the national economy. The values for these variables in each country are shown in the right two columns.

Overall, when policymakers experience strong democratic pressure, they seek to pass reforms that constitute a response to the most salient concerns among voters. In striving to do so, however, they are constrained by the specific state-banking sector dependency of the political economy. As policymakers seek to respond to salient voter concerns by disrupting the regulatory status quo, the role of industry lobbying recedes and instead constraints imposed by banking sector dependency shape the outcomes produced.

The following sections elaborate the variables and hypotheses underpinning this model of financial reform as *democracy under constraint* in a processual way. Section 2.3.1 outlines the crucial effect of the raised public salience of banking regulation after the GFC. This is followed by a discussion in 2.3.2 of how salience differentially affects reform depending on whether a policy reform primarily demands the use of national or multilateral policymaking institutions. Section 2.3.3 elaborates the dimensions of business power which act as holdbacks to policy responsiveness. The penultimate section (2.4 Testing a Theory of Reform as Democratic Response) engages with the measurement and evaluation of outcomes, including identifying evidence that would align with expectations of the theory, or lead to its rejection. Finally, 2.4.3 details the methods and data sources that have been deployed to build and test the theory.

The next section begins by proposing that a necessary condition of reform challenging banking sector interests is that issues of financial regulation and reform become salient to the public, which represents a change to the democratic environment and incentivises policymakers to action.

Table 2.6: Drivers of State-Banking Sector Dependency

	Driver of State-Bank Dependency	
Country	**Internationalised financial sector**	**Bank exit options**
Asymmetric Dependence		
United Kingdom	++	++
Switzerland	++	+
Netherlands	++	+
Symmetric Interdependence		
France	+	+
Australia	-	-
Strategic Independence		
United States	-	-

Key: ++ represents high/very high, **+** mid/high, and **-** low/insignificant.

2.3 Substantiation of Theory

2.3.1 Public Salience of Financial Reform

Existing scholarship shows that when an otherwise esoteric domain of public policy becomes highly salient among voters, firms are exposed to the world of "noisy politics" (Culpepper 2011). This puts industry on the back foot as policymakers seek to incorporate public interests and are less swayed by established business interests than they are in the low salience domain of "quiet politics". In line with this general proposition, the theory proposes that high salience environments are most likely to create conditions for reform that challenge the interests of the financial sector. Even under high salience conditions, however, policymakers do not necessarily deliver a response that is against business interests, due to specific constraints that exist in the political economy. In other words, high issue salience is a necessary but not sufficient condition for driving through reforms against business interests.

It is incontestable that the GFC saw high attention in public debate to issues associated with the conduct and regulation of global banking (Ganderson 2020a). The source of contention is whether that high attention can decisively shift public opinion against financial interests, and whether this in turn influences the policy process (Culpepper and Lee 2022). Some literature, for example, suggests that in contemporary capitalist democracies everyday voters are more financialised, which leads to higher demand for policies aligned with financial sector interests (Chwieroth and Walter 2019; Krippner 2012). One way of testing the connection between issue salience and public opinion is through the effect of media coverage. This has been studied recently in survey experiments conducted by the Banklash Project at the University of Oxford (Banklash Project Website n.d.). One recent study using this data finds that voters have significantly higher preferences for financial regulation after they have been exposed to negative informational media cues about scandals in the sector (Culpepper, Jung, and Lee 2022). This is an intuitive, but vital link in the causal process underpinning the theory: voters react when exposed to negative cues about banks, and their preference for higher regulation increases.

After the GFC, the presence of these negative cues from the media was far higher if a country experienced bank bailouts. Media trends analysis conducted in a separate stream of the Banklash Project using a comprehensive database of news media coverage about banks in six countries shows that high attention to the GFC and subsequent bailouts was subsequently followed by higher coverage of associated regulatory issues (see Figure 2.1). As can be seen, a significant difference is observable in Australian media trends, being the one country that did not experience bank bailouts (see case analysis in Chapter 6). While lower coverage of crisis/bailout articles does not mean that regulatory issues were not covered in the Australian media at all, the peaks of articles on both the "Crisis/Bailouts" and "Regulation" categories are lower, and the tails shorter, relative to coverage in countries that did see bailouts. Where banking sector failures precipitate major government intervention, such as in France, Germany, the UK and the US, this increased the salience of regulatory issues in the following period, as measured by media coverage. When voters are exposed to a regular intake of media coverage about the failures of banks and the inadequacy of existing regulation, it is expected that this will increase negative attitudes towards finance in society (Culpepper, Jung, and Lee 2023).

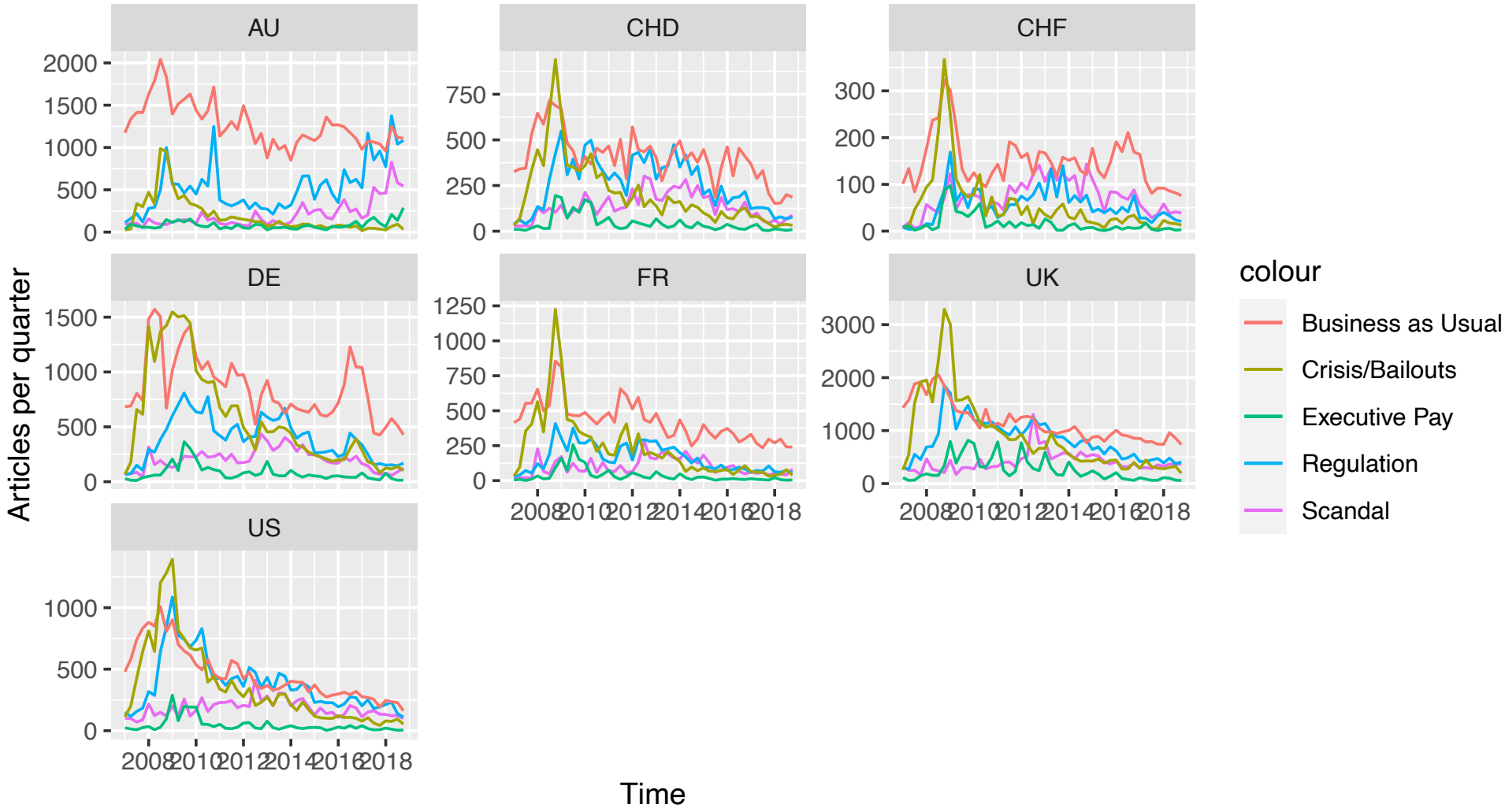
Once the salience of financial regulation has increased and public opinion shifts decisively against industry, this generates democratic pressures on policymakers to undertake reforms which challenge established industry interests. An uptick in salience is likely to be targeted towards certain issues, and the perceived importance of different reform issues may vary over time and by country. Financial regulation is a complex domain of governance which can require technical understanding about how global financial markets are run. It cannot be expected that voters will understand every aspect of a regulatory issue. Media coverage of an issue is likely to assist in developing understanding, for example through regular use of particular frames and narratives, and in persuading voters of the importance of that topic to their lives (Barnes and Hicks 2018; Ladd and Lenz 2009). Thus we can expect the media to assist voters in grappling with complex regulatory topics where a particular issue recurs within the financial sector. Even so, the technical detail of regulatory policy will almost definitely remain less salient to everyday voters than the broad issue and the associated moral economy that emerges from a scandal and recursive discourse about it.

The empirical chapters detail the issue salience of four distinct policy issues in the three case countries in the aftermath of the GFC. Table 2.8 below and the supporting discussion in Section 2.3.2 detail this in more summary terms. Given the limited time and resources available to policymakers, it is expected that politicians will focus on delivering a response to the issues that attract the greatest public attention. For example, in a country where executive pay remained a persistently salient issue (as in the UK; see Figure 2.1, "Executive Pay" articles), policymakers will experience stronger democratic incentives to respond to related policy issues than in a country where that debate is of relatively lower salience (as Figure 2.1 shows was the case in the US for articles of the same category).

Some issues may also attract the attention of left partisans more than right partisans, or vice versa, particularly in a highly polarised polity such as the United States (Arceneaux, Johnson, and Murphy 2012). However, a complex domain of public policy such as financial regulation is not one that any one party automatically "owns", unlike for example some social policy issues (Culpepper 2011). In fact, the pre-crisis decades saw most parties becoming generally favourable to less stringent regulation, with finance seen as a motor for economic growth. When a regulatory issue becomes broadly salient to voters, its complexity and lack of straightforward redistributive effect mean that individual parties rarely have well-developed policy positions. The TBTF problem in banking became a broadly salient issue after the GFC and most political parties agreed that it was one that needed resolving. When financial regulatory issues capture broad public attention, this is expected to incentivise a broad political response. If an issue is less salient, or salient to only parts of the electorate, the political response should be correspondingly weaker.

This account of the effect of issue salience on regulatory governance accords with some existing findings in the political economy literature (Chwieroth and Walter 2019; Culpepper, Jung, and Lee 2023; Culpepper and Lee 2022), although to date investigation into how that salience shapes the content of public policy has been limited (although see Ganderson 2020a, 2020b).

Figure 2.1: Number of articles about topics related to banks, bankers and banking, by category, in six countries
See Appendix 1 for methodological note



Key: CHD = Swiss-German newspapers; CHF = Swiss-French newspapers, etc.

The model incorporates two important variables that affect how salient issues are refracted through the policy process. The first of these is how the salience effect is mediated depending on the "level" at which policymaking takes place in the multi-level system of financial regulation. Salience is expected to have the greatest effect on outcomes when national democratic, as opposed to multilateral, policymaking institutions are the default forum for a regulatory response. The second and typically more significant dynamic is the effect of business power in tempering democratic responsiveness, even when policies related to high salience issues are channelled through national political institutions. Salience is the *sine qua non* of public policy that disrupts big business interests, but it cannot alone explain why different policy outcomes have occurred despite similarly high democratic pressures exerted on policymakers.

2.3.2 Salience in a Multi-Level Regulatory System

Even where an issue is broadly salient to public debate, the enhanced role of international institutions in the regulation of global banks means that there will not always be a policy response to a particular issue in national policymaking institutions. Scholars have long recognised that many areas of modern governance result in a dynamic interplay between national and multilateral policymaking (Gourevitch 1978; Putnam 1988). Even implicitly, this literature can accord with salience-based accounts of politics and policymaking. Operating in multilateral institutions, policymakers engage in a two-level game and must pay attention to issues that domestic groups care about, striving for an outcome which will be sellable to these constituencies. As Robert Putnam observed in his agenda-setting essay, the agency enjoyed by policymakers to negotiate international agreements in multilateral fora can help states resolve seemingly irreconcilable domestic cleavages (Putnam 1988, 460).

Drawing on this insight, it is proposed that policymakers will experience fewer pressures to respond to salient issues among domestic constituencies when they undertake reforms primarily through multilateral rather than national institutions. How the forum or "level" of policymaking (James and Quaglia 2020) alters the democratic pressures experienced by policymakers is shown in Table 2.7. In high salience scenarios, the pressures experienced by policymakers to respond to voter interests are higher when national institutions are the default forum of policymaking. Meanwhile, on low salience issues, the democratic pressures experienced by policymakers are similarly low regardless of at what level of policymaking they take place. The following paragraphs further substantiate these claims, incorporating insight from the cross-case analysis.

Table 2.7: Democratic Pressures Experienced in Different Policymaking Contexts

Predominant Policymaking Forum	Salience of Policy Reform	
	High Salience *varying democratic pressure*	**Low Salience** *low democratic pressure*
National Institutions	Higher ↕ Lower — *Pressure to Respond to Voters Higher in National Institutions*	Low
Multilateral Institutions		Low

The difference between the trade-offs experienced by policymakers in multilateral compared to national policymaking is a product of the costs often borne when states impose regulatory constraints in the national economy that do not exist in other jurisdictions. When financial regulation is at its low salience equilibrium, policymakers often prefer to regulate via multilateral institutions: regulation imposed unilaterally can either result in a firm no longer being able to engage competitively in a financial service, for example because the reforms make it commercially unviable for it to do so, or because the firm can arbitrage a domestic regulation through shifting activity abroad. Since the 1970s, as capital controls were abolished and financial services became an increasingly cross-border industry, states' demands for multilateral institutions have grown (Goodhart 2011). In countries where significant cross-border banking activity occurs, the benefits of multilateral regulation are likely to be higher if there exist less regulated alternative jurisdictions for firms to relocate to.

Specifically, multilateral regulation can ameliorate competitive distortions associated with multiple sets of national regulations. With a few exceptions, when countries are exposed to financial instability, there are typically strong incentives to act multilaterally when seeking a solution, since regulations that are applicable across many jurisdictions are less liable to arbitrage. Policymakers may also enjoy first-mover advantage if they can successfully export their policy preferences to these institutions (James and Quaglia 2020).

National policymakers operating in multilateral institutions are nonetheless constrained by domestic interests, including the public salience of certain regulatory issues. More constraints are expected where issue salience is higher. In these situations, policymakers will need to track public opinion more closely, at least in their public negotiating positions on multilateral reform, or risk a backlash among domestic constituencies. This difference is reflected in the

move from the bottom right to the bottom left quadrant of Table 2.7: while democratic pressures are expected to be low on all low salience issues, they will generally increase when an issue becomes highly salient. Consistently low democratic pressure under low salience makes way for a spectrum of democratic pressure experienced under high salience.

Policymakers will opt for multilateral regulation where that option creates fewer competitiveness costs compared to the alternative pathways to reform available in national institutions. This is typically because the scope for regulatory arbitrage will be higher if a reform is achieved through national regulation. Even if national interests are diluted in a multilateral negotiation, policymakers are willing to accept this if the regulation can be implemented at lower cost to plausible alternatives available via national policymaking. Indeed, much of the time they will be better able to regulate business operating within their borders through multilateral than through domestic reform. As David Singer observed, state preferences for multilateral regulation often derive from a position of weakness, not strength, vis-à-vis industry (Singer 2007, 31). In Singer's terms, multilateral regulation helps states ameliorate stability-competitiveness trade-offs (cf. Singer 2004).

Of course, not every issue can be dealt with through policymaking in multilateral institutions. The scope for a multilateral route to reform depends on the area being regulated. There must be the willingness and means among a group of states to use – or create – multilateral institutions to achieve reform. After the GFC, some areas of reform were channelled through multilateral fora almost by default, typically because there were pre-existing institutions designed for that very purpose. The prototypical case of this has been the reform of bank capital requirements, where the BCBS has been an active forum for regulation and standard setting since the 1970s. For other issues, new institutions were created or expanded after the GFC. Here, the G20's mandate for the FSB to both coordinate reforms to global derivatives markets and to create a framework for the regulation of G-SIBs shows how new institutions are periodically created and empowered to deal with emergent regulatory issues. Notably, both derivatives and G-SIB regulation mostly involve the regulation of cross-border markets. These issues more readily lend themselves to multilateral coordination (Helleiner 2014; Helleiner, Pagliari, and Spagna 2018).

There were also some reform issues directed through national policymaking institutions after 2008 where the scope for multilateral reform was much narrower. Issues associated with bank structure are one such example: reform in this area is generally difficult to achieve through multilateral institutions due to the continuing heterogeneity of national banking systems and corresponding divergences in state preferences for reform (Hardie and Macartney 2016). Another important example is tax policy, which mostly remains a national prerogative which does not (or to date has not) lend itself to reform through global governance institutions. After 2008, an exception occurred when the G20 requested that the IMF consider different options for the taxation of banks which could be coordinated multilaterally (International Monetary Fund 2010). Tellingly, its recommendations have for the most part not come to fruition.

The decision on whether to channel a reform through multilateral or national institutions is also partly contingent on the state or group of states in question. For European Union member states, for example, the role of supranational policymaking is more significant than

for a large state not part of such a grouping, most obviously the United States. This phenomenon is mainly legal-institutional, but also cultural-historical. For example, when it was a member of the EU, the UK was more prone to act unilaterally than were core Eurozone members (Best, Lengyel, and Verzichelli 2012). Whether national policymakers opt for a multilateral route to reform is of course not just a decision for one country to make in isolation: it requires a group of countries, and often the buy-in of specific countries that possess the most regulatory power, for such a process to bear fruit. As Chapter 5 shows, the size and role of the United States in the global economy meant that American policy decisions to pursue domestic or multilateral reform also often shaped the scope of multilateral policymaking available to other countries (cf. Drezner 2008).

If the prospects of a multilateral reform are slim and a country instead debates regulatory proposals in national institutions, the democratic pressures experienced by policymakers operating in these bodies depend on the issue being debated. In a low salience equilibrium, it is expected that policymakers debating reforms that take place in national institutions will experience low democratic pressure. The public does not take a strong stance on the issues being debated by policymakers, and so the responsiveness to voter interests is weak, as hypothesised in Section 2.3.1. If an issue debated in national institutions is or becomes highly salient to voters, the effect is to raise the democratic pressure experienced by policymakers. As is shown in Table 2.7, out of the four policymaking environments, the highest democratic pressure will be experienced by policymakers who debate high salience issues in national policymaking institutions.

Table 2.8 identifies whether for the specific regulatory outcomes under study the main thrust of each was dealt with primarily through national or multilateral institutions. In the three empirical chapters, the underlying policies passed (or which did not pass) in each of the UK, US and Switzerland are elaborated further. The dynamics of reform in Australia are brought in as a comparative reference point in Chapter 6. The issues that became most salient to national political debate in each country are shaded in mid-blue. Issues shaded in dark blue, meanwhile, are those where high issue salience and the predominance of national political institutions combined to produce the highest democratic pressures for policymakers.

Table 2.8 can be further explained with reference to the UK case. The UK passed a domestic version (D) of bank structural reform, while no significant multilateral reform occurred in this area. On capital standards, the UK has introduced some domestic regulation which supplements international standards, but the bulk of reform implemented in the UK conforms to BCBS standards, which until Brexit was implemented via EU directives. It is these multilateral rules which act as the main regulatory constraint on banks (D < M). The same is true of derivatives reform, which was predominately achieved through reforms achieved at the FSB. In the area of executive pay, the most salient post-crisis reform has been a cap on banker bonuses introduced via the EU, although the UK also introduced a “clawback” regime for bonuses via domestic regulation (D < M). The reverse order of policy importance is true for bank-targeted taxation, where the main initiative in this area was a UK domestic policy, although it also had to comply with an EU directive on a bank resolution and recovery fund (D > M).

The binary coding of issue salience (high/low) and venue (multilateral/domestic) presented draws on several types of evidence from the research process (see also Section 2.4.3 for methods and data sources). First, interviews conducted with actors in the policy process often cited which issues faced more or less scrutiny from the public and which venues were most crucial in the reform process. Interview data was supplemented by an inductive qualitative analysis of news articles from the period to understand how particular issues were covered by the news media over time, including references to particular policy drivers and institutions. This qualitative process could in future be supplemented by quantitative measures, such as analysing media trends using computational text analysis. A more detailed discussion of issue salience is offered in the three empirical chapters to supplement the binary coding in Table 2.8, which similarly relies on a grounded inductive approach to identifying when and how different issues became salient to voters. For example, the TBTF problem became a highly salient issue to voters in many countries, yet the technical detail of bank structural reform that was thought by some policymakers to be a possible solution to it struggled to attract such broad attention.

Table 2.8: Domestic, Multilateral or No Policymaking Reforms Across Cases Post-GFC

	Financial Regulation			**Tax and Pay Issues**	
Country	Bank Structural Reform	Capital Standards	Derivatives Reform	Executive Pay	Bank-Targeted Taxation
Australia	-	M	M	-	-
Switzerland	D	D > M	M	D	-
United Kingdom	D	D < M	M	D < M	D > M
United States	D	D > M	D > M	D	-

Key: **D** = Domestic; **M** = Multilateral; **-** = No Reform.
Reforms shaded in mid-blue were the most salient issues in each country; reforms shaded in dark blue were those on which policymakers also experienced the highest democratic pressure.

As becomes evident from Table 2.8, some policy issues saw regulations being passed in both domestic and multilateral policy fora. Often, there exists a dynamic interplay between national and multilateral policymaking on a single issue. Analysis of these dynamics is an important part of theory testing. For example, a reform channelled through multilateral institutions may also be highly salient to national public debate. How national policymakers negotiate in multilateral fora may as such yield evidence relevant to the core theoretical claims. The example of the EU banker bonus tax implemented in the UK from 2013 onwards, discussed in Chapter 3.6.4.3, exemplifies how a policy strongly opposed by national policymakers in a multilateral institution was nonetheless ultimately agreed to in part due to the high salience of executive pay in British public debate (cf. Figure 2.1). This instance shows how a policy issue under negotiation in multilateral fora can periodically spill over into national political debate and come to exert pressure on policymakers to reform (cf. Putnam

1988). On the other hand, a preponderance of unilateral policymaking, such as occurs in the US, may have spill-over effects for negotiations in multilateral institutions.

Overall, the key terrain for testing the influence of democratic interests on reform is national policymaking institutions. Meanwhile, as set out in Table 2.7, multilateral institutions are conversely expected to be sites in which the expression of these interests is weaker. It is an issue of concern to theory testing, however, when this neat binary is disrupted, given the plausible role of salience when issues spill-over between levels of regulatory governance. The next section sets out how business power acts as the main constraint to policymakers who seek to respond to democratic pressures when particular issues come to be of high public salience.

2.3.3 The Business Power of Global Banks in Crisis

A considerable weight of political economy literature has demonstrated how business power works to narrow the scope of policy reform that occurs, even after major crises and scandals. Existing work has shown that industry exerts its influence over the policy process in two ways, through its instrumental and structural power (Culpepper and Reinke 2014; James and Quaglia 2019a; Macartney, Howarth, and James 2020). Instrumental business power is gained through activities such as lobbying and campaign contributions, which are non-core to firms' commercial activity, but which can grant privileged access to policymakers. Structural power, on the other hand, is enjoyed by firms given their important economic role in the economy, independent of their extrinsic interactions with policymakers. At a low salience equilibrium, global banks possess high instrumental power given the scale of their lobbying operations. Often, but not always, they also enjoy structural power in the political economy because of the important role they serve in a financialised economy, including by providing high wage employment and contribution to state fiscal revenues.

After a systemic crisis, however, it should be expected that the low salience equilibrium of "quiet politics" will be disrupted (Culpepper 2011), and that as a result global banks' consistently high influence over the policy process will come under threat. The mechanisms by which this occur are not well understood. As Table 2.2 demonstrated, a hypothesis deriving from a bald interpretation of the lobbying literature – that the countries with the best resourced banking lobbies will see the weakest reforms – singularly fails to explain the variation in one notable post-crisis policy outcome across countries. Indeed, the studies of post-crisis reform cited in Section 2.1 have generally shown that global banks were more successful in countries such as France, Germany and the Netherlands than in their traditional lobbying strongholds in the US and UK.

The theory offers an explanation for these surprising outcomes. Section 2.3.3.1 explores how instrumental business power is sustained or breaks down. Notably, in the three cases studied in this dissertation, there were key mechanisms in these political economies through which an increase in the public salience of financial reform came to be experienced as strong democratic pressure to reform industry.

Since industry's instrumental power broke down in Switzerland, the UK and US, the subsequent variation in reform outcomes among this group of countries cannot be explained

by this variable alone. Section 2.3.3.2 proposes that the cause of their diverging outcomes is the differential structural power enjoyed by global banks in these three countries. The scope for policy reform responsive to democratic demands was determined by the structural position that global banks occupy in each national market.

2.3.3.1 Instrumental Power

Public debate after 2008 often stood sharply against the interests of the global banks at the centre of the GFC. As has been identified, that debate did not however produce similar reforms across different countries. Two existing explanations for this are from the salience and business power literatures. The first of these is – simply put – that policymakers pass strong reforms when issues are highly salient (Culpepper 2011). As Section 2.3.1 articulated, high salience is hypothesised as a necessary cause of reform against business interests. A univariate salience account, however, struggles to explain why commonly salient issues, such as TBTF banking, had such different effects on policy.

On the other hand, if the instrumental power hypothesis alone held, we would expect policymakers to be responsive to firms as they seek to strategically advance their interests (Pagliari and Young 2014; Young and Pagliari 2017). That might lead to the plausible observation that better resourced (Hacker and Pierson 2010) or more united (Howarth and James 2023; Woll 2014) business lobbies are more successful. As explained in Section 2.1, these accounts also fail to hold when applied across a range of cases. The theoretical advance here is to propose that it is how democratic institutions respond to surges in issue salience, rather than the strategies used by firms to advance their interests, which determine whether industry continues to wield instrumental power.

Responding to the weak plausibility of a straightforward lobbying explanation, existing work in political economy has to date shown how firms' instrumental power can be stabilised through institutions, which prevents what might otherwise be dramatic ruptures in state-business relations after a major crisis. In the case of France, firms' instrumental power is sustained through closed elite networks of policymakers and industry executives (Massoc 2018). In the Netherlands and Germany, a "politics of association" in coalitional politics weakens the incentives that parties experience to disrupt the policy status quo (Ganderson 2020a). In other words, the mechanism that leads to firms being able to preserve their privileged access to policy elites has been found to vary by political economy. The more distal constant across these cases is that specific political institutions created incentives for ongoing cooperation between banks and policymakers, even after a major shift in public opinion against banks post-GFC.

Where these institutions are lacking, as in the UK and US, a rupture in state-bank relations is more likely to occur under equivalent high salience conditions. Ganderson (2020b) has argued that in the UK, that rupture occurred through the incentives inherent in a system of political adversarialism, where parties are incentivised to compete and push for stronger reforms. Adversarial politics also plausibly explains why bank instrumental power eroded in the United States after 2008. However, it clearly cannot explain the Swiss case, given its coalitional politics and neo-corporatist arrangements of political economy (Kriesi and Trechsel 2008).

In these more cooperative political economies, a breakdown occurs when democratic mechanisms successfully countervail the highly institutionalised elite behaviour that typically shields big business from democratic demands. In the Swiss case, the empirical chapters show how the institutionalised referendum, and specifically the *Volksinitiative* (popular initiative) device, works to interrupt cooperative relations between industry and policy elites. The possibility that a referendum might occur after a relatively low threshold of voters demand one alters habitually cooperative behaviours among Swiss elites. Policymakers take on public demands when designing reforms, knowing that if they fail to do so this might activate the referendum device, which may in turn lead to reforms over which they have far less influence. Industry, even though it would usually prefer not to face any major reform, is incentivised to participate proactively in the reform process, as walking away from the negotiating table is likely to hamper their ability to shape reform. An adversarial approach may also incentivise already angry voters to demand a *Volksinitiative*. As such, while referendums only occur on some issues in Switzerland, this institution encourages policy elites to respond to public pressures associated with high issue salience, disrupting established cooperative norms.

Overall, while the mechanism through which banks' instrumental power is destabilised in the three countries under study differs, the common feature they share is political institutions which lead high salience issues to be experienced by policymakers as strong democratic pressures. Conversely, in many European countries, political institutions exist which encourage continued cooperation between industry and policymakers despite a surge in the issue salience of financial reform. These cooperative mechanisms reduce the weight of democratic pressure experienced by policymakers, in turn allowing industry to sustain its instrumental power and water down reform proposals. Table 2.9 summarises the proposed mechanisms through which instrumental power is sustained in a low salience equilibrium in six countries; and how it is predicted to break down or stabilise when the salience of reform surges. Since Australia did not experience that salience surge after 2008, instrumental power did not breakdown. Nonetheless Table 2.9 offers two plausible pathways through which industry's instrumental power might breakdown or be sustained in Australia if there were a future salience surge, given certain features of its political economy.

To be clear, a breakdown in the instrumental power of firms is possible in any country where high democratic pressures are experienced by policymakers. High salience is however felt sooner by policymakers in a country where institutions exist that incentivise policymakers to reform against industry interests. It is countries where such institutions are more prevalent that are studied in this dissertation. In the US and UK, the expected observation if this theory is right would be that in a high democratic pressure environment the bank lobby experiences a collapse in its influence over policy compared to in low salience conditions (Drutman 2015; Green 2018; Hacker and Pierson 2010). In Switzerland, where neo-corporatist institutions and coalitional government predominate, it would be expected that large firms highly connected with government no longer reap the benefits of that proximal relationship as reforms are designed.

This account of how salience is mediated through political institutions could be rejected, however, if evidence were presented that salience alone can explain different policy responses (per Culpepper 2011). For example, if it were found that the UK passed a stronger reform than France simply because that issue attracted more public attention in the former

country, this would cast doubt on this more institutional account of how democratic pressures are mediated. Alternatively, if it could be shown that different strategies used by business as they seek to exert instrumental power can indeed explain significant within or cross-case policy variation (per Howarth and James 2023; and Woll 2014), this would similarly lead to a rejection of the hypothesis that outcomes vary depending on the weight of democratic pressure experienced by policymakers.

Table 2.9: Industry Instrumental Power and its Breakdown or Sustenance

	Low Salience Equilibrium	**Post-2008 Issue Salience Surge**	
Country	**Key Mechanism of Instrumental Power**	**Instrumental Power Breakdown?**	**Mechanism of Breakdown/Stabilisation in Instrumental Power**
France	Closed elite networks	✗	Stable elite network limits exposure to democratic pressures
Netherlands	Closed elite networks Coalitional politics	✗	Stable elite network limits exposure to democratic pressures
Switzerland	Closed elite networks Neo-corporatism Coalitional politics	✓	Democratic pressures amplified through institution of popular referendum
United Kingdom	Well-resourced bank lobby	✓	Adversarial political system increases exposure to democratic pressures
United States	Well-resourced bank lobby	✓	Adversarial political system increases exposure to democratic pressures
Australia	Closed elite networks	✗	Lower salience of reform post-2008
		Plausible Outcomes	
		✗?	Stable elite network
		✓?	Adversarial political system

2.3.3.2 State-Banking Sector Dependency

Once a breakdown in instrumental power has occurred, policymakers actively seek to deliver a response to democratic pressures exerted by voters. Policymakers' scope to do so depends on the structural power enjoyed by firms in the political economy. This varies as a result of the dependencies that exist between states and banks in contemporary ACDs. States experience financial benefits in remaining an attractive place for global firms to do business, and costs if they pass burdensome reforms. This grants structural power to business, allowing firms to exert power over the policy process. This mechanism of business power is referred to as *State-Banking Sector Dependency*. Varying levels of dependency among states influence the extent to which policymakers can deliver a strong democratic response to salient voter issues. Varying democratic responsiveness is the core explanation for why the three countries under study achieved different reform outcomes.

State-bank dependency is analytically distinct, and in processual terms subsequent, to how firms exert instrumental power. Firms which continue to possess instrumental power are granted privileged access to the policy process, even when voter interests conflict with banks. Without the disruption to bank-state relations that a breakdown in instrumental power incurs, policymakers do not opt to pursue reforms in a way that would reveal the constraints imposed by state-banking sector dependencies. Meanwhile, in the scenario in which instrumental power does breakdown, the resulting democratic pressure leads policymakers to actively pit the interests of voters against those of business. As policymakers scope out different options for reform, this process reveals the state-bank dependencies which then become the hard constraint on democratic responsiveness.

To demonstrate this process with an example, as is identified in Table 2.6, the Netherlands experiences high dependencies on banking. However, as Table 2.9 shows, Dutch banks' instrumental power did not break down after the crisis. Given the persistence of instrumental power, policymakers opted to design policy reforms that were broadly favourable to bank interests (Ganderson 2020b). In this case, it was instrumental power that acted as the chief constraint to reform. Meanwhile, for the UK, which also exists in asymmetric dependency, the breakdown in firms' instrumental power led to policymakers actively pursuing a reform agenda responsive to democratic pressures. Here, asymmetric dependency rather than instrumental power became the chief constraint to reform. Were a breakdown in instrumental power to occur in the Netherlands, the expectation would be that Dutch policymakers would experience many of the same constraints as their British counterparts.

As Table 2.5 identifies, it is proposed that states exist on a spectrum of dependency on large banks. Of course, all ACDs are dependent on banks to the extent that the industry is crucial to the functioning of any modern financialised economy (Chwieroth and Walter 2019). For the type of ACD under study, the financial sector has become an equivalently large source of added value. The value created by finance however acts as a constant, not a variable, on the policy process.[5] State-bank dependency within these similarly financialised economies varies given how global banks create value in each national market. In some banking sectors, global firms primarily create value through their domestic economic activities, while in others firms do so through participating in internationalised cross-border activity. Different levels of internationalisation among national banking sectors produce varying state-bank dependencies. A core hypothesis posed is that the level of state-bank dependency experienced in the political economy leads policymakers to enjoy a starkly different scope to respond to democratic pressures.

For some ACDs, such as the Netherlands, Switzerland and the United Kingdom, the international market activity of the national financial sector constitutes a large share of overall activity, and in turn added value to the national economy. For others, such as Australia and the US, this international component is marginal to how value is created by the financial sector. Quantitative measures of banking sector internationalisation are shown in Table 2.10. The three key metrics are the international market activity of home-headquartered banks,

[5] Among the countries cited in this chapter, France and Germany are relatively less financialised economies, while the cases studied in the dissertation all register equally high financialisation, when defined as amount of value added to the economy by financial sector activity (OECD 2022). See Table 2.14.

the cross-border positions of each national banking sector (i.e., including both home-headquartered and foreign components) and foreign banks' cross-border positions in each country. With comparative data shown in both monetary (US dollar) and share-of-GDP terms, this offers a holistic picture of the relative importance of cross-border banking to the financial sector of each country.

Table 2.10: Three Dimensions of Banking Sector Internationalisation (2006 Q4)
Source: Bank for International Settlements (see Appendix 2 for detail)

Dimension	1		2		3	
Internationalisation Variable	**Outward** International Market Activity of Home Banks		**"Flow"** Cross-Border Positions in Overall National Banking Sector		**Inward** Foreign Banks in National Market	
Country	*US$bn*	*As % GDP*	*US$bn*	*As % GDP*	*US$bn*	*As % GDP*
Australia	174	22	369	19	247	32
France	3022	146	2196	106	1545	74
Netherlands	1893	283	943	140	1058	158
Switzerland	2931	847	1122	324	670	152
United Kingdom	2388	113	5056	239	4341	205
United States	2623	19	2383	17	4739	34

Key: Light blue 0-100% of GDP (mid); Mid-blue 101-200% of GDP (high); Dark blue 201%+ of GDP (very high)

It is proposed that countries with highly internationalised sectors will be constrained in how far they can respond to democratic pressures if reforms threaten the competitiveness of firms active in global markets. The framework refers to this relationship between states and banks as *Asymmetric Dependence*. If subjected to highly burdensome regulatory constraints, these firms will either not remain competitive in global markets, or they will choose to exit the national market and relocate activities to jurisdictions with less regulatory burden.

In some countries, the main dependency constraint to policymaking is the need for the national market to remain one conducive to firms remaining globally competitive, while for others, firm exit options play a more significant role (cf. Table 2.6). As the data presented in Table 2.10 show and the empirical chapters further elaborate, after the GFC British policymakers confronted an industry which possessed particularly strong exit options relative to Swiss policymakers, whose main constraint related to international financial sector competitiveness. At a high level, the constraint of Swiss policymakers was to ensure that policy reforms allowed Credit Suisse and UBS to remain internationally competitive. The constraint of British policymakers was the need to sustain a regulatory regime which would allow a wide range of global banks to remain internationally competitive when doing business in the UK *and* which would not lead to these firms exiting the UK economy. Some British banks possess strong exit options, but the highest structural power is enjoyed by non-British cross-border firms, such as those from the US and Asia, which have significant presence in financial centres other than the City of London to which they could plausibly relocate. One quantitative

measure showing this difference is in the rightmost column of Table 2.10, where on the "Inward" internationalisation variable – which is to say the quantum of cross-border banking positions on UK residents – total positions stand at 205% of GDP, compared to Switzerland's 152%. To be sure, the UK does have some levers of influence over these firms (Kalaitzake 2022), such as the financial infrastructure they purchase in the UK, but overall global banks headquartered elsewhere are less tied to the UK's national economy. Few foreign global banks, for example, have significant retail and commercial banking presence in the UK, and the UK is a "host" not a "home" regulator to these firms (Kynaston 2002; Singh 2020). As Chapter 1 identified, the City of London has been "Wimbledonised", and the primary task of policymakers is to sustain the agglomeration effects which make it a desirable place for firms to collocate.

In an asymmetrically dependent political economy, if firms in the financial centre become less globally competitive, or if they decide to exit, the national political economy loses out on the value created by this internationalised financial sector on which it is dependent for the provision of tax receipts and high-wage employment. Where democratic pressures run high, policymakers will still be forced to design policy which reflects the constraints imposed by asymmetric bank-state dependency. Thus, even after instrumental power has broken down and policymakers perceive voter and business interests to be in fundamental conflict, reforms will remain aligned to business interests insofar as this allows banks to remain globally competitive. Since policymakers seek to mitigate regulatory costs faced by business despite high democratic pressure for reform, policymaking in countries that are asymmetrically dependent will deliver *Constrained Responsiveness* to those pressures.

Where a national financial sector is less internationalised, on the other hand, policymakers do not face such structural constraints when pursuing a policy response motivated by high democratic pressure. In such political economies, there are fewer costs associated with imposing reforms on business harmful to their international competitiveness. Relatedly, because a less internationalised financial sector is made up of firms with a higher ratio of domestic to overall (including global) activity, firms' plausible exit threats are weaker (Culpepper and Reinke 2014). They are more reliant on domestic revenue streams, making it less plausible that they can relocate significant activities elsewhere. Lower state-bank dependencies thus allow for a stronger democratic response than that available in a political economy experiencing asymmetric dependency.

As Table 2.10 identifies, a country like France possesses banks that conduct a significant share of activity in international markets, meaning it experiences some – but not high – state-bank dependencies. It is *Symmetrically Interdependent* on global banks, meaning that French policymakers experience fewer structural holdbacks to passing regulation that might harm these firms' competitiveness than countries existing in asymmetric dependence. With weaker exit options, the state can impose some regulatory costs without firms seeking to arbitrage them. State-bank dependency is even lower in Australia, meaning that if banks' instrumental power broke down and policymakers experienced strong democratic pressure, then they have a broad scope to impose reforms. Like France, Australia remains interdependent on big banks to the extent that every ACD is constrained by how costly regulation can be before costs are felt in the real economy (Chwieroth and Walter 2019). For this reason, if states are not

asymmetrically dependent on banks, in most remaining instances they are interdependent, which precludes reform which would be highly deleterious to their commercial interests.

In rare cases, a state's dependency on global banks is low enough that policymakers operate in *Strategic Independence*. The prototypical case of strategic independence is the United States. The country operates in strategic independence from its banks due to its sheer size and unique role in the global economy. The size of firms' domestic commercial activity means that even the largest US banks are far more dependent on access to US markets than they are on foreign/international markets (Culpepper and Reinke 2014). Banks are themselves also relatively smaller players in the US financial sector.[6] The world's largest non-American cross-border banks, perhaps with the exception of those headquartered in China, must also sustain substantial operations in US markets in order to meet the funding demands necessary to compete in international markets (M. Beck 2021). Both the largest US and non-US banks thus possess a weak exit option from US markets. Even if non-US banks can in some instances credibly threaten to exit certain activities from the US in response to burdensome regulation, such a strategy is not expected to materially affect US policy outcomes, given the insignificance of this activity in aggregate (Table 2.10).

As a result, US policymakers responding to high democratic pressures are expected to be responsive neither to the competitiveness costs to US-based internationalised market activity, nor to exit threats made by firms. The state gains far more value from the activities the sector undertakes in its US-based activities than from its international operations. This effectively compounds the "exorbitant privilege" US policymakers enjoy. US policymakers are in a unique position not only in the functional sense of the dollar being the international reserve currency in which all global banks must remain liquid. US policymakers also have fewer dependencies, and therefore experience fewer constraints, because they know that banks will continue to demand access to – and thus possess effectively nil exit option from – US markets.

The causal role of structural power in the policy process has long been a topic of contention in political science and political economy (Culpepper 2015; Iversen and Soskice 2019; Przeworski and Wallerstein 1988). As one contribution recently put it, "since policy outcomes remain the main metric … available to political scientists, the ability to distinguish between the causal effect of structural and instrumental power is limited by problems of observational equivalence" (Macartney, Howarth, and James 2020, 9). The empirical strategy adopted in this study offers one path to disentangling these two aspects of business power. If the claim made in Section 2.3.3.1 that in the UK and the US banks' instrumental power collapsed precipitously after the GFC stands up to scrutiny, then instrumental power cannot account

[6] There are various ways of identifying both the relative size of large US banks into the overall economy, as well as their dependency on access to the US economy. In terms of size, while in 2009 domestic banking assets as a percentage of GDP (consolidated by nationality of headquarters) in the UK were close to 600%, in the US this figure was just slightly over 100% of GDP (Independent Commission on Banking 2011b, 22). In another dataset managed by the St Louis Federal Reserve, in 2009 the assets of the five largest banks as a share of total commercial banking assets was 76% in the UK, but just 44% in the US. Non-bank financial institutions are also far larger in the US financial landscape, and in 2009 their assets stood at 158% of GDP. All in all, large US banks are far less important to the overall US economy than are home-headquartered banks to the UK, other European countries, and Australia. Further supporting data are presented in the empirical chapters.

for the remaining variation in policy outcomes. It is hypothesised that variation in structural power accounts for this.

It can be observed whether the two components of structural power – internationalisation and exit options – constrain democratic responsiveness by further leveraging the case of Switzerland. Similarities in the exercise of bank power in the US and UK at the low salience equilibrium – i.e. high instrumental power – are transformed after policymakers experience a surge in democratic pressure. The contours of business power in the political economy allow the US to deliver an unconstrained response, but Britain and Switzerland should only be able to deliver a constrained response, to these democratic pressures. This research design therefore offers a pathway to observing the effect of different dimensions of structural power on policymaking, in so doing delivering a substantial theoretical advance to scholarship on business power.

The next section responds to a broader challenge of research design, which is how to evaluate policy outcomes. Predictions are also given of what policy responses would be expected if the hypothesised variation in state-banking sector dependency is indeed driving the outcomes of interest.

2.4 Testing a Theory of Reform as Democratic Response

2.4.1 Measuring Outcomes

Comparatively assessing regulatory policy often presents challenges of measurement given heterogeneity in the object of study, which is usually highly tailored public policies affecting distinctive national industries made up of a specific group of competing firms. To address this challenge, researchers have often opted for qualitative metrics which rest on “stringency”, evaluating policies by how high the costs they impose on business are relative to alternative possible outcomes. In studies of crisis-era policymaking, such an approach has been used to evaluate, for example, bank bailouts (e.g. Culpepper and Reinke 2014; Grossman and Woll 2014) and capital standards (e.g. Jones 2019). Here, researchers have comparatively assessed costs imposed on different actors, for example financial institutions or the state.

Measures of stringency and cost become more difficult to apply, however, when variation in the object of study (industry) or type of reform (the outcome being measured) become significant enough to problematise measurement validity. To date, this challenge has often meant that political economy studies of post-crisis regulation have opted for single-case analysis (e.g. Jabko and Massoc 2012; James 2018; Woolley and Ziegler 2011; Ziegler and Woolley 2016); or restricted their comparative design to political economies sharing particular features (e.g. size of national economy; comparability in bank size/structure) (e.g. Ganderson 2020b; Massoc 2020).

This study seeks to explain outcomes across economies of different size and among financial sectors of considerable heterogeneity. Given the variation this introduces, the research design confronts certain challenges associated with measurement. To provide a sound basis for cross-case comparison and theory testing, each empirical chapter offers a within-case analysis of particular areas of post-crisis policymaking on which there is a sound rationale for

cross-case comparison. Importantly, this is a study of *global* banking regulation, investigating how states regulate banks that have significant global market presence. Switzerland, the UK and the US are each home to such firms, according to the commonly agreed definition of the FSB (see Table 2.14).

In each country, there was a reappraisal of how to regulate the structure of these global banks, especially due to the TBTF problem. TBTF arose because these firms provided an array of financial services both within and across national borders, meaning that it was deemed unacceptable to allow them to fail. This spawned a policy discussion about bank structure, which constitutes the first policy issue under study. Similarly, in each of these countries, bank capital standards and tax and pay issues in the sector arose in debates on reform. On the other hand, derivatives reform was a major issue in the UK and the US, but far less pertinent to the Swiss policy debate. In Chapter 4, a functional explanation is advanced for this: Swiss policymakers are responsible for regulating a far smaller share of the global derivatives market. In the empirical chapters, derivatives reforms are used primarily as a means to comparatively assess US and UK policymaking. Australia, meanwhile, is discussed in Chapter 6 as a shadow case, to test the application of the theory in a situation where bank bailouts did not occur and regulation remained a low salience issue. While the four policy areas covered in each empirical chapter are not exhaustive of the regulatory challenges faced by policymakers, taken together they offer a suitable basis for cross-case comparison and theory testing. The within-case analyses also introduce some choice variation – in particular on issue salience and usage of national/multilateral policy fora – that similarly provides a fertile terrain for theory testing.

A second issue where research design choices are instrumental for theory testing is choosing a suitable measure for evaluating and comparing policy change. As has been pointed out, difficulties arise with the use of both quantitative and "stringency" measures. For example, when comparing capital requirements – an area of regulatory policy that would most obviously lend itself to quantitative study – the national policies that have been introduced are often too bespoke to reach an objective conclusion on which is comparatively "more" or "less" stringent. This makes meaningful quantitative evaluation of outcomes difficult. Indeed, it is something of a cliché in post-2008 policymaking that national bureaucrats responsible for capital standards can demonstrate how their own country's capital requirements are higher than those elsewhere.

Beyond the case of capital rules, more generally it became clear during the research process that what is considered a stringent regulation in one country is often contingent on features specific to its political economy. For example, the proprietary trading ban in the United States was a costly reform for US investment banks, while if imposed by Australian policymakers an equivalent regulation would have much less impact given the limited proprietary trading activity that takes place under their jurisdiction.

In this study, a more qualitative means of assessing comparative outcomes is offered that takes account of the specific contexts in which a regulation is imposed, while also providing grounds for within and cross-case comparison. That schema is offered in Table 2.11. The main outcomes measured are the scope of the policy (primarily the number of firms affected within and outside the jurisdiction), and the costs and constraints firms face due to the regulation.

In the distinctive case of caps and extraordinary taxation of executive pay, the scope of the policy would apply more specifically to *number of individuals (bankers) affected*, and the impact of the policy would be the *quantum of tax receipts*.[7]

Table 2.11: Schema for Qualitative Assessment of Policy Outcomes

Aspect of Outcome	Policy Enacted	Policy Scope	Policy Impact
Qualitative Assessment	Y/N	• Type and number of firms affected • Extraterritoriality of regulation	• Nature of constraint or cost imposed on firms

2.4.2 Testing Hypotheses and Evaluating Outcomes

In this study, evaluating policy outcomes involves testing whether observations – policy outcomes – correspond with or differ from the predictions of the theoretical framework elaborated in the previous sections. During a reform period, the most significant variation will be between the maximal policies considered in policymaking institutions and the outcomes preferred by big banks. Even if sweeping proposals for reform are mooted by lawmakers, for example when they are championed by reformist policy entrepreneurs, it is often the case that these do not ultimately pass. Policies are instead designed in ways that incorporate the preferences of big banks, which favour an outcome which minimises regulatory costs. The theory proposes that the difference between the maximal policy considered in policymaking institutions and the policy outcome achieved is a consequence of the broad democratic pressures policymakers experience to reform and the dependency constraints they experience as they seek to do so. As Table 2.12 sets out, testing the theory thus entails evaluating whether the outcome of a reform agenda (Reform Agenda A) tracks more closely to the maximal policy considered in policymaking institutions (Policy 1) or the policy preferred by global banks (Policy 2). Where outcomes are closer to the maximal policy considered (as is shown by Policy 1 being the bolded cell), the theory predicts that this is a response to democratic demands. Where it is closer to the industry preference (Policy 2), it predicts that this is the result of a weaker democratic response. The investigation into different reforms in the empirical chapters provides more substantial discussion about each policy outcome, offering further nuance on where it stands in the field of possible outcomes. Each policy evaluation also tests key alternative explanations for why outcomes occur where they do within that field.

[7] If quality data were publicly available – which is usually not the case – taxation of executive pay is one policy issue which more readily lends itself to comparative quantitative assessment.

Table 2.12: Evaluation of Public Policy in this Study

Reform Agenda	**Field of Possible Outcomes**	
	Maximal Policy Considered	Industry Preference
Reform Agenda A	**Policy 1**	Policy 2

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Testing whether the theory of *democracy under constraint* offers a good fit with observed policy outcomes requires close analysis of how each reform affects the specific commercial environment that they seek to regulate. Table 2.13 identifies evidence that would be coded as aligning with, or challenging to, the expectations of the theory in a prospective policy environment characterised by high democratic pressure. For each country, the key source of added value in each national financial sector is included as an indicator of where state-banking dependencies are most expected to constrain policymaking. The rightmost two columns of Table 2.13 present plausible evidence that could be observed in each country that would be either expected by, or challenging to, the theory. For example, the UK extracts especially high value from global investment banking, and if policy outcomes are the result of its asymmetric dependency on the sector, this should yield reform outcomes that do not threaten the competitiveness of this specific business segment. On the other hand, if reforms were to occur that did compromise the global competitiveness of the UK financial sector in investment banking, this would present a major challenge to the theory. The next paragraphs further elaborate the theory testing strategy deployed in this study.

Table 2.13: Evaluating Causes of Regulatory Reform Across Cases

Country	State-Banking Sector Dependency	Key Sources of Added Value	Possible Outcomes Under High Democratic Pressure	
			Outcome Expected by Theory	*Outcome Challenging to Theory*
Switzerland	Asymmetric Dependence	Global Wealth Management and Private Banking	Reforms which preserve global competitiveness of sector	Reforms that deplete global wealth management / private banking competitiveness
United Kingdom	Asymmetric Dependence	Global Investment and Wholesale Banking	Reforms which preserve global competitiveness of sector	Reforms that deplete global investment / wholesale banking competitiveness
United States	Strategic Independence	Investment and Wholesale Banking	Reforms responsive to democratic demands	Reforms responsive to exit threats made by banks
Australia[8]	Symmetric Interdependence	Domestic Commercial and Retail Banking	Reforms responsive to democratic demands	Reforms seeking to preserve banks' competitiveness in international markets

As earlier sections have explained, the theory predicts that policymakers responding to high democratic pressure will be constrained in how far they can reform global banks as a result of the specific dependency of the state on the value these firms create. The two dependency variables integral to the theory are financial sector internationalisation and the exit options available to banks. The study leverages the cross-case variation in these two measures in order to test the strength of the theory against a roster of reform outcomes.

In particular, the two countries that are said to exist in asymmetric dependency on global banking differ on one of the two key dependency measures, which should be observable in the regulatory outcomes they achieve. As the data presented in Table 2.10 shows, on the eve of the GFC Switzerland possessed a highly internationalised banking sector. On both a raw outstanding claims basis and as a percentage of Swiss GDP, Swiss-headquartered banks were the most "outwardly" internationalised compared to the five other countries represented, including the UK. The cross-border positions of the banking sector overall (i.e., not just Swiss-headquartered firms) were also the highest relative to GDP. On an outstanding claims basis,

[8] NB: Regulatory reform was less salient to the post-GFC debate in Australia, where banks' instrumental power remained strong. Predictions are here offered for a hypothetical scenario in which regulatory reform is of high salience and policymakers experience strong democratic pressures to reform.

UK banks approached the size of Swiss banks in their international operations, although when weighted by GDP they were far less outwardly internationalised (on this metric, about an eighth as internationalised). Despite these differences, the Swiss and British banking sectors are clearly both "most likely" cases for observing the influence of banking sector dependency influences on policy.

Yet the countries differ in two important dimensions, offering variation to be leveraged in theory testing. Prior to the crisis, foreign banks had (in dollar terms) financial positions on UK residents about 6.5 times higher than in Switzerland, equivalent to about a 50% higher penetration relative to GDP (205% of UK GDP compared to 152% of Swiss GDP of "inward" internationalisation). As Table 2.6 set out, large Swiss banks also enjoy a much weaker exit option than banks operating in the UK: most Swiss retail and commercial banking, including their crucial private banking activity, takes place in Switzerland, which for much of last century has enjoyed a *sui generis* position in the management of global offshore wealth (Alstadsæter, Johannesen, and Zucman 2017; see also Chapter 4). Meanwhile, UBS and Credit Suisse's investment banking activity already primarily takes place in London and New York, substantially reducing the exit threat available to firms in this area. When responding to high democratic pressure, it is not expected that Swiss policymakers will be constrained by the need to preserve the competitiveness of investment banking. Instead, the key activity where dependency constraints are predicted to play out is in cross-border wealth management.

For the UK, in contrast, dependency constraints are expected to be observable in terms of how policymakers seek to avoid imposing regulatory costs on international activity in the City of London. As the "Flow" and "Inward" measures of banking sector internationalisation in Table 2.10 (as well as further data presented in Chapter 3) demonstrate, the City is a highly open financial centre in which global banks compete. A large share of foreign banks' financial positions relate to global capital markets activity in which the City is a preeminent international centre. In comparison to Switzerland, private wealth management is far less crucial to the City of London's comparative advantage. As a result of London's internationalisation, the more footloose nature of capital markets activity, and the comparably small size of the UK domestic economy, global banks possess strong exit options. While both the UK and Switzerland are asymmetrically dependent on global banks, the availability of a strong exit option in the UK is expected to shape British policymaking more.

The United States sits on the opposite end of the range of state-banking sector dependency to the UK and Switzerland; as a result its policymaking is expected to yield substantial cross-case variation in scenarios where policymakers experience high democratic pressure. Since its policymakers operate in *strategic independence* from global banks, this grants scope for reforms that deliver a response to salient voter issues unconstrained by the structural-economic barriers that exist for most other ACDs. This does not necessarily mean that US lawmakers will always opt for the maximal type of reform under consideration. Indeed, in a political system that is both veto-laden and polarised along partisan lines, it takes a particularly strong surge in issue salience, creating sustained democratic pressure on lawmakers on both sides of the political aisle, to produce an unconstrained response (Culpepper and Lee 2022; Young and Yagci 2019). To borrow the term coined by Lee (2016), the "insecure majorities" that parties possess in the contemporary US Congress make building such winning coalitions difficult. A prediction of the theory is that high salience leading to

strong democratic pressure periodically allows for such a coalition to be built and for an unconstrained response to be delivered. Contrariwise, as Table 2.13 sets out, if evidence were presented that industry exit threats were inhibiting the democratic response of US policymakers, this would be contrary to a core expectation of the theory.

Finally, the shadow case of Australia offers a counterfactual case that enhances the testing of the theory in the three main cases. Australian firms possess neither the exit options nor the global market activities that produce the asymmetric dependencies of Switzerland and the UK. Crucially, bank bailouts did not occur after 2008, and as a result financial regulation remained a low salience issue during the post-GFC reform period. Absent strong democratic pressures, it is expected that the interests of its "Big Four" firms will continue to exercise a strong influence over Australian policymaking institutions. As Table 2.13 sets out, predictions can nonetheless be made about how policymakers might respond if there were a strong surge of democratic pressure in future. Australian firms conduct very limited activities abroad, and the preponderance of their activity is domestically focused, meaning that they possess weak exit options. This makes for a policymaking environment in which reforms of broad scope and impact can in principle occur. Even anecdotally, it was in this respect revealing that a senior Australian policymaker stated in interview that a future reform they could envisage would be the carving up of the dominant "Big Four" banks into a "Big Six" or "Big Eight". Unlike in the UK, where the availability of firms' exit threats would be expected to preclude such a move, Australian banks would have little power to avoid major reforms.

This section has provided a framework for measuring and evaluating policy outcomes for the purposes of theory testing. The next section identifies the methods and data sources that have been used to collect evidence to conduct this theory testing.

2.4.3 Methodology and Data Sources

The research question this thesis interrogates is: *Why are reform outcomes sometimes similar, and other times different, when countries undertake regulatory reform on similar issues?* This section sets out the methods that have been used to answer this question.

Answering this question has entailed a two-step qualitative methodological approach. The first step entailed selecting cases for structured comparison. Switzerland, the UK and US were chosen as three countries which are similarly 'financialised' – i.e., official data presented in Table 2.14 shows that, on the eve of the GFC, finance created a similarly high share of value in each national economy. Each of these three countries is also home to several G-SIBs, as well as a financial centre which most would consider global in size and importance (Cassis and Wójcik 2018). As the data in Table 2.15 show, during the GFC, policymakers in these countries provided banks with significant bailouts and other extraordinary financial support. As Table 2.16 presents, each also experienced major economic costs in the years after the GFC. However, existing explanations were found not to fit with the observed outcomes (see Table 2.2). The bulk of this chapter has set out how co-variation in democratic pressure for reform and bank-state dependency is proposed to explain within and cross-case variation of policy reform outcomes since the GFC (cf. Table 2.5).

Table 2.14: Global Banks and Financial Sector Value-Add In Case Countries
Source: IMF and Financial Stability Board

Country	Australia	Switzerland	United Kingdom	United States
Global Systemically Important Banks (2011)[9]	0	2	4	8
Finance and Insurance, % national value-added (2006)	8.4	12.0	8.6	7.8

As part of this structured comparison, Australia was selected as a shadow case because it is highly financialised, but avoided the worst effects of the GFC. While the government had to provide some support to the financial sector, it was not required to enact bank bailouts (as identified in column (A) of Table 2.15). As the discussion of the Australian case in Chapter 6 sets out, it was generally perceived that the country had avoided the worst of the GFC. Australia therefore acts as a counterfactual; its reform process was one that took place without what the theory proposes as the catalyst event (bank bailouts) that made regulatory reform a high salience issue in the other three countries. Even though Australia is not home to global banks, it possesses four large banks (the "majors" or "four pillars") which cumulatively possess very high market concentration.[10] This makes this small group of firms both quantitatively large and economically important to the Australian economy.

After case selection, answering the research question has required an investigation of processes of policy reform that each country undertook on similar issues. The second methodological stage of this research has entailed what Hall calls "systematic process analysis", more commonly known as process-tracing. As Hall (2003, 2006) sets out, the unique benefit of this method is in how it allows the researcher to establish causal inference in a setting where "the number of available cases is too small to allow a statistical analysis to control for all the potentially relevant causal factors as well as one in which many of the relevant variables do not lend themselves readily to accurate measurement" (Hall 2008, 312).

[9] Country of headquarters only

[10] The St Louis Federal Reserve aggregates data of five bank asset concentration in different countries. Between 2006-2014, the five biggest Australian banks had a high of 93.4% and a low of 83.6% of all commercial banking assets (Federal Reserve Bank of St Louis n.d.).

Table 2.15: Headline Support for the Financial Sector and Upfront Financing Need As of 19 May 2009 (in % of 2008 GDP). Source: IMF (2009)

Country	**(A)** Capital Injection	**(B)** Purchase of Assets and Lending by Treasury	**(C)** Central Bank Support Provided with Treasury Backing	**(D)** Liquidity Provision and Other Support by Central Bank	**(E)** Guarantees	Total **(A+B+C+D+E)**	Upfront Government Financing **(= A+B+C)**
Australia	0.0	0.7	0.0	0.0	8.8	9.5	**0.7**
Switzerland	1.1	0.0	0.0	7.2	0.0	8.3	**1.1**
United Kingdom	3.9	13.8	12.8	0	51.1	81.6	**18.9**
United States	4.6	2.3	0.7	41.9	31.4	81.0	**7.5**

Table 2.16: Estimated post-crisis deflection of potential output in countries in 2014 as a percentage reduction relative to a pre-crisis counterfactual scenario. Source: Ollivaud and Turner (2015)[11]

	Australia	**Switzerland**	**United Kingdom**	**United States**
(1) Productivity	0.8	-4.1	-7.6	-2.2
(1a) Capital/worker	5.0	-1.6	-1.9	-1.5
(1b) Total factor productivity	-3.5	-2.4	-5.5	-0.5
(2) Employment	0.8	0.9	0.6	-0.2
(2a) Labour force participation	1.6	1.2	1.2	-0.5
(2b) Structural unemployment	-0.8	-0.2	-0.5	0.3
(3) Total	1.6	-3.2	-6.9	-2.4

[11] Authors' Note: Estimated effects of the crisis are measured relative to a counterfactual scenario in which trend productivity continues at its pre-crisis (2000-07) trend growth rate, structural unemployment rates remain at their pre-crisis (2007) levels and trend participation rates are projected to allow for evolving demographics by holding labour force entry and exit rates constant at pre-crisis levels. Row (3) = Row (1) + Row (2); Row (1) = Row (1a) + Row (1b); Row (2) = Row (2a) + Row (2b).

A hallmark of positivist-type process-tracing involves the researcher setting out the constituent parts of a causal chain deemed critical to determining outcomes of concern. The underlying causal chain advanced by the theory was identified in Table 2.4. Judging whether that causal chain, as well as the case-specific predictions made in Table 2.5, are a good fit has required making judgements about whether empirical observations correspond well with the theory proposed or an alternative (existing) theory. Lakatos famously called this the "three-cornered fight" (Lakatos 1970). Some have argued that mechanistic process-tracing is best applied to single-N studies. However, the structured comparison deployed, which uses both process-tracing and within/cross-case study analysis, is deemed to produce valid results given the use of clearly identifiable variables and causes. Indeed, as Hall puts it, "it is *desirable* to apply systematic process analysis to several cases … Increasing the number and diversity of the cases increases the investigator's confidence that the causal process observed is not idiosyncratic to one of them" (Hall 2008, 315, emphasis added).

Each step of a systematic process analysis must be independently evidenced. The empirical chapters draw on various sources of primary and secondary data to do so. The secondary data collected is derived from a variety of publicly available sources, including: coverage of individual financial events and the policy process in the news media; aggregate news media data;[12] national opinion polling, where available; official (e.g. government and market) and non-official (e.g. consultancy) data related to the national and global economy and specific banks; official reporting and documentation, including cited testimony from industry officials and policymakers; and interview data cited in other academic studies or quality publications.

The primary data collection involved interviews with participants in the policy process.[13] In total, 81 interviews were conducted with politicians, regulators, central and private bankers, and civil society leaders. The present author conducted 64 of these in English between 2021 and 2022. A further 16 were conducted by another Banklash Project team member in German during the same period, the content of which was made available in a shared data repository. One interview cited was conducted in the United States in 2015 by another Banklash Project member. Most interviews were conducted online via Video Teleconference due to restrictions during the Covid-19 pandemic. Interviews typically lasted about one hour.

There are reliability and validity issues that accompany the use of interview data (Weiss 1995). For example, interviewees may invent, embellish, or inaccurately recall detail. To mitigate these issues, where possible interview data was triangulated by corroborating that data with further interviews or secondary sources. Where there was doubt about the reliability of the data, it was either excluded from the evidence base, or an effort has been made to cite where there is uncertainty or conflict within the data. Where possible, interviewees' names and/or roles have been cited, but anonymity was of course granted where requested. To respect that anonymity, Appendix 4 only lists those interviews explicitly cited in the study and on the basis of the identity disclosure agreed.

[12] See Figure 2.1 and Appendix 1.

[13] Interview data was collected after a Research Ethics Approval was granted by the Blavatnik School of Government's Departmental Research Ethics Committee (SSD/CUREC1A/BSG_C1A-20-09) on 25 February 2020.

The next chapter looks at the case where the highest democratic constraints are expected: the United Kingdom.

3. Post-Crisis Reform in the United Kingdom

3.1 Explaining Cases of UK Post-Crisis Reform

This empirical chapter describes and explains the causal process of several post-crisis reforms in the United Kingdom, the country that the theory predicts will deliver the most constrained response to strong democratic demands. This within-case analysis studies several focal regulatory issues debated in the post-GFC period, as well as choice reforms to banking sector tax and pay. Assessed in parallel, this reveals that the UK has been among the most active of ACDs in both unilateral and multilateral regulatory debates, reversing the pre-crisis trend in which it had widely been characterised as a protagonist of global financial deregulation (Helleiner 1994).

However, the evidence reveals that for all the UK's recent regulatory activism, policymakers did not reach outcomes which jeopardised the City of London's competitiveness as a global financial centre. While few would disagree with this qualitative assessment of the post-GFC regulatory regime, there remains substantial puzzlement about the causes of this vacillating approach. In the context of the UK's 2016 referendum decision to leave the European Union, which is widely considered to have created long-term challenges for the City's pre-eminence as an international financial centre, the relationship between democracy, regulatory governance and global finance remains not only in flux, but a live issue of political debate. This makes the task of untangling the complex causal chain of events since the GFC pressing for those interested in British politics and public policy, but that challenge also carries far broader implications for the study of capitalism and democracy.

The previous chapter identified the inconsistencies of some of the key explanatory frameworks in the political economy literature when applied to one of the focal regulatory issues of the post-GFC period. Table 3.1 further substantiates that summary on a within-case basis applied to British reform, evaluating the fit of each competing explanation with the outcomes observed. This demonstrates that no single explanation holds consistently. The empirical account elaborated in this chapter corresponds with an insight made in established scholarship – that the UK's post-crisis policymaking has been characterised by a seemingly inconsistent approach to the defence of business interests (James and Quaglia 2020). Yet it offers a different causal account of what led to that variation. *Democracy under constraint* gives primacy to the force driving policy processes when policymakers periodically sought to incorporate democratic pressure for reform.

Table 3.1: Explanatory Power of Competing Explanations for UK Regulatory Reform

Predictions of Existing Literature		**Evidence Base for Competing Explanation by Policy Issue**			
Explanatory Variable	**Expectation Associated with Explanatory Variable**	**Bank Structural Reform**	**Derivatives Reform**	**Capital Standards**	**Bank Tax and Pay Issues**
Bureaucratic Autonomy	Centralised bureaucracy leads reform	✗	✓✓	✗	✗
Financial Resource of Bank Lobby	High lobbying expenditure; weak reform	✗	✓	✗	✓
Political Institutionalist	Adversarial politics leads to political conflict over reform	✗	✗	✗	✗
	Few veto points allow significant reforms to be introduced	✓	✗	✓	✓

Key: ✓✓ evidence in support; ✓ limited evidence in support; ✗ evidence against

Table 3.1 can be further explicated through summarising the strength of the core explanation associated with the literature on industry lobbying (column 2, row 4). The strength of the UK financial sector lobby – its "instrumental power" – is regularly identified as the driving force behind policy which favours big business (Green 2018; Johal, Moran, and Williams 2014). As sections of this chapter demonstrate, some evidence is found for the lobbying explanation in the policy areas of derivatives reform and issues of bank tax and pay. The moderate fit of that explanation is identified by the single tick in the corresponding fields in Table 3.1. However, evidence contrary to that explanation is found in reforms to bank structural and capital standards, indicated by a cross in the corresponding fields. A bald lobbying account does not adequately explain the within-case variation in the UK, given the varying success of the bank lobby in attaining its interests.

Overall, Table 3.1 identifies that among three mainstay explanations of the policy process cited – the strength of the bank lobby, the role of autonomous bureaucratic action, and the incentives occurring given the specific political-institutional design of the UK – each have inconsistent explanatory power for the observed reform outcomes. These outcomes are detailed in Table 3.2. Recent scholarship has recognised this weakness, moving from monocausal explanations to build more hybrid models of the policy process. Most research to date, for example, explains that the notably stringent British bank structural reform outcome was a product either of competitive interactions among policymakers (Ganderson 2020a; Massoc 2018) or between firms (Howarth and James 2023; James 2018). That conflict, it is argued, led an otherwise strong bank lobby to experience serious defeats. Instead, the empirical account of British bank structural reform offered herein (Section 3.6.1) demonstrates that it is the remarkable consensus, not the pronounced conflict, among key policy actors involved that stands out. At least on the bank structural reform issue, neither the highly resourced bank lobby, nor the adversarial tendencies of British politicians, does a good job explaining how this policy landed.

Table 3.2: Summary of UK Policy Reforms Studied in Chapter

<table>
<tr><th>Feature of Policy</th><th>Bank Structural Reform</th><th>Capital Standards</th><th>Derivatives Reform</th><th>Bank Tax and Pay Issues</th></tr>
<tr><td>Level(s) of Policymaking in sequential order</td><td>UK-national</td><td>1. Multilateral
2. UK national</td><td>Multilateral</td><td>1. UK national
2. EU/multilateral</td></tr>
<tr><td rowspan="3">Policy Outcome</td><td rowspan="3">Ringfencing of UK retail bank balance sheets</td><td>UK follows Basel III regime</td><td rowspan="3">Central Clearing Mandate</td><td>Bank Levy for UK-headquartered banks</td></tr>
<tr><td rowspan="2">Higher requirements for ringfenced UK banks</td><td>UK accedes to EU bonus tax</td></tr>
<tr><td>No Financial Transactions Tax</td></tr>
<tr><td rowspan="3">Policy Scope & Policy Impact</td><td rowspan="3">Large UK-headquartered banks subject to significant new regulatory burden

Structural reform costs for large foreign-headquartered banks negligible</td><td rowspan="2">UK policymakers align bank capital rules to Basel III standards</td><td rowspan="3">UK coordinates with US on central clearing mandate

Reforms implemented via EU regulation</td><td>Bank Levy applied to UK-headquartered banks; not foreign banks</td></tr>
<tr><td>EU bonus tax applies to all banks</td></tr>
<tr><td>Higher requirements for large UK-headquartered banks introduced; eroded during implementation</td><td>No Financial Transactions Tax introduced</td></tr>
</table>

Table 3.3 meanwhile recaps what the theory of *democracy under constraint* predicts would occur in the UK given particular conditions of issue salience. As represented in the first column, the UK financial sector is highly internationalised, and many of its constituent banks possess strong exit options from the UK economy. Under low salience, where democratic pressures for reform faced by policymakers are correspondingly low, *asymmetric dependency* is expected to produce *symbiosis* between policymakers and large cross-border banks. High salience conditions, on the other hand, result in high democratic pressure for reform. This incentivises policymakers to respond to salient voter issues by delivering democratically responsive reform. Given the UK's specific structural dependencies, however, policymakers

can deliver only *constrained responsiveness* to such voter demands. The expected empirical observations associated with the two types of policy outcome – constrained responsiveness and bank-state symbiosis – are italicised in the middle of the table.

Table 3.3: Expected Empirical Observations of UK Policymaking Given State-Bank Dependence and Level of Democratic Pressure

Drivers of Policymaking		*Policymaking Outcomes*	
State-Bank Dependence	**Democratic Pressure for Reform**	***Expected Empirical Observations***	**Policy Outcome**
Asymmetric ++ Financial Sector Internationalisation ++ Bank Exit Options ++	High Democratic Pressure →	*Policymakers mitigating costs to international finance; and firm exit threats* →	Constrained democratic responsiveness
	Low Democratic Pressure →	*Policymakers supporting global banks' commercial interests* →	State-Bank Symbiosis / Alliance

Key: ++ high/very high; **+** mid/high; **-** low/insignificant
Note: Democratic Pressure for Reform can change temporally

If evidence consistent with this theory can be observed in the UK reform process, it would cast doubt on the strength of many existing explanations which have focused on divides among elite actors in the British political economy as causing its variegated approach to business regulation. Instead, evidence consistent with *democracy under constraint* would be able to show that there was more often than not high policy elite consensus about the need to respond to democratic demands for reform, as well as to tailor policy to avoid imposing high regulatory costs on what remains the UK's most important export industry.

Assessed in parallel, British reform outcomes do indeed show up some inconsistencies in policymakers' willingness to incorporate the preferences of global banks: reforms sometimes placed particularly high costs on these firms, but other times policymakers sought – even at considerable expense to their own political capital – to avoid them. Despite the costs of reform to some big banks, the competitiveness of the City of London as a place for global banks to do business remains intact.

Given the political consensus on the policy response to high democratic pressure, it is intriguing that the UK's subsequent referendum on EU membership has widely been characterised, by analysts and scholarship alike, as a backlash against elites broadly speaking (Iakhnis et al. 2018). That vote was the product of cultural cleavages too, such as concerning

immigration policy (Inglehart and Norris 2016). Yet the UK's post-GFC crisis-to-reform process must be put within the full context of this "long decade" of policy flux. If, as the theory proposes, post-2008 reforms constituted a *constrained democratic response*, it puts these later events into sharp relief. Considering the high economic costs of the GFC, it is rather less surprising that the subsequent result of the Brexit referendum led to an outcome that gave short shrift to the economic rationale behind a constrained democratic response. This issue is returned to in Chapter 6.

The chapter proceeds as follows. Section 3.2 details the industrial contexts of UK post-GFC reform, explaining the role of global banks in the British political economy. Section 3.3 identifies how the instrumental power of global banks in the UK is sustained and breaks down. Section 3.4 examines the interaction between multilateral and unilateral policymaking in UK financial regulation. Section 3.5 sets out existing public opinion data about British attitudes towards financial regulation. Section 3.6 elaborates policy reforms in four issue areas, describing how each outcome unfolded as well as the fit of the competing explanations alongside the causal account presented in Table 3.3. Section 3.7 concludes the chapter, summarising the fit of the theory and the implications for the study of British politics and policymaking.

3.2 Global Banking and the British Economy

Finance is the internationally competitive industry of the British economy. The value added to the UK economy by the financial sector (as a share of GDP) is about the same as that of the other two countries whose reforms are documented. Like Switzerland but unlike the US, a high share of UK financial sector activity occurs through cross-border trade. Much of the financial sector's activity thus relates to economic activity occurring outside the country. Around half of the UK banking sector's assets are also located offshore.[14] Cross-border banking as such makes up a high share of overall financial activity. Indeed, as a percentage of GDP, the UK is the world's largest net exporter of finance and insurance services.

This scale of financial services trade makes the UK financial sector peculiarly large relative to the size of the national economy: UK GDP is just over £2tn, but the UK financial sector holds around £23tn. Of this, over £10tn is held by deposit-taking institutions (i.e. banks). Most financial sector exports relate to commission and fee-based income. This reflects the dominance of investment and wholesale banking in the City of London, which is by far the largest industrial agglomeration in the UK. As the data in Table 3.4 show, financial sector exports are a crucial structural component to the UK balance of trade. Table 3.5 meanwhile presents data on the size and international ranking of the UK in certain market segments. In the areas where the UK is not the global leader, it is usually ranked second to New York.

[14] Figures cited here are from IMF (2022), using IMF and UK ONS data.

Table 3.4: Structural Importance of UK Trade in Financial Services
Source: House of Commons Library / ONS Data

Year	Financial Sector Exports (£bn)	Financial Sector Imports (£bn)	Trade Balance (£bn)	Overall UK Trade Balance (£bn)
2007	47.8	9.2	38.7	-30.7
2010	49.0	8.7	40.2	-32.0
2013	55.2	11.3	43.9	-22.8
2016	56.5	13.5	43.0	-32.3
2019	59.2	18.1	41.1	-29.3

The financial sector also provides high-wage employment and consistently high tax receipts. Some key employment statistics are shown in Table 3.6. On almost every measure, UK financial sector activity is highly concentrated in the London area. (cf. Fraccaroli, Regan, and Blyth 2023). The provision of high wage employment is no exception.[15] As of 2021, financial services firms provided approximately 7% of all jobs in London, a city in which 37% of all financial services jobs in the UK were registered (Hutton and Shalchi 2021). Between 1998 and 2019, on a UK-wide basis, finance and insurance jobs increased by 46%, from a per-job output of £78k to £113k. The only other UK sector that today comes close to the productivity potential of finance jobs is ICT. Yet on a national basis, as of 2019 jobs in ICT remained only about 0.8 times as productive as jobs in finance. Strikingly, even among financial sector jobs in the UK, London is the only region that registers per-job productivity above the national average. While the GFC dented the productivity of finance jobs in the UK as a whole, London-based finance returned to high productivity, and firms to high profitability, soon after 2008. The City of London has been an outlier in what has otherwise largely been a lacklustre national economic picture in the decade-plus since 2008, especially in industries such as manufacturing.

[15] The data that follow are from the Office for National Statistics, *Region by industry labour productivity data* (1998-2019 edition).

Table 3.5: Global Market Share and Ranking of the UK in Financial Services
Source: IMF / TheCityUK (2011 data)

Products	UK Global Market Share (%)	Global Ranking
International Lending		
Lending	18	1
Borrowing	21	1
European activities	50	1
Insurance market		
Global insurance premia	($309bn)	3 / 1 (global/Europe)
Pension fund assets	9	1 (Europe)
Equities		
Global foreign equity trading	19	2
International Public Offerings	12	-
Turnover of the London Stock Exchange	-	4 / 7 (global turnover / market capitalisation)
Bonds		
Euro-bonds secondary market	70 (trading by bookrunners in London)	1
Securitisation issuance	6	2
Fund management (source of funds)	9	2
Hedge fund assets	19	2
Private equity investment value	13	2
Derivatives		
OTC interest rate derivatives	46	1
Exchange-traded derivatives	-	1 / 2
Foreign exchange		
Turnover	37	1
Commodities		
Commodities derivatives trading	-	1 / 2
Bullion markets (gold/silver)	-	1
Maritime services		
Marine insurance premium	21	1
Shipping finance	13	1
Ship classification	18	1
Ship-broking	30-50	1

Table 3.6: UK and London Average Weekly Earnings by Sector
Source: ONS Data (Earnings and hours worked dataset)[16]

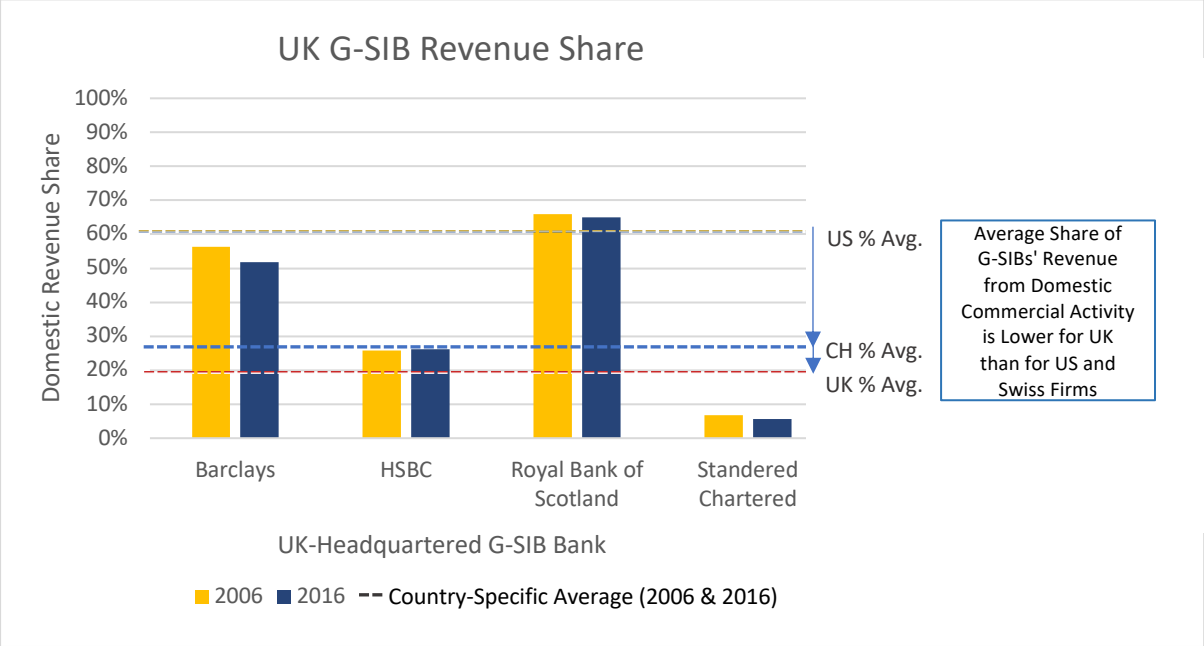
Geography	Average Gross Weekly Pay by Sector (£)	2000	2007	2009	2019
UK-wide	Manufacturing	401	514	539	606
	Financial and Insurance Activities	529	692	748	968
	Avg. additional earnings in finance jobs (%)	32%	35%	39%	60%
London only	Manufacturing	524	681	650	742
	Financial and Insurance Activities	845	1079	1149	1502
	Avg. additional earnings in finance jobs (%)	61%	58%	77%	102%

There are strong similarities between the British and Swiss financial sectors in terms of their high internationalisation. This differentiates these countries from the United States, which is highly focused on domestic activity. A differentiating factor between the UK and Switzerland, however, is the strength of exit option available to dominant cross-border banks in each country, which are the focal business actors of this study. Chapter 4 explains that the Swiss financial sector is dominated by two global banks – Credit Suisse and UBS – whose commercial focus is wealth management, in which Switzerland has long been the global leader. At the time of writing, the UK is home to three G-SIBs, although when the FSB first defined this term in 2011, Royal Bank of Scotland and Lloyds Banking Group were included, while Standard Chartered was not (Financial Stability Board 2011). In 2008, RBS and Lloyds firms received government bailouts of £45.5bn and £20bn respectively. As of January 2018, the cost of the public interventions was estimated at £23bn (Mor 2018), by which date both firms had significantly contracted their balance sheets. Lloyds in particular became a firm focused almost exclusively on UK retail and commercial banking. Figure 3.1 shows that the UK's three remaining G-SIBs plus RBS remain as a group far more internationalised than US G-SIBs, and slightly more internationalised than Swiss G-SIBs.[17] If RBS is dropped out of the calculation of the UK average, UK G-SIBs become even more internationalised in overall orientation.

[16] Standard Industrial Classification of Economic Activities (SIC) Codes used by the UK Office for National Statistics changed in 2007.

[17] Note that Lloyds, unlike other UK banks, never reported their revenues by geographic location in their annual reports.

Figure 3.1: Share of UK Domestic Bank Revenues to Overall Global Revenues
Source: Bank Annual Reports



The UK and Swiss banking sectors are similar in the sense that both have highly internationalised G-SIBs, yet they differ in that the overall commercial mix of firms in the UK banking sector is far more heterogenous. Table 3.7 shows that the ratio of foreign banking to total banking activity is far higher in the UK than it is in Switzerland. Policymakers as a result encounter a more varied terrain when they go about regulating the British financial sector. For firms headquartered in foreign jurisdictions with a significant British presence, London is one important global financial centre among several, often competing alongside New York, Singapore, Hong Kong and other financial centres.

While the share of activity conducted by foreign firms in the overall industry cannot be calculated through a single metric, one useful macro-indicator is the share of UK banking assets that are in international foreign bank subsidiaries and branches. As of 2011, this figure stood as high as 50% (International Monetary Fund 2011, 8).[18] In terms of the distribution of activity by firm, overall a high share of retail banking activity continues to be conducted by the large UK-headquartered firms, notably the "Big Four" banks which possess a very high market share (Independent Commission on Banking 2011a, 165–201). Since the Big Bang reforms of Margaret Thatcher's government in the 1980s, foreign banks have become the dominant players in global wholesale and investment banking (Appendix 3, George 1999; Independent Commission on Banking 2011b, 109–10; Kynaston 2002). This trend has been referred to as the "Wimbledonisation" of the City.

[18] The difference between the data reported in Table 3.7 and the IMF source quoted here is presumably due to differences in how each assess asset value and code locational data. Both indicators show that the UK's banking sector is far more internationalised than Switzerland and the US.

Table 3.7: Percent Foreign Banking to Total Banking by Number of Firms and Amount of Assets in United Kingdom and Other Jurisdictions
Source: Bankscope Data; Claessens and van Horen (2014)

Foreign Banks to Total Banks By Country		2005	2006	2007	2008	2009	2010	2011	2012	2013
Switzerland	Firms	21	23	23	23	23	21	20	20	20
	Assets	4	4	5	5	6	6	5	2	2
United Kingdom	Firms	54	54	56	57	56	58	58	58	58
	Assets	12	12	13	19	15	15	15	15	14
United States	Firms	24	24	26	28	31	32	33	31	31
	Assets	21	21	22	18	19	16	14	14	10

The cross-border value added to the British economy as such owes far more to the commercial activity of foreign firms than is the case in the US and Switzerland. The primary way that the state benefits from this is through extracting the value made through financial sector employment. Market surveys and tax data show that non-UK-headquartered investment banks employ workers more productively on a per-job basis, and that the government particularly benefits from this through taxation. In 2017, when the relevant data were first reported, foreign banks contributed 54% of all employment-related taxes, while employing just 25% of total employees in the banking sector. This figure remained roughly the same in 2020. Foreign banks have consistently paid between 40-50% of the overall tax contribution of the banking sector since data were first reported in 2015-16 (PwC 2016, 2021, 2022). Comparable data is not available for Switzerland, but Credit Suisse and UBS are by far the two biggest employers. In terms of aggregate tax receipts, the UK and Swiss financial sectors (as opposed to banks only) make a similarly high overall contribution to the national economy.[19]

The particularly high penetration of foreign firms is one consequence of London being a commercially advantageous centre for financial companies to perform cross-border activity (Cook et al. 2007; Kalaitzake 2022; Lysandrou, Nesvetailova, and Palan 2017). By most measures, this comparative advantage has remained constant or only declined slightly since Brexit (Fraccaroli, Regan, and Blyth 2023; Kalaitzake 2022). One effect of this particular industrial mix is that the most globally competitive firms in the UK possess a stronger exit option – and thus higher structural power – compared to other countries which are more significant regulators of "home" banks (Iaydjiev 2016; Pistor 2010; Singh 2020).

Since, as Figure 3.1 shows, even UK-headquartered banks are less reliant on the UK domestic economy than the equivalent in the US or Switzerland, as a whole the City of London is constituted by a highly structurally empowered mix of firms. This changes the trade-offs experienced by policymakers. With firms more able to relocate activities elsewhere, the state will lose out on economic activity at a lower threshold of regulatory incursion compared to an equivalent scenario of less structurally powerful firms (Culpepper and Reinke 2014;

[19] Data cited in Chapter 4 show that in 2018 the Swiss financial sector contributed about 12% of total tax revenues. In that same year, the estimated tax contribution of the UK financial sector was about 11% of total tax revenues, representing a decline from about 12% in the years immediately after the GFC, and a high of about 14% in 2007 (City of London Corporation and PwC 2019).

Lindblom 1982; Winters 1996). The theory proposes that a combination of high internationalisation and strong exit options means that the British state exists in asymmetric dependence on cross-border banking.

3.3 Instrumental Bank Power: Special Interests and The Salience Effect in the UK

In Section 3.1 it was identified that a mainstay explanation in the literature for British regulatory outcomes – the strength of the financial sector lobby – has inconsistent explanatory power when assessed against the evidence presented in this thesis. Overall, on two of the crucial reform issues – structural reform and bank capital standards – the bank lobby was able to exert a negligible influence over outcomes. On the issues of derivatives reform and bank tax and pay, on the other hand, the bank lobby had some influence. Even in these instances, though, the evidence presented of a significant lobbying effect remains inconclusive.

Given the scale and resources commanded by the bank lobby in the UK (e.g. Mathiason, Newman, and McClenaghan 2012), the limited explanatory role given to instrumental power in the UK case may be surprising. It clearly remains the case that banks in the UK do sometimes achieve their lobbying goals. For example, in 2015 HSBC scored what one trade association official called a "stunning lobbying coup" when its liability for the UK Bank Levy was significantly reduced.[20] Yet it is proposed that these lobbying successes cannot explain the overall within and cross-case variation under study. Outcomes have overall presented far greater challenges to established business interests than isolated wins by individual firms. The bank lobby's successes are far fewer than what might *prima facie* be expected for a country with such a large financial sector and associatively well-resourced business lobby.

The weak causal role given to the UK bank lobby in the proposed theory is in fact generally consistent with some recent empirical accounts of British policymaking in the post-GFC era (James 2018; James and Quaglia 2019a; Thompson 2017). These have generally presented the failure of the bank lobby in the UK as a departure from pre-GFC norms. Such a temporal break accords with an application of the theory as set out in Table 3.3: before 2008, during a sustained period of financial sector growth, this low salience environment saw policymakers govern the sector in symbiosis with industry preferences. After the crisis, that same policymaker-industry alliance continued to characterise low salience policy issues, on which democratic pressures for reform were low. Yet overall the symbiotic engagement was severed by certain reforms undertaken in the post-2008 era: the structural and bank tax and pay reforms analysed herein represent two significant departures from the state-industry alliance of the low salience equilibrium.

These outcomes provide for the within-case variation that can be exploited in the sections that follow, in which the process behind the shift from the more proximate state-banking alliance is examined. Here, the literature on British post-crisis reform can be brought into comparative relief by accounts of continental European post-crisis policymaking. These find, relatively consistently, that strong mechanisms of cooperation between industry and policymakers precluded significant reform after 2008, including on what was for the UK the

[20] Interview UK#20, UK bank trade association official, 3 March 2021.

high-profile issue of bank structural reform. These cooperative mechanisms have been identified as particularly pronounced in France, Germany and the Netherlands (Ganderson 2020a; Grossman and Woll 2014; Massoc 2020; Woll 2014). These studies, some of which also have bank structural reform as a focal object of study, also find that British policymakers took a more adversarial approach toward industry on this issue than these continental European economies. On this measure, the UK is more similar to the US, a country which similarly lacks the cooperative institutions found in much of continental Europe (Hall and Soskice 2001). It is on the crucial bank structural reform issue that the UK and US reached very different outcomes to many European countries – except, as is elaborated in Chapter 4, Switzerland.

Despite having one of the world's best resourced financial lobbies, then, a fraying of the state-industry symbiosis of the pre-GFC equilibrium occurred. This led to some high-profile failures for the UK bank lobby. Without politically institutionalised incentives to cooperate with industry, British policymakers pursued a more adversarial stance towards industry when they faced strong democratic pressures – or, in Ganderson's terms, when a "salience window" opened – to deliver policy reform. It is on the highest salience issues that politicians should face the strongest incentives to demonstrate responsiveness to voter interests (cf. Culpepper 2011). The shift in political behaviour observed in the UK, from a symbiotic towards an adversarial engagement with industry, can in turn produce pronounced changes in the policy regime, especially in terms of regulatory costs experienced by industry.

The chief theoretical advance when applied to the UK case is twofold. First, whether a shift in policymaking environment occurs – from a symbiotic towards an oppositional stance towards industry – is attributed to the varying democratic pressures faced by policymakers on different policy issues. This variation is revealed through the within-case analysis, where issues that were less salient to the national political debate continued to demonstrate many of the hallmark features of a state-industry symbiosis. Second, the theory provides an explanation for what holds back policymaking, even once the instrumental power enjoyed by industry has broken down and policymakers seek to respond to strong democratic pressures favouring reform. As Table 3.3 identifies, under high democratic pressure, British policymakers are expected to deliver a *constrained democratic response* given the country's asymmetric dependency on cross-border banking. Structural not instrumental power acts as the main constraint to democratic responsiveness in these cases. The following within-case analysis in turn yields important insight to corroborate the cross-case analysis, when UK reforms are assessed in parallel with US and Swiss policymaking.

3.4 Rules of the Game in UK Policymaking: Balancing Domestic with Multilateral Policymaking

Table 2.8 identified that of the various reforms undertaken by the UK, it was only on the bank structural reform issue that the regulatory response was almost exclusively achieved through unilateral policymaking. On most other issues, multilateral institutions were an important vehicle for achieving reform. This, it was explained, was partly a function of issue salience, but also due to the functionalist realities of British policymaking. In terms of the latter, the UK is an active member of various multilateral bodies, and at the time of the reforms was also part of the European Union whose substantial financial regulatory responsibilities usually take legal precedent over national law.

There is also a salience dimension to whether reform issues become actively debated in national policymaking institutions. As in Switzerland and the US, bank structural reform was the issue that came to be of highest salience to the UK reform debate. The debate on structural reform was shaped by voter concerns about exposure to international markets and banks being deemed TBTF. In comparison to most areas, multilateral routes to reform were closed off at an early stage of the reform period due to limited interest among states in coordinating structural policies.

Bank capital reform and the regulation of markets in financial instruments (MFIs) were also salient issues in UK political debate. However, these policy issues struggled to attract such broad interest from voters, given the highly technical character of the associated regulatory debates. Capital requirements are not an accessible issue for all but a few experts. It is also the case that capital and MFIs reform were achieved through multilateral institutions. Multilateral regimes create strong international norms and standards, which often have considerable influence over the content of domestic reform (cf. Jones 2019). For a mid-sized country such as the UK, there are strong incentives to seek influence over, and later enact, multilateral rules. The UK has far less regulatory power to influence global business regulation through its domestic policymaking than a very large economy such as the United States (Simmons 2001). Significant lack of alignment between domestic and multilateral regulation is likely to create significant competitiveness costs for the UK. As David Singer has shown, a preference for multilateral over national regulation derives from a position of weakness, not strength in the international political economy (Singer 2007).

The prevalence of multilateral bodies did not make the political debate over enhancing capital or MFI regulation redundant in the UK. There were, after the GFC, strong economic arguments in favour of bolstering bank capital in excess of international standards (Admati 2014; Admati and Hellwig 2014). As a result, capital reform became salient to the UK national political debate on banking reform, even if its broad contours were decided through multilateral negotiation. On the other hand, in the UK the regulation of MFIs was almost exclusively achieved through reforms agreed to at the multilateral level. Multilateral institutions, notably the FSB, had a strong mandate to pursue reform of derivatives markets; and the EU acted as the primary policy forum for designing implementation of the regime in the UK.

Bank levies and taxes were meanwhile highly salient to the domestic political debate, given the costs of the GFC to British taxpayers, the clear redistributive dynamics, and the limited scope for tax policy at the global level. While levies and other taxes were also discussed in multilateral institutions (e.g. the G20, IMF and the EU), the absence of cohesive international policymaking in this domain often left states to consider their own tax policy interventions. However, as is shown in Section 3.6.4, while policymaking on banker bonus caps primarily played out at the EU level, this issue was also a salient one to the UK political debate. While, as Table 2.7 set out, it is generally the case that democratic pressures will be felt most by policymakers when an issue is debated in national political institutions, this instance shows how, when a particularly salient issue plays out in multilateral for a, it can create domestic pressures for policymakers, who must engage in a "two-level game" (Putnam 1988).

3.5 Banks and Banking in the British Public Eye

Relative to the other countries in this study, the British public have persistently negative opinions about banks and banking. While cross-country surveys that ask the same questions are generally not available (although see Culpepper, Jung, and Lee 2023) , the available data all suggest that British people have low regard for bankers, and that they generally favour higher financial regulation.

Survey data across time shows this consistent finding of negative feeling towards banks and bankers. First, British respondents attribute high blame at bankers for causing the GFC. In October 2008, one poll found that 93% thought that bankers should take responsibility for the crisis. In a multi-choice response field, a similar number also blamed bad financial regulation (92%), the government (88%), the general global downturn (86%) and consumers who had borrowed too much money (84%). However, while blame attribution was broad, more respondents (74%) thought banks rather than politicians (45%) should take more responsibility (Glover 2008).

These perceptions have remained remarkably consistent over time: as the results of a May 2013 survey presented in Table 3.8 show, considerably more people attributed blame at the banking industry rather than different parties of government. Over four years after this, another survey presented in Table 3.9 found that a significant majority of people (67%-7%) thought that bankers should have been jailed after the GFC. This implies that many people in the UK think that bankers were not sufficiently held to account for their role in the crisis.

Table 3.8: Blame Attribution for Financial Crisis in the UK
Source: Survation, 2-3 May 2014, N=1,005 British adults

Blame attribution	Response (%)
Previous Conservative governments	12.8
The last Labour government	33.9
The banking industry	53.3

Table 3.9: Perception of bankers' criminality in the UK
Source: YouGov, 4 October 2018, N=3,789 British adults

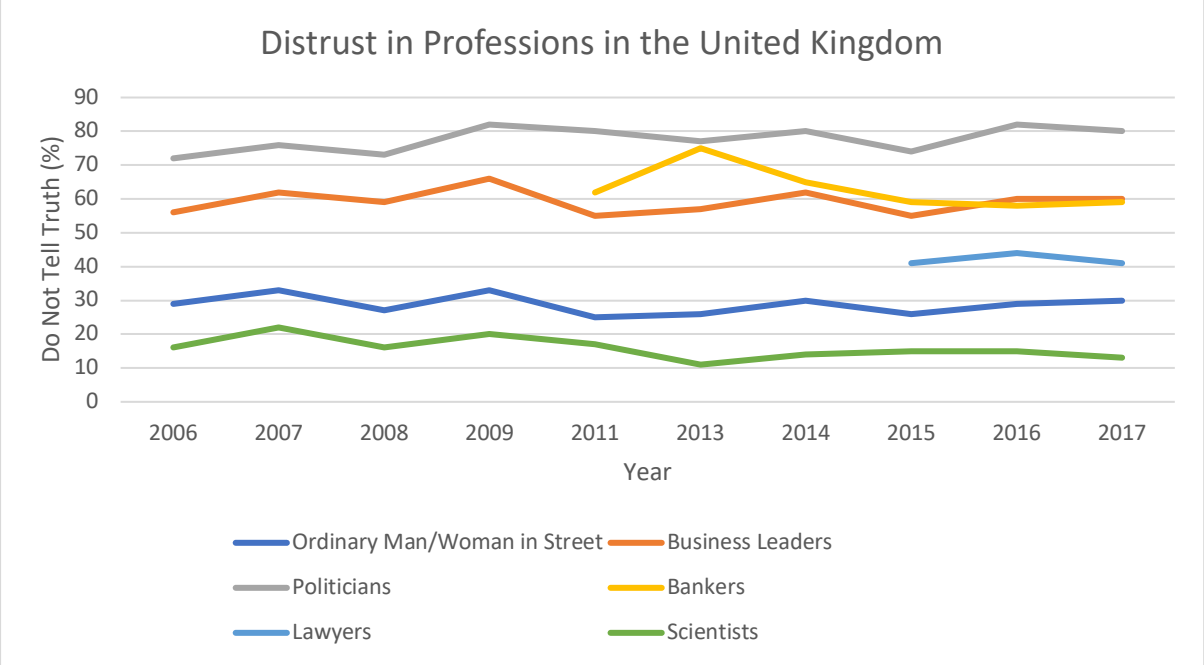
Bankers should have been sent to jail after GFC[21]	Response (%)
Yes	67
No	7
Don't know	26

Bankers as people are also unpopular relative to other professionals. One survey that has been running since the 1980s polls people on their trust in professions. Figure 3.2 presents selected data from these annual surveys, showing the share of people who thought

[21] The question asked was: "Do you think that there are bankers who should have been sent to jail over the financial crisis in 2008?"

professionals "do not tell the truth".[22] Bankers have been included in the panel only since 2011, so it cannot be deduced how trusting people were of bankers in the immediate aftermath of the crisis. However, a particular rise in distrust is observable in the year after the Libor scandal. Unsurprisingly, bankers are shown to be less trusted than everyday people in the street. Notably, British people do not seem to have generally negative feeling towards elites: scientists are particularly trusted professionals, and the three years of data available suggest that lawyers are far more trusted than bankers. While bankers were consistently more trusted than politicians, trust in bankers appears highly correlated with trust in business leaders. This correlation may suggest that British people have negative opinions about bankers and business leaders for similar reasons. Similarly low trust in bankers has been found in surveys conducted during 2020 by Culpepper, Jung and Lee (2023), who show that British people are less trusting of banks[23] than American, Australian and Swiss respondents. This indicates that lack of trust in banks and bankers is a long-term feature of British public opinion.

Figure 3.2: Distrust in Selected Professions in the United Kingdom 2006-2017
Source: Ipsos, c.1,000 British adults each year



Note: No annual survey was run in 2010 or 2012.

British people are also found to be consistently favourable to more financial regulation. In addition to the 2008 poll cited above which found high blame attribution of pre-crisis regulation, a 2010 poll presented in Table 3.10 shows that a majority (75%-18%) of British people thought that banks recovering after the crisis meant that banks had not changed and were still not being properly regulated. A 2013 poll shown in Table 3.11 similarly found that the vast majority of people (74%-11%) thought that the 1997-2010 Labour Government had been too soft on regulating banks. A smaller but clear majority (55%-26%) thought that the post-2010 Conservative-led Government had also been too soft on regulating banks. These

[22] The remaining percentages of respondents said "tell the truth" or "don't know".
[23] As opposed to bankers as individuals.

polls do not say much about why people think more financial regulation is important, but this finding can be deduced from other questions asked in surveys conducted in the same period. Table 3.12 shows that, five years after the GFC, quite a high number of people (40%) thought that the UK was more protected from a future financial crisis than it had been. When asked a slightly different question about whether changes made in the sector (regulatory of otherwise) mean a future crisis will be avoided, the majority (65%-22%) were not confident that this was the case. These mixed results mean it is difficult to reach any firm conclusion on whether people thought that new regulations had solved the issue of what a regulatory expert would call "systemic risk".

Table 3.10: British perceptions about banks' post-GFC financial recovery
Source: YouGov/Compass, 18-19 February 2010, N=1,281 British adults

Response to banks posting profits and paying bonuses post-crisis[24]	**Response (%)**
On balance I'm pleased, as it shows that banks are recovering which could be good for the economy	18
On balance I'm worried, as it shows that banks have not changed and are still not being properly regulated which could be bad for the economy	75
Don't know	7

Table 3.11: British public opinion about previous government's regulations of banks and financial sector
Source: YouGov, 23-24 June 2013, N=1,694 British adults

	Opinions about government regulations of banks and financial sector	
	Previous (1997-2010) Government	Current (2010-13) Government
Response	(%)	
Were too tough	1	3
Got the balance about right	11	26
Were too soft	74	55
Don't know	14	16

[24] The question asked was: "In response to the recent financial crisis, the UK Government supported banks to help kick-start the economy. As the industry recovers, banks have posted large profits and paid their staff bonuses. On balance what do you think about this?"

Table 3.12: British public opinions about the UK's resilience to a future financial crisis
Source: YouGov, 23-24 June 2013, N=1694

Protection of the UK from a future financial crisis (June 2013)[25]		**Confidence changes to sector will avoid a future crisis** (October 2013)[26]	
Perception of protection	Response (%)	**Confidence**	Response (%)
Total more protected	40	Total confident	22
About the same	38	Total not confident	65
Total less protected	11	-	
Don't know	10	Don't know	14

There is however stronger data to suggest that after 2008 British people were consistently supportive of specific regulations. This chapter shows that all of these were mostly not achieved, or only partly achieved, by policymakers during post-GFC reform. Table 3.13 presents survey data about British public support for certain policies after the crisis. It also cites which section of this chapter each policy issue is further discussed in. Overall, in 2010 British people were highly supportive of policies against banks' commercial interests. Correspondingly, they also had very low support of the idea of not regulating in order to promote those interests. As data presented in Chapter 4 show, this is different from Switzerland where polls show that Swiss people are supportive of the country's bank secrecy regime and are overall more trusting of their banks.

[25] The question asked to N=1,694 British adults was: "Thinking about the banking crisis that started in 2008, do you think we are more or less protected from a future financial crisis than we were five years ago?"
[26] The question asked to N=1,736 British adults was: "Thinking about the changes to the banking sector that have happened in the last few years, how confident, if at all, are you that enough has been done to avoid another banking crash like 2008 happening in the future?"

Table 3.13: British public opinions about different regulatory policies
Source: YouGov/Compass, 18-19 February 2010, N=1,281 British adults

Policy	Support - Opposition - Don't Know (%)	Section in which Policy discussed
Apply the one-off windfall tax of 50% on bankers' bonuses to staff in other financial institutions such as hedge funds and private equity houses	60-20-20	3.6.4
Introduce a law to cap bankers' bonuses (set as a percentage of profits)	76-14-10	3.6.4
Introduce a financial transactions tax to raise revenue and reduce financial speculation	51-23-26	3.6.4
Introduce a law to separate retail banking (consumer deposits and loans) from investment banking (speculating and raising funds on international currency and stock markets)	68-12-20	3.6.1
Allow banks to pay whatever they choose in bonuses in order to attract the best staff	20-70-10	3.6.4
Stop any new regulations on the financial sector as it is a valuable part of the economy	20-59-21	3.6

There is very strong evidence that the British public were in favour of more stringent financial regulation, and did not think that banks' commercial interests should be protected, after the GFC. More recent surveys conducted by Culpepper, Jung and Lee (2023) in 2020 show that British people have higher preferences for financial regulation compared to Americans, Australians and Swiss people. The next section analyses, considering these strong voter preferences for reform, to what extent British policymakers delivered a response to democratic pressures.

3.6 Four Cases of UK Post-Crisis Reform: Policymaking under Asymmetric Dependency

The following sections analyse three crucial regulatory policy issues which each commanded considerable attention among British policymakers: structural reforms to the banking sector, higher capital requirements, and the regulation of markets in financial instruments (e.g. derivatives products). Each of these issues demanded a policy response given the vulnerabilities observed in the UK during the crisis period.

Across these three regulatory issues, the expectation is that the effect of high democratic demands will be most observable on the highest salience issue that policymakers responded to through national institutions: bank structural reform. Applying the theory set out in Table 3.3, it is on this issue that we should expect to observe the most acute case of a *constrained democratic response*. The effect of democratic demands is expected to be least observable, meanwhile, on the least salient and most technical policy issue that was primarily dealt with through EU and other multilateral regulation: the reform to MFIs. Each of the following sections begins with a summary table which identifies the maximal policy reform that was considered in policymaking institutions; and B) the policy that was preferred by big banks. The table provides an assessment of where the outcome achieved sits in relation to A) and B).

3.6.1 Bank Structural Reform: The Ringfencing of Big UK Banks

Table 3.14: Overview of Possible UK Bank Structural Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Separation of bank balance sheets	*Retail banking separated out*	No change to universal banking
Making banks smaller	Breaking up big banks	*No size limits*
"Narrow" banking	Narrow banking	*No narrow banking*
Proprietary trading ban	Broad proprietary trading ban	*No proprietary trading ban*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Bank structural reform attracted high and persistent public and political interest from an early stage of the post-crisis period. Unlike bank capital and liquidity standards and derivatives regulation, issues of bank structure remained almost exclusively an issue for national, as opposed to multilateral, policymaking.[27] Regulation concerning the size, structure and mixing

[27] This was both for legal-jurisdictional and political reasons. There was limited appetite for bank structural reform among large EU member states such as France and Germany (Hardie and Macartney 2016). The strong

of activities within large banks was, and largely remains, bound by national law and regulation. A combination of high salience and national policy competence threw the issue into the public limelight. Given the structural dependencies of the UK economy, this section shows how high democratic incentives led policymakers to deliver a constrained democratic response in an attempt to satisfy both the structural-economic and democratic drivers of policymaking.

The public and political debate on bank structure in the UK began in earnest towards the end of 2009. In September of that year, the eminent business economist John Kay (2009) published a volume titled *Narrow Banking: The Reform of Banking Regulation*. It proposed that universal banks be broken up to better protect retail deposits, backing them only by safe assets such as government bonds. The report attracted widespread interest among policymakers, with drafts being reviewed by both Governor of the Bank of England Mervyn King and Chair of the Financial Services Authority (FSA) Adair Turner. King – who would, after leaving office, again become Kay's academic collaborator – publicly championed the report to MPs at the Treasury Select Committee as "probably … the most important piece [of work] on regulation for ten years" (Nesta 2010).[28] In the same month, the powerful Labour backbench MP John McFall, Chair of the Treasury Select Committee at which King spoke, together with author and thought leader on topics related to finance, Philip Augar, wrote an article in the *Financial Times* titled "To fix the system we must break up the banks". In it, they called for "a banking commission informed but not dominated by people outside the industry … [with a] remit … to consider structural change" (Augar and McFall 2009). The idea of a commission driven by civic society concerns was soon picked up by the consumer group *Which?* which called this convening the Future of Banking Commission. It brought together key individuals at a critical time and crystallised the public debate on structural reform.

By the end of 2009, the UK was gearing up for a General Election. With the proximity of an election, Labour was reluctant to undertake a major review into bank structure, especially as it had not been a policy recommended by FSA Chair Adair Turner who had led the major review in the Brown Administration (Turner 2009). Absent government leadership on the issue, and seeking to inform the pre-election debate, the Future of Banking Commission produced its report just before the May 2010 election. Eight commissioners, including John McFall, the Conservative MP David Davis, and the future ICB member Claire Spottiswoode

commitment among these countries for universal banking was recognised among UK policymakers from the earliest stages, and they instead chose to pursue a unilateral route to structural reform. After the ICB reported, the European Commission set up its own group, known as the Liikanen Group after its Chair Erkki Liikanen. In October 2012 it published its *Report of the European Commission's High-level Expert Group on Bank Structural Reform*. By this point, France and Germany had each pre-empted EU reforms with a weaker version of structural reform passed through domestic legislation. Eventually, in July 2018, EU Parliament proposals for bank structural reform along the lines of the Liikanen recommendations were dropped due to lack of political appetite among member states.

[28] At the Treasury Select Committee, King also praised to MPs the work of Boston University economist Laurence Kotlikoff, who wrote publications on breaking up banks and ending fractional reserve banking, and who was formally engaged in work at the Bank of England commissioned by King and his senior staff. King told MPs: "I hope that when you take evidence from people from the US … people like Professor Kotlikoff, who have a wide set of proposals. I'm not saying anyone should be signing up to them today, but unless we look at the deep structural issues that have got us to where we are, we simply repeat the crisis again on an even bigger scale. There's a political will for a discussion of radical solutions. It's taking things off the table that we need to avoid at this stage" (qtd in Jagger, Leroux, and Ralph 2010).

recommended that the "crucial issue" of the "compulsory separation of banking activities" be looked at "urgently and in great detail [as] a structural solution to the problems caused by large, integrated banks". Relatedly, the Future of Banking Commission also recommended "breaking up investment banks" by "[e]xtending the Volcker [Rule] to prohibit banks from trading any form of securities, and separating corporate advice from investor advice" (Which? 2010, 8). Martin Taylor, who would soon also become a member of the ICB, appeared as a witness at the Future of Banking Commission. In his oral evidence, Taylor argued for "some kind of attempt to ring fence the retail deposit base" because, in his experience as CEO of Barclays (1994-98), "investment banking activities of a universal bank were at all times parasitic on the retail bank balance sheet" (Future of Banking Commission - Evidence Session 15th March 2010). This was the first time that the idea of "ringfencing" retail deposits entered the policy lexicon in the UK, at a civic society convening which brought together three of the five future ICB members, as well as Vince Cable who would become the key Coalition Government actor pushing for structural reform. While politicians could not gauge the popularity of different versions of bank structural reform, the left-leaning pressure group Compass ran a survey with YouGov at this time in which "[introducing] a law to separate retail banking … from investment banking" attracted 68% total support (Table 3.13).

While the Labour Government remained generally muted on structural reform, both main opposition parties put financial regulation front-and-centre of their reform programmes. The Coalition Agreement, which saw the Conservative and Liberal Democrat parties form a government, contained the Conservative manifesto pledge to abolish the FSA and fundamentally reform the New Labour-era tripartite regulatory system. Aligned with Lib Dem priorities, the Agreement also contained a commitment to institute an independent commission to consider structural and non-structural issues of banking reform. Establishing an independent commission was a compromise position that emerged from the headline Liberal Democrat manifesto pledge to "break up the banks" and to "establish a clear separation between low-risk retail banking and high-risk investment banking" (Liberal Democrat Party 2010, 7, 10, 21, 22). The Conservatives, for their part, had in the year prior to the election cautioned against "unilateral" domestic structural separation, which they argued would "be likely to do significant damage to the UK's competitiveness as a global financial sector and drive some of our most successful banks offshore" (Conservative Party 2009, 34). Instead, their manifesto pledge was to pursue a multilateral agreement to ban proprietary trading (Conservative Party 2010, 29). The Conservative agreement to institute an independent commission was therefore widely seen, in the words of one former ICB official, as a way "to keep Vince Cable happy".[29] Cable's support for structural reform, and his instrumental role in holding together the Liberal Democrat side of the Coalition bargain, meant that he acted as "a potential bomb under the Coalition".[30] There could be no rowing back on the commitment to a genuinely empowered and independent commission without jeopardising the stability of the government.

Once the Coalition Agreement was signed and the ICB soon established, it became all but inevitable that the UK would proceed unilaterally with some version of structural reform. Once the Volcker Rule had been inserted as a late-stage addition to the Dodd-Frank

[29] Interview UK#1, ICB official, 16 April 2021.
[30] Interview UK#2, Conservative Government adviser, 24 September 2021.

legislation, multilateral (G20, FSB or similar) policymaking on bank structural reform, which had been the stated preference of the Conservative Party, was effectively dead in the water. Nor did UK policymakers perceive appetite for structural reform among the large EU member states, where universal banking was a longstanding institutional feature. Concerted action by EU institutions was thus deemed an unpromising avenue for policy reform. National political institutions became the default venue. Among policymakers, banks' instrumental power had substantially broken down, as was reflected in the cross-partisan participation of politicians in the Future of Banking Commission, which had recommended sweeping reforms. On the high salience policy issue of the structure of large cross-border banks, policymakers now experienced high democratic pressure to pursue strong policy reforms.

The ICB was instituted by and accountable to the UK government, and it carried no authority or mandate outside the UK. To have a chance of being enacted, any ICB proposal for structural reform would need to be implemented through national institutions. As the ICB convened, among its members there was already "an assumption that … [the existing] structural solution was out-of-date".[31] A senior Bank of England official pithily summarised the political bargain with the ICB as "here's some power, go away and do something – and by the way, you better do something".[32] Among ICB members, it was clear that politicians were serious about pursuing structural reform, and were delegating power with a clear understanding that the status quo was not the preferred option.

Initiated as a priority of the Coalition Government, the ICB began deliberating just a month after the post-election agreement. There was political momentum and clear public appetite for structural reform; the main contingency now was what type of structural reform the ICB would opt for. The mandate from government offered some direction, and its membership was chosen by Osborne to temper what were perceived as more radical proposals such as had been delivered by John Kay. The ICB was to consider "the extent to which large banks gain competitive advantage from being perceived as too big to fail" and to evaluate structural measures "including the complex issue of separating retail and investment banking functions", while having regard to "the competitiveness of the UK financial and professional services sector and the wider UK economy" (Independent Commission on Banking 2010). George Osborne opted for Sir John Vickers as a compromise candidate for Chair instead of Vince Cable's preferred candidate, John Kay. While Kay had pre-positioned himself as an advocate of narrow banking, it was hoped by both Osborne and many in the regulatory community that Vickers would quickly "put these ideas to bed" due to fears they would carry major costs.[33] Like Kay, Vickers was well-respected in both academic and regulatory spheres, but Vickers had not made his views on banking reform public. He had, however, co-authored an academic article with Kay in the early stages of his career, in which he had argued that structural regulation of industry was generally superior to the regulation of professional conduct (Kay and Vickers 1988).

A policy proposal that involved creating some degree of separation between retail and investment banking took shape very early in the ICB process. This was achieved because the ICB quickly reached consensus on a definition of the problem, or market failure, to be solved.

[31] Interview UK#1, ICB official, 16 April 2021.
[32] Interview UK#3, former senior Bank of England official, 31 March 2021.
[33] Interview UK#4, former senior Bank of England official, 18 February 2022.

In interview, Martin Wolf (ICB member and chief economics editor of the *Financial Times*) stated that ICB members "reached a natural conclusion very clearly [and] very, very quickly" that the key task was to create a banking system in which retail services could continue to function under any foreseeable market stress, while also ensuring that "the exposure of the British state to [the largest UK banks was] contained".[34] In the UK, an actual bank run had occurred (the first since 1866) and politicians were forced to bail out what in 2008 had become the largest bank in the world by assets. Wolf also pointed out that the UK bank bailouts had been provided to institutions where "roughly half … of those balance sheets were outward-facing … related to a whole slew of very different international activities" that were not core to the UK economy. In other words, Wolf and his colleagues perceived the key issue to be that the UK had a highly internationalised banking sector which had transmitted huge systemic risk from the global into the domestic economy, contagion which had been contained only through hefty taxpayer-funded bailouts. The ICB saw it as its job to increase UK financial stability by mitigating that transmission mechanism. One possible mechanism for doing so – massively increasing capital requirements – was rejected early on due to competitiveness concerns (see Section 3.6.2).

Simultaneously, there was a perception among ICB members that the US approach to reform in the Volcker Rule did not answer what was referred to internally as the "exam question" asked of the ICB by the government. Nonetheless, a UK proprietary trading ban "was definitely on the table for quite a long time" for the simple reason that it had been the approach taken by the City of London's main financial sector competitor and closest regulatory partner.[35] For John Vickers, the main point of debate was "do you add [a] Volcker [Rule] to what we're doing [structural separation], not to do Volcker instead?"[36] Meanwhile, the Volcker approach was dismissed by Martin Wolf, who argued that attempting to regulate banks' speculative activity would ultimately be politically unviable because "the City of London *is* a speculative entity".[37]

Doubts about the effectiveness of a proprietary trading ban were perceived by most ICB members, even after formal meetings were held with Paul Volcker. Not only was it felt that a proprietary trading ban would not adequately deal with the core issues facing the UK economy, but the ICB had also been mandated to navigate the competitiveness costs of its reform proposals. At the beginning of the ICB process, there was some concern among members about whether "you can leave these players [Goldman Sachs, Morgan Stanley, etc.] alone", but the ICB reached an early conclusion that "we didn't want all of these kind of 'foreign' banks to leave, so that was why we took such a precautionary approach with the UK retail banking system".[38] Paraphrasing Adair Turner's widely quoted words, Gregory Thwaites – an ICB secretariat member – remarked that while ICB members recognised that some financial activities might be "globally socially useless", they also saw that "the rents that these banks are appropriating are getting taxed by the UK Exchequer and spread around the UK … [so] they might still be positive sum for the UK". It was said by one ICB member that the UK's position was "a bit like having a pirate's nest in your jurisdiction" and that the UK-specific rent

[34] Interview UK#5, Martin Wolf, 12 November 2021.
[35] Interview UK#1, ICB official, 16 April 2021.
[36] Interview UK#6, John Vickers, 8 November 2021.
[37] Interview UK#5, Martin Wolf, 12 November 2021, emphasis in original audio.
[38] Interview UK#7, Gregory Thwaites, member of the ICB secretariat, 28 February 2021.

from global financial activity "should be considered by a policymaker [who's] optimising for UK welfare".[39]

This formulation of competitiveness effects was highly specific to the UK because the global trading activity perceived as creating risks for consumers was also a key source of added value to the UK economy. Put another way, the risk transmission mechanism from global into domestic markets was effectively the same as the value creation mechanism. In opting to focus specifically on safety buffers between retail and investment banking, the ICB aligned its recommendations to the thrust of political attention and support for banking reform. The decision to increase buffers in the retail banking sector also allowed the ICB to avoid imposing constraints on parts of the financial sector that delivered high value to the UK economy, such as wholesale and investment banking. As the anxieties quoted by Thwaites imply, global or "foreign" banks possessed stronger exit options (they were "highly mobile") compared to UK-headquartered banks with large domestic retail operations, which were in contrast "geographically bounded" and could be targeted more easily (Independent Commission on Banking 2011b, 103–4). The approach taken by the ICB is shown to be a product of the two crucial state-banking sector dependencies of the UK political economy: its highly internationalised financial sector and the strong exit options among firms which create notable value.

Once the decision had been made to focus on banking reform that would only affect banks with large operations in UK retail banking markets, the key deliberation for the ICB became whether full structural splits were necessary, or if less interventionist approaches could achieve the financial stability benefits at lower cost. While full structural splits remained officially on the cards throughout the process, and had been the stated preference of the Liberal Democrats, the ICB had already sketched out and settled on a ringfencing-style solution by the time of its Interim Report, published in April 2011.[40] The stated concern among ICB members was that full splits would remove possible diversification benefits in a universal banking group. For example, if UK retail banking was under threat, then funding could not be sourced from other divisions within a banking group (Independent Commission on Banking 2011b, 89). Indeed, even the structural divide ultimately created through ringfencing has, since the ICB, been a topic of considerable scrutiny among the regulatory community. In interview, one Bank of England official referred to large UK ring-fenced banks as a "one-way bet on the UK property market" because these firms have become insufficiently diversified.[41] On the other hand, one recent study finds that financial markets perceive ringfenced banks to be safer; and that banks that are ringfenced reduce risk-taking (Erten, Neamțu, and Thanassoulis 2022).

Once the ICB had floated ringfencing rather than full splits in its Interim Report, the proposal quickly achieved widespread consensus among all relevant actors, including politicians and industry executives. Lord Stephen Green, for example, had left as Chair of HSBC – the universal bank set to lose most from structural reform – to enter the Coalition Government, and sat on the Cabinet Committee for Banking Reform. Rather than Green's link to industry leading him to oppose reform, John Vickers identified in interview that he appeared

[39] Interview UK#7, Gregory Thwaites, member of the ICB secretariat, 28 February 2021.
[40] Interview UK#6, John Vickers, 8 November 2021.
[41] Interview UK#8, former senior Bank of England official, 31 March 2021.

comfortable with the proposals and himself began "kicking the tyres" of the ringfencing plan in government from early 2011.[42] In fact, from the time of the early Future of Banking Commission led by civil society leaders, former executives had been expressing their support for the public policy benefits of structural separation. This situation differs markedly from other countries, such as France, where it has been argued that policy and industry elites cooperated in tight social networks, leading to the stabilisation of banks' instrumental power (Massoc 2020). In the UK, in contrast, the well-resourced bank lobby was not able to erode the credibility of the ICB's proposals in government. The UK lacks France's cooperative elite institutions, which resulted in industry's instrumental power losing its potency on this policy issue. Policymakers' primary incentive was to respond to the democratic pressure they commonly experienced.

After the Interim Report, John Vickers perceived that "the Coalition [was] at one on this, and [while] I don't think Osborne and Cable started off that close … they both seemed very content with where we came out".[43] The ringfencing plan fitted with the "clearing-up-the-mess" narrative that the Conservative Party had promoted,[44] while also mitigating competitiveness concerns associated with full splits. While the Liberal Democrats, and especially Cable, were the most radical major party on banking reform, now in government they became more wary of delivering highly punitive reform, which they perceived would amount to "driving a car with your foot on the brake and the accelerator".[45] The economic picture was bleak for the parties in government, and the focus soon moved from electoral pledges to leading the country out of recession. Vickers and his colleagues also met with Labour figures, including the Shadow Chancellor as well as John McFall (who had by then been ennobled and entered the House of Lords) to garner opposition support.

Finally, for the two banks that would be most affected by structural reform – Barclays and HSBC – ringfencing came to be seen as a climbdown or compromise. As an ICB secretariat member put it, "if you're threatening full separation, and you offer ringfencing, then they'll grab at it".[46] Yet these global banks nonetheless remain scathing about ringfencing's costs and distortive effects. One senior HSBC official referred to ringfencing as "a bizarre and unnecessary contribution to post-crisis reform, and one that was not replicated by any other G20 member",[47] in particular because of the high costs it brought to large banks and their clients engaged in both commercial and wholesale services.

As Chancellor of the Exchequer and one of the two most senior figures in the Coalition, it was George Osborne whose embrace of ringfencing settled any doubts that the government was ready to proceed with structural reform. At the halfway point between the ICB's interim and final reports, Osborne delivered his annual Mansion House speech – with Vickers in attendance – at which he not only endorsed ringfencing, but also offered a distinctive rationale for the policy solution. He referred to the ICB's proposal – still in draft form – as a solution to the "British Dilemma", and further stated that:

[42] Interview UK#6, John Vickers, 8 November 2021.
[43] Interview UK#6, John Vickers, 8 November 2021.
[44] Interview UK#2, Conservative Government adviser, 24 September 2021.
[45] Interview UK#9, Liberal Democrat politician, 9 July 2021.
[46] Interview UK#10, ICB secretariat member, 5 February 2021.
[47] Interview UK#22, Senior HSBC official, 19 July 2021.

> As a global financial centre that generates hundreds of thousands of jobs, a successful banking and financial services industry is clearly in our national economic interests.
>
> But we cannot afford to let it pose a risk to the stability and prosperity of the nation's entire economy.
>
> We should strive for global success in financial services, but that success should not come at an unacceptably high price.
>
> We should be clear that we want Britain to be the home of some of the world's leading banks, but those banks cannot be underwritten by the British taxpayer.
>
> (Osborne 2011)

Osborne's endorsement was, according to those involved, uncoordinated with Vickers and his team; and the "British Dilemma" was not a term they ever employed. Nonetheless, this "dilemma" emerged as the dominant framing among UK policymakers for why the UK was undertaking bank structural reform through national law in a way that no other country would after 2008. The UK was, insofar as possible, to remain a dominant centre of global financial services. However, it was also seen as unviable that the state – or taxpayers – should remain exposed to the same risks that had built up in the years before the crisis. As Osborne stated, "the British Dilemma will remain as long as taxpayers are first on the hook if things do go wrong" (Osborne 2011). The bailouts, and the Great Recession that followed, had shown UK policymakers how crisis events in the financial industry could have contagious effects and weaken the fiscal strength of the state. This in turn brought strong voter demands for financial reform. Equally, the financial sector's size and role relative to the national economy also meant that it remained the key enabler for the UK economy's route to recovery. It was therefore seen as highly costly to impose reforms that would lead to a smaller financial sector yielding lower revenues.

Ringfencing was the reform outcome that emerged from the core trade-off facing British policymakers: to respond to democratic pressures to reform TBTF banking while not depleting the value created by the international financial sector on which the government was highly dependent. For those closest to the evidence, such as ICB members and government ministers, ringfencing was the outcome that best navigated this trade-off. After a cross-partisan group of politicians convened the Parliamentary Commission on Banking Standards (PCBS), they came to essentially the same conclusion as the ICB. One Conservative adviser recalls that "the primacy of Vickers … was sort of untouchable" and that, when more radical interventions such as full structural splits were being considered by the PCBS, Osborne's team "leaned very heavily on [the PCBS Chair Andrew Tyrie] to say that that's not your purview."[48]

To Greg Clark, who as Financial Secretary to the Treasury steered the ringfencing legislation through Parliament, it was clear that "there wasn't really any interest in amending [legislation] in light of what the PCBS had to say." In interview, Clark stated that if the PCBS

[48] Interview UK#2, Conservative Government adviser, 24 September 2021.

had recommended full splits "it's still not certain that the government would have enacted this" because it "didn't have much appetite … for Glass-Steagall-type separation."[49] By 2012, government priorities had already shifted from banking reform to the Eurozone crisis and the prospect of a double-dip recession, meaning that "the idea that you would be taking steps to dismantle or handicap a reliable source of jobs and tax revenue when both were thought to be in jeopardy, people were very nervous about".[50] The PCBS recommendations – an "electrification" of the ringfence and a rejection of a Volcker-style ban on proprietary trading – essentially reiterated the core findings of the ICB (Parliamentary Commission on Banking Standards 2013a, 2013b).

Some scholars have argued that "the primacy of Vickers" is evidence of how a venue-shift to a non-majoritarian institution can limit the influence of lobbying, because politicians who might otherwise be susceptible to special interests are no longer key decision-makers (Howarth and James 2023; see Table 2.3). In fact, there was essentially political unanimity among Conservative and Liberal Democrat ministers for the chosen policy outcome. The ICB was mandated by and sent its recommendations to government, who swiftly executed the plan with support of the cross-party PCBS. It is far more pertinent to see the role of the ICB as providing technical expertise, rather than reducing the influence of politicians prone to industry capture. Moreover, the alternative explanation presented by Ganderson (2020a), that UK structural reform was the product of adversarial politics among opposition parties, also appears problematic given the evidence presented. It is the remarkable political consensus that the ringfencing agenda achieved which stands out in this crucial case of British reform. The lack of cooperative institutions in the political economy changed how politicians engaged with industry, not with each other. This drive to respond to democratic pressures was widely felt.

Regulators are another actor often referred to as possessing strong influence over financial policymaking (e.g. Carpenter 2010; Carpenter et al. n.d.). Writing on UK ringfencing specifically, James and Quaglia make the causal claim that "structural reform was driven primarily by regulators who were determined to address too-big-to-fail banks" (2020, 13). While evidence was presented that addressing the TBTF problem was indeed a cited rationale for much of the regulatory community, the argument that bureaucratic preferences have a causal role is difficult to square. While a few senior officials, including Governor Mervyn King, had been vocal advocates of structural reform early on, British central bankers as a whole were far more equivocal about the ICB plan. After King had left the Bank of England, one official referred to "full-scale culture wars" among its senior officials in the following years. They remained split on whether ringfencing would be an effective reform, especially given advances to the resolution regime achieved mostly through multilateral fora, in which the Bank of England has been among the most influential progenitors.[51] There was disagreement among regulators responsible for reform implementation about the interoperability of these two regimes, and whether enacting both might even have deleterious financial stability

[49] Interview UK#11, Greg Clark, 21 April 2021.
[50] Interview UK#11, Greg Clark, 21 April 2021.
[51] Interview UK#12, former senior Bank of England official, 9 April 2021.

effects.[52-53] Yet bureaucrats had very limited scope to adjust the regime from the ICB's detailed proposals, despite the reservations of some. This stands in contrast to the significant changes that the Bank of England were able to institute to the capital standards regime also proposed by the ICB and about which some senior regulators were similarly ambivalent (discussed in Section 3.6.2). Unlike these capital reforms, ringfencing became a sacrosanct policy whose passage was driven by the democratic, not bureaucratic politics. The required political settlement was achieved as soon as the key senior political figures publicly threw their support behind ringfencing in 2011.

Overall, the key political leaders acted in this way not just because there was a market failure that needed resolving (cf. Kapstein 1989), but because a response to strong and persistent democratic pressure was required. Specifically, there existed a clear public demand to reduce the UK economy's exposures to global financial market risk, which was seen as a major cause of the country's economic woes. The government threw its weight behind a policy which would reduce voters' financial exposures via closing the TBTF subsidy large firms enjoyed, but which would neither lead to major financial sector disinvestment, nor jeopardise the value created by the UK's internationalised financial sector. For this reason, the structural splits advocated by the Liberal Democrats, and the narrow banking reforms promoted by John Kay, were rejected. During the PCBS, politicians were again given the opportunity to craft alternative or additional reforms, including full splits to banks, but they opted not to do so. This decision came despite the second surge in the salience of banking reform that occurred after the Libor scandal in 2012. Instead, the reform that had been carefully designed to reduce costs to the UK's global financial sector was opted for. Among the array of options for structural reform available, politicians delivered a constrained response to the strong democratic pressures vying for reform.

Recent developments in British politics and policymaking since the implementation of ringfencing have however raised questions over the future of the regime. These developments invoke what one legal scholar calls a "regulatory sine curve", whereby falling salience allows industry to reassert its authority and lobby for rollback (Coffee 2012). A review of ringfencing was mandated in the relevant legislation (the Financial Services [Banking Reform] Act 2013) for three years after its full implementation to assess its impacts. This became known as the Independent Panel on Ring-Fencing and Proprietary Trading, and was chaired by former chief executive of the asset management firm Abrdn (formerly Standard Life Aberdeen), Keith Skeoch. The "Skeoch Review", published in March 2022, recommended that the ringfencing regime remain in place, but that smaller non-systemic players should not be subject to the same ringfencing constraints as large systemic competitors. This adjustment is intended to reduce the burden of regulation, and thus to help smaller banks compete in the concentrated UK retail banking market.

However, Skeoch and his colleagues did not agree with the long-term critique from the UK's two remaining systemic universal banks, HSBC and Barclays, that ringfencing has put them at a competitive disadvantage to foreign competitors in wholesale and investment banking.

[52] Interview UK#8, former senior Bank of England official, 31 March 2021.

[53] Global regulators have sometimes been critical about national ringfencing policies, given how they segregate capital by geography, potentially restricting the flow of funds to where they are most needed. See for example reporting by the FSB (2019).

Indeed, in interview, one HSBC official went so far as to state that ringfencing has "materially undermined" UK wholesale banking.[54] The authors did however concede that ringfencing "may over time have an adverse effect on the growth and competitiveness of [non-ringfenced banks]" (Ring-fencing and Proprietary Trading Independent Review 2022, 12). This conclusion accords with the holistic analysis of the Skeoch Review, which is that the benefits of ringfencing are likely to erode over time as the internationally mandated and coordinated bank resolution regime is fully implemented and tested. The core conclusion of Skeoch is that "the resolution regime provides the most comprehensive means of managing bank failures in an orderly way without seeking taxpayer support", that it is "overtaking the ring-fencing regime", and should as such "be prioritised" over ringfencing in future policy decisions (Ring-fencing and Proprietary Trading Independent Review 2022, 112). This argument in favour of the resolution regime achieved through multilateral reform over unilateral ringfencing measures was one that had been aired by some in the Bank of England from the earliest days of implementation.[55]

The Skeoch Review was published at a time of significant policy and political flux, in which three successive Conservative governments sought ways to bolster financial sector growth in the context of national economic challenges since the Covid-19 pandemic. Chancellor Jeremy Hunt's decision to follow the recommendations of the Skeoch Review has been reported in the financial press as part of the wider process of City "deregulation" – referred to as "Big Bang 2.0" or the "Edinburgh Reforms". In the aftermath of Hunt's announcements, John Vickers publicly expressed concern about the scope of the ringfencing review being considered by the government, arguing that it should remain "the bedrock" of UK regulation and that "roll back" would be "an extremely dangerous and wrong path for us to follow" (Makortoff 2022).

It is, at the time of writing, the case that the government has simply agreed to incorporate the recommendations of the Skeoch Review, which do not change the scope of the ringfencing rules for the UK's largest systemic banks. To date, the two large banks whose business model is most affected by ringfencing – Barclays and HSBC – have made scant public comment on their preferences. In interview, a senior banking executive stated that while ringfencing continued to frustrate the universal banking model, bank executives remained reluctant to air their preferences for fear of public backlash.[56] According to polls, there remains widespread support for post-crisis reforms such as the banker bonus cap, which the government has scrapped as part of its Edinburgh Reforms (YouGov 2022).[57]

The theory's core prediction is that policymakers will impose reforms against industry's interests when there is a strong democratic incentive to do so. The UK's structural reforms agreed to under these strong democratic pressures have had the highest costs for the largest banks headquartered in the UK, but effectively zero costs for other constituent firms in the City of London. This, the theory proposes, is the outcome of the constrained democratic responsiveness that occurs in a high salience environment in a political economy

[54] Interview UK#22, Senior HSBC official, 19 July 2021.
[55] Interview UK#12, former senior Bank of England official, 9 April 2021.
[56] Interview UK#13, senior banking executive, 19 May 2021.
[57] The bonus cap was introduced via EU legislation and has continued to apply in the UK since Brexit. In this survey, respondents were not told that the policy was introduced via EU law. See also Section 3.2.2.

asymmetrically dependent on global banking. Recent events however beg the question of the circumstances under which a regime created during a period of high issue salience might be rolled back (cf. Romano 2014). The salience of banking reform is certainly far weaker today than during the key reform period (c.2009-13). Nonetheless, the survey data presented in Section 3.5 suggests that there is high latent anti-bank public opinion in the UK, where people have consistently high preferences for financial regulation compared to in other similar countries (cf. Culpepper, Jung, and Lee 2023). The redistributive tenor of these attitudes to banking and finance was on show when Prime Minister Liz Truss' government announced its intention to scrap the bankers' bonus cap (discussed in 3.6.4.3).

A prediction derived from the theory is that UK public policy will favour the banking industry on low salience issues, because under these conditions a symbiosis exists between policymakers and industry. Until democratic pressures in favour of strong financial regulation fall away in the UK, it is unlikely that this proximate state-industry alliance will return. As such, the ringfencing of large systemic banks that were at the centre of the GFC is likely to continue so long as discussion of rolling back the regime produces ripples of public dissatisfaction. Without evidence that ringfencing has harmed the City of London as a whole, it is also difficult to see why politicians would be incentivised to rollback policies in a way that would almost certainly be unpopular with voters. To return to the extended metaphor used in the opening of the chapter, the contest of global banking can continue in the UK despite the "Wimbledonisation" of the City (cf. George 1999). In 2023, the financial turmoil at Credit Suisse that led to a bailout and forced buyout by UBS, as well as the collapse of several mid-tier US banks, has meant that issues of bank structure have been once again brought back into the public eye. Neither the politics nor the economics offer ripe conditions for a further rollback to structural reform in the UK.

3.6.2 Bank Capital Requirements

Table 3.15: Overview of Possible UK Bank Capital Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Capital reform of all banks	Far higher capital requirements than Basel III	*De minimus application of Basel III rules*
Capital reform of big UK banks	Far higher capital requirements than Basel III and FSB rules	*De minimus application of Basel III and FSB rules*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

The defining feature of UK policy decisions on bank capital standards has been its alignment and conformity to rules decided in multilateral fora, especially the BCBS (James and Quaglia 2020, 52–70). In December 2010, the BCBS issued the rules text on capital and liquidity known as Basel III. On capital, the rules dictate that banks should hold loss-absorbing capital – Common Equity Tier 1 (CET1) – at a minimum of 4.5% of risk-weighted assets (RWAs). This was supplemented by a CET1 capital conservation buffer set at 2.5% of RWAs, as well as additional preference shares and contingent capital requirements (which could be written down or converted into equity) amounting to 3.5% of RWAs. In this analysis, and in line with the overall focus of the ICB which investigated these issues, only the CET1 element of the capital rules are considered. These amounted to 7% of RWAs. The Basel III rules were decided while the ICB was deliberating, although the original implementation period (which was subsequently delayed) was set at 8 years. The ICB considered the CET1 requirements, as well as additional proposals for G-SIBs advanced by the FSB, as "important steps" but "by some margin too low" (Independent Commission on Banking 2011a, 9, 28). In particular, the authors identified that the 7% rate had been generated using conservative estimates of the costs of crises, which could otherwise be plausibly prevented through higher capital ratios (Independent Commission on Banking 2011b, 69).

The ICB's stated dissatisfaction with the capital requirements of the Basel regime was the product of sustained internal debate among its members from the outset. For example, in an unpublished position paper prepared in the months after the ICB began its reporting, Martin Wolf recommended much greater emphasis on higher capital requirements, well beyond Basel III rates. In this early phase of ICB deliberation, Wolf proposed that banks should be given the option of either some version of structural reform (e.g., what would become the ICB's ringfencing proposal), or dramatically higher CET1 requirements, in the order of a 20% ratio. In interview, Wolf argued that "our banks would have hated [higher capital requirements] much more than ringfencing", because it would have significantly reduced return on equity and performance-based pay.[58]

Wolf's recommendation, informed by the work of Stanford financial economist Anat Admati, did not find consensus among ICB members, and was soon discounted. Their rationale related to the anticipated costs to banks and the economy if capital requirements were too high. They noted that "the incremental stability benefits of higher capital requirements diminish as they increase, whereas estimated growth effects do not", that it might have the detrimental effect of some financial activities migrating to non-banks (such as shadow banks), and finally that "geographic arbitrage possibilities do constrain UK policy beyond some point" (Independent Commission on Banking 2011a, 29). As is identified below, the subsequent rollback of ICB recommendations makes it highly likely that there would have been political resistance to higher Basel "super-equivalency", given the competitiveness effects it would have on the UK banking sector.

As such, while the ICB recognised the "powerful case" for dramatic increases in (global) capital requirements, they were precluded from recommending this on a unilateral (UK only) basis due to the associated competitiveness costs (Independent Commission on Banking 2011a, 28). Reflecting on these constraints, John Vickers described the dilemma facing the ICB as:

[58] Interview UK#5, Martin Wolf, 12 November 2021.

"it's one thing to say what should the world do? It's another to say what should the UK do given Basel III … later I was much more explicit that *but for* Basel III, we … would have gone way higher on capital than we did".[59] If the UK were to create a more stringent capital regime, these requirements would (unless various exclusions were granted) apply to all firms that were UK-regulated. In a highly open economy such as the UK, it was thought by ICB members that going significantly above the international baseline would create high regulatory arbitrage potential that would "backfire" policy attempts to increase financial stability.[60] Differentiating capital standards applied to UK-headquartered banks and not to foreign subsidiaries was also problematic because "the wholesale/investment banking markets in which UK banks compete are international", and so a capital standard targeting only UK banks would have rendered a lot of the wholesale and investment banking activity of these firms commercially unviable (Independent Commission on Banking 2011a, 88). According to Martin Wolf, "the politics … would have been hopeless" and would have led to "the chancellor, and the government, and probably the MPs, and certainly the financial industry" collectively protest that "you're crippling the British financial industry, it's just impossible to do this".[61]

Even though the ICB believed Basel III capital requirements were insufficient to deliver on UK financial stability, the final option of reforming capital requirements across the UK banking sector was likewise unviable due to competitiveness costs for international or "foreign" firms conducting business in London. Capital regulation affecting whole banking groups (rather than a subdivision, such as ringfenced entities) would be applied not just to UK-headquartered firms, but also to the many subsidiaries of foreign firms doing business in London. Most large US firms, for example, operate as subsidiaries in the UK, and these entities are regulated according to the same standards as a UK-headquartered bank.[62] On this issue, the ICB noted that "international wholesale financial activity is dominated by highly mobile firms", which would exit if the costs of regulation became too high. They also identified that "opportunities for regulatory arbitrage would reduce the stabilising effect of higher capital requirements" (Independent Commission on Banking 2011b, 104, 70).

Citing these concerns, in interview Martin Wolf described how a consensus emerged early on that neither structural reform nor capital requirements alone would be optimal:

> …since there was a limit on how much capital we could impose, because we had to look at competitiveness so we couldn't have vastly higher capital requirements than other countries … that more or less forced us, in the end, into some form of separation of balance sheets.[63]

Ringfencing was as such a policy innovation that emerged partly as a result of the highly open and internationalised structure of the UK banking sector. As was demonstrated in Section

[59] Interview UK#6, John Vickers, 8 November 2021. Emphasis my own.
[60] Interview UK#6, John Vickers, 8 November 2021.
[61] Interview UK#5, Martin Wolf, 12 November 2021.
[62] The UK has developed a supervisory framework for the regulation of international banks (Bank of England 2021). In simple terms, a bank can opt to "branch-in" to a jurisdiction or to create a subsidiary, and in the second but not the first case the local entity is subject to enhanced supervision by the host authority. In principle, larger entities generally become subsidiaries, although in practice the distinction is rather less clear-cut, and there are several cases of large international banks that have long retained a branch structure in the UK (e.g. Deutsche Bank). The branch/subsidiary issue became a charged debate during Brexit negotiations (Davies 2017).
[63] Interview UK#5, Martin Wolf, 12 November 2021.

3.6.1, the UK applied structural reform to the parts of the UK banking sector least capable of relocating activities to other jurisdictions. This intervention created an internal divide within the UK's biggest universal banks, which in turn provided the means for policymakers to apply higher capital standards to the most systemically important functions of the UK banking system. That also posed a far lower arbitrage threat than if applied across the banking sector. With a ring-fence in place around the more "geographically bounded" component of the banking sector (Independent Commission on Banking 2011b, 104), it became possible to increase capital requirements with much lower risk of arbitrage. In its Final Report, the ICB explained: "By averting the need for much higher capital standards across-the-board, the ring-fence helps keep down the costs to the international wholesale and investment banking business of UK banks, relative to alternative regulatory approaches" (Independent Commission on Banking 2011a, 309). This outcome resulted in large UK-headquartered banks – rather than the array of other firms active in the City of London – experiencing the costs of both structural and capital reform.

The capital regime applied to UK ringfenced banks, which became known as the O-SII Buffer,[64] was however implemented in a way that created lower standards than had been envisaged by the ICB, which was already seen by its members as a compromise. The size and systemic role of UK banks meant that their regulation also fell under the newly vested authority of the FSB. As the ICB deliberated, the FSB was consulting on additional capital standards for Global Systemically Important Financial Institutions (G-SIFIs). Since the UK was home to several such firms, the ICB had to consider the interaction between the additional measures it proposed for ringfenced banks, and those the FSB was developing for G-SIFIs. In its Interim and Final Reports, a substantial Annex (3) provided a review of external studies on the impacts of higher capital requirements. Drawing on these studies, the ICB concluded that all systemically important banks should have a "minimum credible ratio" of Tier 1 Common Equity to Risk-Weighted Assets (on a Basel III basis) of 10%, i.e. 3% higher than the Basel III rate of 7%. The authors argued that "It seems very doubtful that any figure below this can be robustly supported by the available evidence". Given this, the ICB concluded that "regardless of what international consensus is reached on the SIFI surcharge, large retail banking operations in the UK should have an equity ratio of at least 10%" (Independent Commission on Banking 2011b, 71). However, even though ICB members saw it as vital that entire banking groups be subject to these higher rates, it did not make recommendations on the non-ringfenced part of G-SIBs, citing arbitrage concerns and ongoing FSB negotiations.

By the publication of the Final Report, the FSB had agreed to a sliding scale of G-SIB surcharges of between 1-2.5% of CET1 to RWAs – considerably lower than the minimum rate deemed "credible" by the ICB for systemically important banks (Independent Commission on Banking 2011b, 71). However, given the scope for regulatory arbitrage in the UK, the capital rate deemed bare minimum by the ICB would only be applied to ringfenced balance sheets

[64] The Other Systemically Important Institutions (O-SII) Buffer was first referred to as the Ring-Fence Buffer in the Independent Commission on Banking's reporting. This was implemented by the Bank of England as the Systemic Risk Buffer. Since December 2020, the UK changed the legal basis of the Systemic Risk Buffer due to the introduction of the Capital Requirements Directive V (CRD V) by the European Union and specifics of the UK's exit agreement. Since this time, the new (but essentially unchanged) regime has been called the O-SII Buffer. For simplicity and in line with current naming convention, the policy is referred to throughout as the O-SII Buffer.

(Independent Commission on Banking 2011a, 95). The rest of the UK banking sector – both banks headquartered in the UK and elsewhere – faced no additional requirements beyond what was required by international (and EU) standards.

When implementing the regime, the Bank of England soon found itself making difficult trade-offs given the overlapping new requirements agreed by the BCBS, FSB, ICB and UK government. It came under considerable political pressure to reduce the stringency of the unilateral rules. After the crisis, the Bank had become a notably tough regulator on capital and liquidity under Governor Mervyn King. In the months before standing down, he had crystallised his philosophy, identifying how "The better capitalised banks are the ones expanding lending, and … the weaker capitalised banks that are contracting lending" (Masters 2013). The short-term effects of pursuing higher capital standards created tensions with the UK Treasury. This came to a head when the country began facing significant headwinds from the Eurozone crisis from August 2011 onwards. In interview, a special adviser in the Treasury spoke of "enormous frustration" with the Bank of England, which they argued remained "obsessed with tough liquidity and capital regulation in the face of what should have been a much more permissive regime". Bank-Treasury tensions led to Treasury officials perceiving the Bank of England as the "capital Taliban", in which "jihadist" factions continued to push for higher standards despite the economic gloom.[65]

Under the leadership of Mark Carney from mid-2013, the PRA made substantial amendments to the regime proposed by the ICB, notably by reducing the size of buffer faced by large UK banks. This decision led to enormous friction between Bank of England executives and John Vickers, who had previously been the Bank's Chief Economist and worked with some of the officials responsible for these changes. In 2016, in the consultation stage for the implementation of the O-SII Buffer, Vickers wrote an academic article critiquing the Bank's proposed adjustments (Vickers 2016c). In the ICB version of the buffer, banks with a RWAs-to-UK GDP ratio of over 3% would have been subject to a 3% buffer. In practice, this would mean that every major UK bank would be subject to the full ringfence buffer, while smaller banks (e.g. the Co-operative Bank) would be subject to a lower buffer (Independent Commission on Banking 2011a, 93). The thresholds used in the Bank's O-SII Buffer were substantially lower, with the threshold for the lowest possible rate *higher* than the top rate proposed by the ICB. In practice, no bank has ever been subject to the full 3% rate, and the buffer is not applied at all unless a firm's assets (not risk-weighted) are over 40% UK GDP. Since implementation, the largest UK ringfenced bank, HSBC, has been subject to the highest rate, at 2.5%. The Bank of England stated that lower buffer rates were appropriate because of the increased loss-absorbing capacity of banks, with new bail-in debt and implementation of the Basel III countercyclical capital buffer. The ultimate effect is that the FSB-set G-SIFI buffer has, for many banks, been *higher* than the Bank of England version of the O-SII buffer. The UK-specific policy recommended by the ICB as a backstop to protect UK markets from financial instability ultimately ended up being *less* stringent than the FSB policy rejected by the ICB as inadequate.

Vickers lobbied policymakers to implement the ICB proposals in full. He took to the financial press to argue that regulators should "think again" and were going soft on the banks (Vickers

[65] Interview UK#2, former Treasury adviser, 24 September 2021. See also Parker, Masters, and Goff (2014).

2016b). The Bank released a statement and responded in the *Financial Times* to rebuff Vickers' criticism (Bailey and Cunliffe 2016), stating that the PRA "continues to support the conclusions of the ICB but is proposing a higher level of capital and overall resilience in the banking system than was proposed by the ICB in their final report" (Arnold 2016). Vickers gave public talks, and wrote to lawmakers, to express his disagreement with the Bank's approach (Haritonova 2016; Scheuber 2016), arguing that its policies implementing FSB standards "are adding usefully to the supply of fire extinguishers … but that is no good reason to economise on fire prevention". For Vickers, the only way to ensure UK financial stability was through the higher equity buffers that the ICB had recommended "in the public interest" (Vickers 2016a). Two years later, Vickers would still be critiquing the Bank's approach and warning of "dangerously high" levels of bank leverage in the UK banking system (Arnold 2018b).

When asked why the Bank of England, under the then newly installed Governor Carney, had adjusted the policy recommended by the ICB, former ICB members alluded to Carney's role as chair of the FSB as a potential factor. John Vickers speculated that "he had invested a lot personally in [the FSB G-SIB buffer] and got fairly chunky amounts of capital agreed … he thought that was a great achievement, so you don't need so much equity."[66] Wolf similarly stated that as "head of the FSB … he probably felt ... well, why should [the UK] be different?"[67] While British regulatory authorities were among the most powerful actors pushing for strong reforms in multilateral fora, they enjoyed far less scope to do so when it came to national policymaking.

The push against super-stringent capital standards in the UK originated ultimately from politicians, and notably Chancellor of the Exchequer George Osborne. In March 2012, Osborne had signalled his priorities by deciding not to reappoint the two most outspoken advocates of bank reform to the new permanent Financial Policy Committee (FPC) (Parker and Masters 2013). Osborne would write in his first mandated recommendations to the new FPC members that while:

> …there may be short-term tradeoffs between the Committee's secondary objective of contributing to sustaining economic growth and its primary objective of addressing sources of systemic risk … [it] is particularly important, at this stage of the cycle … [to give] due weight to … the impact of its actions on the near-term economic recovery.
>
> (Osborne 2013)

Throughout this period, Osborne would repeatedly reiterate his opposition to an overly stringent approach on bank capital by UK regulators, famously stating that it was not their job to create "the stability of the graveyard" (Osborne 2012). It was a turn of phrase soon picked up by regulators vying to be Mervyn King's replacement (London Evening Standard 2012b). Despite compromises between the Bank and the Treasury – including a £80bn "Funding for Lending" scheme to provide banks with cheap funds – the Liberal Democrat Business Secretary Vince Cable continued to publicly speak out against the "capital Taliban" at the

[66] Interview with ICB member, 8 November 2021.
[67] Interview with Martin Wolf, 12 November 2021. Vickers also took direct aim at Carney, who was Chair of the FSB, in his academic article and letters to the *Financial Times*.

Bank, accusing it of holding back economic recovery through its capital regime (Parker, Masters, and Goff 2014).

Throughout the post crisis period, both before and after the Final Report of the ICB was published, the Coalition Government put significant pressure on the Bank of England and FSA/FCA to take a less stringent approach to higher capital requirements. The arrival of Mark Carney as Governor led to a less conflictual working relationship between the Government and the Bank of England. A leading advocate for the international regime created by the FSB, under Carney the Bank amended policies based on ICB recommendations so they would align more closely to those international standards. This mitigated perceived competitiveness costs for large British banks, which might otherwise have further consolidated their balance sheets and/or moved their activities abroad. The financial stability concerns of those advocating for capital standards higher than Basel and FSB requirements – including Vickers and his ICB colleagues – went mostly unheeded. The difference between the unflinching political support for structural reform on the one hand, and active opposition to capital reform on the other, is stark. Since both policies were advocated by the ICB as crucial reforms, it cannot be that the venue-shift to an expert body carried much causal weight in the policymaking process (Howarth and James 2023). Similarly, since central bankers' support for both reforms was mixed, the stance of bureaucrats also struggles to explain the varying fortunes of these two policies. The within-case variation instead points to the level of political support for reform being the strongest predictor of outcomes. For politicians, the financial stability gains from higher capital standards and the competitiveness gains from remaining an attractive centre for global banking stood in conflict. UK dependencies on housing an international financial sector were revealed when it came to raising capital levels across the banking sector.

The highly technical regulatory issue of capital standards was primarily directed through multilateral institutions. It also did not become a highly salient issue to the policy debate in the UK: unlike structural reform, no evidence was presented that this was a topic civil society engaged on or that parliamentarians debated at length. Even if bank capital reform could also mitigate the TBTF problem, structural reform became the far more salient mechanism for doing so. Without that force of salience, the strong democratic pressures faced for politicians to pursue ringfencing were not felt on capital reform. Despite the evidence base and arguments made by some financial economists (e.g. Admati and Hellwig 2014) that dramatically higher capital would reduce public costs and increase financial stability, the resulting policy response was comparatively weak. Contrary to claims that it was the venue-shift to the ICB that allowed for strong reform (Howarth and James 2023), on the capital issue Vickers and his colleagues carried far less influence. Accounts of bureaucratic autonomy are also brought into doubt, given the strong evidence presented that the push for weaker capital reforms originated from politicians.

Rather, this reform issue reveals how early ambitions among reformers for capital stronger than Basel III standards were dashed because there were not strong democratic pressures in national political institutions pushing for such reform. For many policymakers, the perceived competitiveness costs were too high, and the democratic incentives too weak. Banks would have preferred that no O-SII buffer was ever implemented, but nonetheless the rollback of capital reform represents state-bank symbiosis.

3.6.3 UK Reform of Markets in Financial Instruments

Table 3.16: Overview of Possible UK Reforms to Markets in Financial Instruments

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Central clearing of derivatives	*Broader central clearing mandate*	More flexible central clearing mandate
Central Clearing Party Governance	Not-for-profit CCP governance and other enhanced supervisory requirements	*Profit-oriented CCP governance*
Direct product regulation of derivatives	Enhanced direct product regulation	*Very limited direct product regulation*
Off-exchange trading regulations	Significant restrictions to off-exchange trading	*Very limited restrictions to off-exchange trading*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

This section analyses the UK policy response to the regulation of markets in financial instruments (MFIs), such as derivatives products. It also considers the regulation of Alternative Trading Systems, on which these products are often traded. It shows that the UK was, in collaboration with the United States, a progenitor of the global reform architecture. However, once the key policy – the central clearing of derivatives – had been sketched out by American and British regulators, other UK negotiating priorities for the reform of these markets were unsuccessful. Large US banks have been able to thrive under this new regime relative to their British and European competitors. These reforms were achieved in multilateral fora, and, relative to other issues, did not become a highly salient issue for the British public. As set out in Table 3.3, the theory predicts that this scenario will produce symbiosis between UK policymakers and industry. Such an outcome is a product of the UK's asymmetric dependency on the financial sector, and specifically, the state's continued ability to extract value from global financial activity occurring in London. Without a strong democratic incentive to pass reforms to the trade of financial instruments, reforms have created a market environment conducive to large cross-border, and especially American, banks. Most financial stability concerns that observers have raised in relation to the new regime have not been addressed. Since Brexit, UK policymakers have strived to sustain London's attractiveness as a venue for these international markets.

At the G20 summit in Washington in November 2008, two months after the collapse of Lehman Brothers and the bailout of AIG, world leaders identified "increasingly complex and

opaque financial products, and consequent excessive leverage" as root causes of the GFC. A number of "immediate actions" were agreed for implementation by March 2009, including "required disclosure of complex financial instruments by firms to market participants" and "efforts to reduce systemic risks of CDS and over-the-counter (OTC) derivatives transactions" (G20 Leaders 2008). Less than a year later, at the Pittsburgh summit, G20 leaders pledged more concrete goals, committing that "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms … and cleared through central counterparties" by the end of 2012. Their statement further pledged that "All non-standardized contracts that were not centrally cleared were to be subject to higher capital requirements", with the FSB responsible for assessing implementation (G20 Leaders 2009).[68]

Before and after the crisis, the UK and the US were, by a big margin, the largest markets for derivatives trading (see Table 3.5). They had also been exposed to significant risk due to turbulence in these markets during the GFC. When Lehman Brothers failed in 2008, its derivatives portfolio stood at $35tn, with its UK subsidiary alone having a £9tn cleared interest rate derivatives portfolio at LCH (London Clearing House), comprising over 65,000 trades (Cunliffe 2018). The US and UK's central banks and regulatory authorities took a decisive role in the international reform process, including through taking an active role at the G20. In the UK, an early analysis was made in March 2009 by the incoming chair of the FSA, Adair Turner, who argued that a primary driver of the crisis was the "complexity and opacity of the structured credit and derivatives system" (Turner 2009, 28). Reflecting on possible reform options, Turner saw that "direct product regulation" of Credit Default Swaps (CDSs) – an approach orthogonal to pre-crisis orthodoxy – might be difficult, but argued that regulators "should be willing to consider over time whether particular markets have characteristics sufficiently harmful, and benefits sufficiently slight, as to justify intervention"(Turner 2009, 110). Turner's scoping review did not offer decisive policy recommendations, but it recognised failures in these markets as a key driver of the GFC. Turner's analysis of derivatives reform reflected his more famous critique that much financial activity is "socially useless".

It was the Bank of England, as the new prudential regulator, that soon took up the mantle of derivatives reform, where it gave particular focus to actioning the central clearing mandate advanced by the G20. Being one of the two global centres for derivatives trading, London was also home to three major clearing houses, two of which – LCH and ICE Clear Europe (Intercontinental Exchange) – actively participated in the OTC derivatives that were the main target of reform. Many of the largest counterparties to derivatives transactions (mostly banks and other financial institutions) as well as the clearing houses collocated in the City of London. Given its centrality to global derivatives trading, the UK would occupy a key role in the regulation and supervision of markets subject in line with the updated post-crisis regime. Despite the collocation of firms and activities in a few major global financial centres, derivatives markets lend themselves to global rather than national regulation and supervision (Helleiner, Pagliari, and Spagna 2018). Indeed, derivatives trading occurring in the UK related to underlying transactions which were far more global in nature. By 2014, after the shift to central clearing was well underway, over 60% of the initial margin required to support transactions cleared by UK-based Central Clearing Counterparties (CCPs) was provided by

[68] Further analysis of this expanding mandate is given in Chapter 5.

non-UK participants, of which over 39% originated from members outside the European Economic Area (Rahman 2015, 283, 290).

From the outset, Bank of England officials recognised that the architecture of post-crisis derivatives reform would concentrate risk within CCPs, especially very large ones hosted in London, and that financial stress on or failure of one of these institutions – or its members – could have a potentially devastating economic impact. As the Bank of England turned to coordination with FSB colleagues and implementation of the G20 mandate, officials soon identified problems with the established practices and corporate structure of CCPs. Within months, the Bank of England began addressing a wide range of CCP risk management issues in its Financial Stability Reports, arguing that the benefits of central clearing could be realised only through more holistic reform of the governance and regulatory regime. Bank of England officials expressed a preference for "user-ownership and not-for-profit governance structures" for CCPs to reduce profit-making incentives, which it was believed could increase competitive pressures among clearers and lead to financial instability (Bank of England 2010b, 2010a, 10).

Paul Tucker, Deputy Governor for Financial Stability at the Bank of England, became an intellectual cheerleader for improving CCP governance to reduce systemic risk in derivatives markets. In 2011, he gave what would become an often cited speech, in which he referred to CCPs as "system risk managers". Tucker explained that:

> Given that CCPs centralise and concentrate risk, their job is not just to deliver ever greater operational and capital efficiency for their clearing members … It is about making it less likely that their clearing members will default on their obligations to the clearing house … They are de facto regulators and supervisors for the markets they clear.
>
> (Tucker 2011, 2)[69]

Tucker's approach became the default position of the Bank of England. LCH and other clearing houses came to be seen as "super systemic, supernode[s]" requiring substantial new regulatory oversight (Tucker 2011, 2).

With the clearing mandate, the UK achieved a key preference of its national regulators for the reform of derivatives markets. It was the product of Bank of England and Federal Reserve coordination at the international level. However, unlike the US, UK implementation of these proposals primarily played out at the EU. The Treaty of Lisbon had been signed in 2007 and entered into force in 2009. The EU was especially active in post-2008 financial services reform both because of the new powers and momentum the treaty gave to enhancing the EU single market, and given the risks that member states were exposed to over the GFC and Eurozone crisis period. The major regulation implementing the G20's central clearing mandate was the European Market Infrastructure Regulation (EMIR) (Regulation No 648/2012), adopted in 2012. Technical standards were drafted, adopted and refined by ESMA over the following

[69] Emphasis in original.

years. The main UK legislative adoption of EMIR occurred during 2013.[70] In interview, one former senior official from the Bank of England identified that the EU acted essentially reactively to US regulatory developments. As they put it, "the Commission … didn't want to move ahead of the Americans … [they] just didn't want to go on their own".[71]

As is identified in Chapter 5, the US had moved to legislate post-crisis reform earlier than other countries. Given the short timeframe, some costs and implications of the move to central clearing were not fully anticipated. They also came to have distributional effects on the banking industry, creating a regime overall more favourable to big US broker-dealers than to their European counterparts. As the major centre in Europe for derivatives trading, the UK had a key interest in how the reforms played out, even if the primary regulatory forum was at the EU level.

The governance of clearing houses emerged as an important strand of the Bank of England's work on financial market infrastructure (FMI). The Bank led a substantial research and policy agenda to enhance the new regime. While legally obliged to fulfil the *de minimus* standards of EMIR, UK policymakers observed gaps in the EU regime immediately after the crisis. For example, absent clear EU standards, the UK saw a need to create an interim regime for CCP recovery, which required these institutions to have in place rules for allocating losses among parties, especially its biggest members which tended to be banks and other financial institutions. In recognition of the considerable presence of global (non-UK-headquartered) FMI operating in the UK, the Bank of England also created regulatory "colleges", in which the national regulator (the PRA) freely shared information with relevant international and other national authorities to enhance supervision. These mechanisms overall worked to reassert the centrality of the UK to global derivatives markets.

While UK regulators were active in promoting their interests in multilateral institutions, their priorities for the reform of derivatives trading were only partially successful. By 2012, initial stated preferences for not-for-profit CCP governance structures had been swept aside due to lack of buy-in among other major jurisdictions. There continued to be high variation in the terms of trade between counterparties to derivatives transactions in different countries, making coordinated action to radically overhaul governance of FMI (e.g. CCPs) a non-starter. Instead, UK policymakers focused on enhancing the resilience and resolvability of CCPs – as the new "super-nodes" of the financial system – to mitigate financial instability that might force future government interventions using taxpayer money. As regulator of the world's preeminent centre for derivatives trading, the Bank of England was acutely aware of the enhanced risks to the UK and global financial markets in the event of some major default by counterparties. Moreover, because FMIs were to be managed as profit-centres, the Bank also saw that a CCP could itself become a source of financial instability if it faced its own investment losses, especially since these investments were themselves tied up in the financial sector. Central clearing created more transparent financial networks, but it also created systemic risk in the financial sector to which the UK was highly exposed.

[70] The relevant legislation was the Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations (2013) that came into force in March, and its second iteration (No. 2) in July.
[71] Interview UK#14 former senior Bank of England official, 18 February 2022.

Both in office and after, as Chair of the Systemic Risk Council (SRC) – a non-profit group made up of experts and former senior public servants – Paul Tucker took up personal leadership on these issues, including using his final two speeches as Deputy Governor of the Bank of England to outline the pressing need to galvanise the reform process. As Chair of the SRC, Tucker regularly lobbied the FSB to address the significant regulatory gaps. In a 2020 interview with the *Financial Times*, he warned of "utter mayhem" in the event of clearing house stress given the incomplete nature of reform (Noonan and Stafford 2020). In late 2022, the FSB – the key intergovernmental progenitor of many global rules and standards – reached a similar conclusion, stating that "urgent work" was required to enhance the resolvability of FMIs (Financial Stability Board 2022; Noonan, Stafford, and Smith 2022). In its 2022 assessment of the UK financial sector, the IMF concluded that during the Covid-19 crisis, "Sharply rising global market volatility and increased precautionary demand in foreign jurisdictions were transmitted to the United Kingdom through its global trading hub" and that "An important channel was the flow-through of increased market volatility to derivatives portfolios" (International Monetary Fund 2022, 43). The US and the UK together drove the clearing mandate announced in 2008/9, but once this had been achieved, many of the UK's demands for bolstering the resilience of derivatives markets – which would mostly require large banks, financial institutions and CCPs to foot higher costs (Stafford 2014, 2017) – went unheeded. More recently, this has led to concerns over the moral hazard associated with central banks, and especially the Federal Reserve, Bank of England and ECB, acting as "market makers of last resort" (Baker 2012; Hauser 2021).

A second important consequence of the clearing mandate for the UK has been the new competitive environment that derivatives reforms precipitated among banks and broker-dealers. The clearing mandate, along with other G20 reforms in this area, brought significant new costs to banks and other market participants. The reforms have had a strong centripetal effect, not only because far more transactions are passed through CCPs, but also because firms operating under this regime can benefit from significant economies of scale. Despite British banks struggling to compete in these reformed markets, the UK's place in global derivatives trading has become even more crucial since the financial crisis (Kalaitzake 2022). This outcome reflects the UK's position in global financial markets observed in other parts of this chapter: London serves an important role as a host centre, but in many markets its own firms struggle to compete against foreign competitors. Reforms to derivatives markets championed by US and UK regulators in fact helped to achieve this outcome, even if these competitive effects were not always anticipated by national policymakers. Since 2009, American banks have attained supremacy in global derivatives trading, while the City of London has remained a crucial provider of the financial market infrastructure that enables global firms to transact. The UK has Wimbledon to offer, but its champions are from further afield.

The process by which this outcome has been achieved was explained in interviews with policymakers. A former Bank of England official put forward the case that the central clearing mandate was essentially the outcome of US first-mover advantage. That advantage produced a model of derivatives trading that allowed US banks to gain the competitive edge in the post-crisis regime. They stated that "the Europeans got in my view suckered into the intellectual logic of, we need to do something to reduce counterparty credit risk … they basically let the Americans do this". That led to "[the Europeans] belatedly [realising] the issue … [that] a

policy that works reasonably well for [the Americans], actually doesn't work very well for us [the Europeans], and will allow … Morgan Stanley and Goldman Sachs and JP Morgan and so on to eat Deutsche and Paribas' lunch". This former official explained that the sheer cost of setting up the infrastructure of the post-crisis derivatives regulatory regime has been a key factor in why British and European banks have struggled to compete in global derivatives markets. It was stated: "there isn't enough business to pay for the infrastructure costs in more than about five banks globally. And all five of those are American".[72] A UK regulatory official leading on FMI policy took a similar position, stating that "the way [the regime] favours those kind of economies of scale for market-makers and brokers is a by-product of the way the markets played out … [and] that angle was not … one that I think was necessarily anticipated right".[73]

The GFC saw the collapse of several key global derivatives markets, which created a confidence crisis in the financial markets, with devastating effect for the global banking system (Murphy 2022). Despite widely observed risks and distortive effects on market competition, the UK has overall been commercially advantaged by the core tenets of the new derivatives regime, notably centralisation and profit-oriented service provision. Central clearing was transformed into to a prized commercial activity run on a for-profit basis. Before the crisis, the UK's main global clearing house, LCH, was majority-owned by banks such as Barclays, JPMorgan and Société Générale, which were also the most significant users of its services. Central clearing was seen as an unlucrative utility service provided for market participants. Since the crisis, the London Stock Exchange Group took a majority stake in LCH, having previously been one of the few exchanges that did not own a large clearing house. This acquisition, and LCH's expansion into new market areas across jurisdictions, reflects the profit-driven orientation of derivatives clearing that the G20 reforms precipitated, and which London has benefited from as a financial centre. The largest, most active trading banks have also expanded their own revenue streams in execution and clearing of derivatives trading under the post-crisis regime, for example through joint ventures with CCPs. The most notable example of this has been through global banks' joint venture with LCH in SwapClear, which is governed by a consortium of mostly American investment banks on a profit-sharing basis. SwapClear today dominates the global interest rate swap market.[74]

Unlike the structural reform and executive pay issues, the reform of derivatives markets was not a salient issue to the UK political debate on banking reform. It played out mostly at the multilateral level. As the theory predicts, low democratic pressures led to a reform process exhibiting symbiosis between policymakers and industry. Creating regulation broadly favourable to established market players, the reforms resecured the UK's centrality to global derivatives trading, but did little to mitigate the financial risks observed by many experts.

[72] Interview #UK8, former senior Bank of England official, 31 March 2021.
[73] Interview #UK15, Bank of England official, 16 December 2021.
[74] The initial banks that joined the service (in alphabetical order) were Barclays, BNP Paribas, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan, Morgan Stanley, Nomura and UBS. The fund manager BlackRock was also a founding member of SwapClear in the USA (Stafford 2013).

3.6.3.1 Regulation of Alternative Trading Systems and Off-Exchange Trading

While on the central clearing policy EU and by extension UK policy was mostly reactive to US policymaking, after the crisis the UK also responded to proposals from other EU member states via EU institutions, which had potentially significant implications for markets in financial instruments in the UK. On most regulatory issues, the tenets of EU membership meant that the UK would have to implement the EU response. While the UK was a vocal proponent of some types of reform – notably on bolstering CCP resilience – it opposed many proposals advanced by other EU member states. The UK's position on these issues advanced through EU institutions can be assessed to evaluate its policy priorities. A key issue on which the UK sought to head off substantive policy initiatives in the EU forum was the reform of certain aspects of trading in financial instruments not passed under EMIR, notably alternative or off-exchange trading in financial instruments (sometimes known as "dark trading"). Similar to the issue of derivatives reform, these issues were not salient to the UK political debate on financial sector reform. These were not just highly technical regulatory issues, but since the signing of the Lisbon Treaty, they would be primarily regulated via a new regime agreed to in EU institutions. The prediction of the theory set out in Table 3.3 is that these conditions will produce a symbiosis or alliance between UK policymakers and industry similar to the central clearing issue.

The political and legal shift towards the EU policy forum that occurred with the coming into force of the Treaty of Lisbon, and the fresh mandate of José Manuel Barroso's post-2009 Commission, saw an array of financial services reforms being undertaken. As well as the clearing mandate actioned through EMIR, the EU undertook more holistic reforms to trading in financial instruments, which had previously been implemented through the Markets in Financial Instruments Directive 1 (MiFID 1) passed in 2004. Observers noted that MiFID 1 had done little to reduce the proportion of trades conducted on an over-the-counter (OTC) basis in EU markets, which remained stubbornly around 40%. One of the aims of MiFID 2 was therefore to address "the lack of transparency and the accompanying opacity of risk patterns in the financial system[, which] was an aggravating factor in the [Global] financial crisis, facilitating the spread of general distrust and thereby contributing to drastically reduced liquidity flows" (European Parliament Committee on Economic and Monetary Affairs 2010). This accorded with the G20's mandate to move trade in financial instruments away from ad-hoc, decentralised processes and onto exchanges. For the UK, a major fault-line emerged over the regulation of "dark" (off-exchange, also known as "internalised") trading, as well as trading that occurred on Alternative Trading Systems (ATS), where orders are not displayed before execution.[75] London was the largest market for such trading, having become the dominant European market in which these new trading venues were established after MiFID 1.

For UK policymakers, a core strategic aim was that the post-crisis drive towards more centralised and regulated trading did not deplete its national comparative advantage in the trade of financial instruments. Financial services reform was a major initiative of the second

[75] Dark trading is typically differentiated from "lit" trading, which occurs on exchanges that display aggregate volumes and prices of orders to buy and sell. In the interests of continuity, these venues are referred to as Alternative Trading Systems (ATS), in line with standard US terminology. For a recent account of these markets in the International Political Economy literature, see Mattli (2019).

Barroso Commission, and the UK was seen to be at a strategic disadvantage in the EU after France's Michele Barnier was selected as European Commissioner for Internal Market and Services, in preference to a British official. UK policymakers sought to influence policy in this area through several channels. In the European Parliament, they worked in particular with the newly-elected MEP Kay Swinburne, who joined the Committee on Economic and Monetary Affairs (ECON), where she took up leadership on its reforms to trade in financial instruments.[76] Swinburne coordinated with London-based officials during the gestation of MiFID 2, persuading George Osborne to initiate a major research initiative on computer-based and off-market trading in financial markets. This became a "Foresight" review conducted by the Government Office for Science – the only review of its kind on post-crisis financial regulation.

The UK's Foresight Review on *The Future of Computer Trading in Financial Markets* was produced at a key moment of MiFID 2's development. It was, according to one official involved, "run very quickly because we had to inform the European Commission within [one] year." Government officials and the Office for Science agreed to take on what had become a "clear priority" for the financial industry because "the fear was … that in Europe with these very negative thoughts about High Frequency Trading … the European legislators might want to just close [it down], without understanding what it really was". Among the Review's Lead Expert Group, which was chaired by the outgoing chief executive of the London Stock Exchange, Dame Clara Furse, there were "highly entrenched views on [High Frequency Trading]".[77] Some lead members were generally against High Frequency Trading (HFT) because of the risk and short-termism that this brought to markets, while others argued that it could have a positive impact on market liquidity.

The analysis of over fifty peer-reviewed reports commissioned by the Foresight Review and conducted by academics was the basis of the findings and recommendations of the report, which (as with other Foresight reports) ultimately fell under the jurisdiction of the UK's Chief Scientific Adviser as Head of the Office for Science. These academic reports addressed topics such as "What has happened to UK equity market quality in the last decade?," "Crashes and high frequency trading," "Standards in financial services," and "Systemic risk arising from computer-based trading". The Review and its supporting academic papers critiqued many of the regulations being considered by EU officials, including minimum resting times and order-to-execution ratios (intended to reduce cancellation of quotes), market-maker obligations (intended to ensure continuous market liquidity) and constraining off-exchange/dark trading (intended to incentivise higher lit market activity). In the foreword, the Chief Scientific Adviser concluded that "The Project has found that some of the commonly held negative perceptions surrounding HFT are not supported by the available evidence, and, indeed, that HFT may have modestly improved the functioning of markets in some respects" (Government Office for Science (United Kingdom) 2012, 5).

Strategic action among UK policymakers led to the UK achieving many of its policy aims at the EU. Senior officials in the Treasury, Bank of England and FCA worked, according to Swinburne, "really collaboratively" with the key UK representatives at the EU (including herself),

[76] For written output, see e.g. European Parliament Committee on Economic and Monetary Affairs (2010).
[77] Interview UK#16, UK regulatory official, 24 June 2021.

especially by "making sure that the [European] Council position was really strong and … [that] when George Osborne needed to come in and bang the desk, he did".[78] Swinburne invited Foresight Review members and supporting academics to present their findings at ECON, which helped bring over MEPs previously sceptical of HFT. This meant that, bar one exception, "all of the recommendations that we made in the project were enshrined into European law".[79] For this Foresight Review official, the Review had produced "evidence-based" and "unbiased" recommendations using the available evidence base. It also came to be seen as "a success for industry," with large firms operating in the City of London broadly attaining a regulatory regime favourable to them.[80] The policy of minimum resting times alone, which was being considered by EU policymakers but which was removed soon after the critical findings of the Foresight Review, was internally estimated to save UK industry around £2bn a year.[81] For Swinburne, MiFID 2 and EMIR were exceptional for the UK because it was "the first time that I'd seen the Council and the Parliament, us really coordinating a position so that the UK really had lined up everything with the evidence behind it all, and using the evidence selectively to make our case ahead of going into the negotiating room."[82] Unlike under high salience issue areas in which policymakers were subject to high democratic pressure, British policymakers here acted in symbiosis with industry. This is reflected in the participatory role that banks and other financial institutions enjoyed as the Foresight Review was undertaken (Government Office for Science (United Kingdom) 2012, 147–55).

Developments since Brexit suggest that the financial sector will, at least on these more technical and low salience issues, continue to enjoy this privileged access to policymakers. After it left the EU, the UK remained subject to MiFID 2 rules, but after the transition period ended, rules surrounding dark trading were among the first to be tapered back. For example, MiFID 2 put in place a Double Volume Cap (DVC) for dark pools, which are services often run by banks and exchanges. The DVC restricted the total volume of trading in an individual stock that could take place in a single dark pool to 4%, and to 8% across all dark pools. In December 2020, the FCA – operating under temporary "UK MiFIR" powers – announced that it would no longer automatically apply the DVC to UK equities. Soon after, in March 2021, the FCA extended this to all equities, meaning that EU-listed and other stocks could be traded in dark pools without being subject to the DVC (Financial Conduct Authority 2021). This was reported in the financial press as an effort by the UK to limit the stocks "Brexodus", where equities trading was being moved from London to EU-based financial centres such as Amsterdam. During this same period ESMA, on the other hand, began a consultation process in which it proposed *stricter* rules for dark pools, in order to further incentivise the shift towards on-exchange trading (European Securities and Markets Authority 2020). Dark pools are thus one of the first areas in which the UK is meaningfully diverging from the EU on financial regulation. From the outset of MiFID 2, the UK sought to make London the default European venue for ATS and off-exchange trading. After Brexit, UK policymakers appear intent on this remaining the case.

[78] Interview UK#17, Kay Swinburne, 21 September 2021.
[79] Interview UK#16, UK regulatory official, 24 June 2021.
[80] Interview UK#16, UK regulatory official, 24 June 2021.
[81] Interview UK#16, UK regulatory official, 24 June 2021.
[82] Interview UK#17, Kay Swinburne, 21 September 2021.

No evidence, on the other hand, has been found that UK policymakers designed policies in response to high salience issues associated with derivatives and off-market trading. This contrasts with the situation in the EU. As Eurozone countries faced increasing contagion risk during the Eurozone crisis, the EU imposed a ban on naked credit default swaps in an attempt to stop traders buying sovereign CDSs (e.g. on Greek bonds) as a bet on sovereign default, as well as a ban on naked short-selling of bonds and shares (Barker 2011). The UK – the jurisdiction in which many of the traders who had been conducting these speculative activities were located – launched a legal challenge at the European Court of Justice to oppose these policies, which was thrown out by judges (Barker 2014).[83] The case of MFI reform yields evidence of policy symbiosis between British policymakers and the financial industry. This policymaking environment is the product of low democratic pressure and the UK's drive to retain London's competitiveness as a global financial trading hub.

3.6.4 Tax and Pay Reform in the UK Banking Industry

Table 3.17: Overview of Possible UK Bank Tax and Pay Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Banker bonus tax	Permanent bonus tax	*No banker bonus tax*
Bank levy	*Bank levy imposed*	No bank levy
Financial activity/transaction tax	FAT/FTT imposed	*No FAT/FTT*
Cap on bankers' bonuses	*Bonus cap imposed*	No bonus cap imposed

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Alongside regulatory reform, the post-GFC period produced significant national and international debate on redistributive issues, most notably matters of tax and pay in the banking sector. This became a charged political debate in the UK, especially in the context of lacklustre overall economic growth, while finance swiftly returned to profitability. As the data

[83] At the height of the crisis in 2008, the UK FSA had itself put in place a short-selling ban on UK bank shares. The disclosures associated with the ban showed that banks and other financial companies were shorting each other's shares (Treanor and Kollewe 2008).

presented in Section 3.2 elaborate, UK financial sector workers, especially those clustered in London, receive far higher wages than those in most other sectors. As Table 3.6 shows, the pay differential between finance and manufacturing jobs nearly doubled between 2007 and 2019, in both London and the UK as a whole, in spite of the GFC. This high geographical and sectoral inequality made redistributive policies associated with banking a high salience issue for many voters. The following section shows that, while the UK did sometimes introduce redistributive policies that placed costs on banks, it also opted against more significant reforms and took concerted action at the EU level to oppose more sweeping tax and pay initiatives. The UK repeatedly struggled to reconcile its high economic dependency on global banking with the strong public antipathy towards tax and pay matters in the financial sector.

3.6.4.1 Taxing Bankers: the UK Bank Payroll Tax

The earliest bank-targeted tax policy in the UK was a Bank Payroll Tax, known colloquially as the bankers' bonus tax. The tax was applied at a rate of 50% to banker bonuses over £25,000, charged to firms rather than individuals, and was non-recurring. It was introduced in December 2009 and planned as a one-off levy. The UK announced the exceptional tax on the same day that the then Prime Minister Gordon Brown cowrote an op-ed article in the *Wall Street Journal* with then French President Nicolas Sarkozy. In that article, the leaders wrote that "we agree that a one-off tax in relation to bonuses should be considered a priority, due to the fact that bonuses for 2009 have arisen partly because of government support for the banking system" (Brown and Sarkozy 2009). The UK tax ultimately netted the Treasury over £3.4bn over the four months that it was in place, with receipts significantly higher than official expectations because banks decided to pay executives high bonuses despite the tax liabilities of doing so.

After leaving office, the Chancellor of the Exchequer Alistair Darling nonetheless admitted that the tax was mainly of symbolic worth and did not have any significant effect on changing bonus culture (Martin 2010). The Payroll Tax is nonetheless significant to the overall story of post-crisis bank taxation: it occurred in advance of the first bonus round after the bank bailouts, and in anticipation of public outrage while issues of regulation and pay in the sector remained highly especially salient with voters (cf. Culpepper and Lee 2022). While there are no public surveys on this specific policy, taxes targeted at banker bonuses have been shown to have consistently high support in the UK throughout the post-crisis period. The UK's later opposition to bank bonus caps introduced via the EU, addressed in Section 3.6.4.3, is therefore puzzling, since it appears at odds with the strong democratic incentives that existed to regulate executive pay.

3.6.4.2 Taxing Banks: the UK Bank Levy

The *Wall Street Journal* article penned by Brown and Sarkozy was titled "For Global Finance, Global Regulation". It argued that the crisis demanded a global regulatory response. Indeed, the "one-off tax" proposed by its authors was expressed as a temporary initiative rather than part of the global package of reform they proposed. As they argued, "no one territory can be expected to or be able to act on its own" (Brown and Sarkozy 2009). As leaders of two G20 governments, Brown and Sarkozy had pushed for the official request made by the G20 to the IMF to prepare a report on how the financial sector could make a "fair and sustainable

contribution toward paying for any burden associated with government interventions to repair the banking system" (International Monetary Fund 2010). Two proposals made by the IMF were a "Financial Stability Contribution" and a "Financial Activities Tax". The Financial Stability Contribution (FSC) was envisaged as a levy paid by all financial institutions, to be set at rates commensurate to each firm's systemic risk, and receivable by national governments. The IMF proposed that there would be two elements to the FSC: a temporary ex-post levy to pay for crisis-period losses, and a continuous ex-ante levy intended to reduce risk-taking incentives in the financial industry, and which would act as a fee for the availability of a credit line in a future crisis.

While Brown was a cheerleader for financial reforms channelled through institutions of global governance, it was the Coalition Government elected after May 2010 that took the primary role in the post-crisis bank-specific tax regime. From late 2009, not only did the Labour Government lack the time to create a permanent bank-specific tax regime before the election, but Brown was also unwilling to do so because "he didn't want to be in a run up to the election … banging on about a new tax." In the context of the bailouts and the opposition strategy to discredit Labour's economic record, Brown "thought that was a liability".[84] Second, and in a story that would soon be repeated throughout the post-crisis period, the momentum that could be produced through US leadership in multilateral institutions was lacking: "after the G20 [in London] in April 2009, the United States weren't interested … they had other fish to fry … for them[, creating a gloal bank levy] … was just a distraction."[85] A unilateral US FSC, called the Financial Crisis Responsibility Fee (and discussed in Chapter 5) was instead proposed by Barack Obama in 2010, but never passed into law. European governments including the UK were, on many issues, in favour of internationally coordinated approaches to financial sector tax reform. Without US buy-in, however, the UK's choice-set narrowed. While the UK initiated its own domestic version of an FSC, both Tobin-style taxation and taxes on banker remuneration were soon actively opposed by the UK. They became a flashpoint in UK-EU relations in subsequent years.

The UK Bank Levy was the UK's version of the IMF's FSC. It was designed in UK policy institutions and related to the high salience issue of banks paying back their crisis-era liabilities. In its 2010 manifesto, the Conservative Party had proposed putting a levy on banks, but had expressed a strong preference for a multilateral approach. Absent similar US initiatives, the UK was far less supportive of taxes proposed in EU institutions, because they were perceived as detrimental to City of London competitiveness. During 2010, partly due to disagreements between the UK and EU, negotiations to create a harmonised EU bank levy failed (Traynor 2010). Absent an EU-wide policy, the UK proceeded with a unilateral version of a levy according to its own preferred design, which would see revenues being used to reduce the UK fiscal deficit. In mid-2010, the UK government announced that the Bank Levy would have a dual aim to "ensure that banks make a contribution that reflects the potential risk to the UK financial system and the wider economy from bank failures" and "to encourage banks to move away from riskier funding" (HM Treasury 2010). Corresponding with this second aim, the rate of the levy was twice as high for short as for long-term liabilities, which incentivised banks to shift their liability management away from money markets and towards

[84] Interview UK#18, Lord Stewart Wood, former adviser to Gordon Brown, 10 September 2021.
[85] Interview UK#18, Stewart Wood, 10 September 2021.

less risk-prone funding arrangements. Only liabilities over £20bn were taxed, meaning that only large banks were affected. The levy applied to the global balance sheets of UK-headquartered banks, but only to the UK-based balance sheets of foreign bank subsidiaries in the UK.

As the Treasury went about designing the Bank Levy, firms actively sought to reduce their liabilities. Only some firms succeeded in doing so, and until years later politicians remained impervious to lobbying efforts to reduce or scrap the levy. Officially estimates cited that the Bank Levy aimed to raise £2.5bn, though internally Osborne discussed setting rates high enough to raise up to £4bn.[86] Yet officials encountered several difficulties implementing the Bank Levy. In the first and second years, receipts were just £1.6bn, creating a near £2bn shortfall at a time of acute fiscal strain. The government faced the issue that it had to legislate the levy rate a year in advance, but it could not accurately forecast what banks' liabilities would be without firms playing ball in giving accurate estimates. Banks took advantage of various arbitrage opportunities, for example strategically moving debt-raising activities to other jurisdictions in order to reduce balance sheet size, and failing to notify the authorities in advance. Low levy returns in the first years brought negative media coverage for the government ministers in charge of the levy, leading them to take a more assertive approach to ensure bank compliance.[87] Treasury officials engaged with executives from thirty of the largest banks in the UK, giving the ultimatum that they were to either proactively assist in helping the government to forecast levy receipts through sharing internal corporate data, or the government would play hardball and increase the levy rates eightfold.[88] Such an outcome would have created a UK levy higher than any European country (Devereux, Johannesen, and Vella 2019). Banks opted to comply with the government, and levy receipts increased year-on-year, reaching a high of £3.4bn in 2015-16, until it was then decided to phase-out the tax.

At the high point of public demand for recouping the costs of the GFC, politicians imposed a tax on banks and extracted year-on-year increases from the sector. However, higher receipts were not achieved across the board. A former Morgan Stanley executive explained that once the Coalition Government introduced the levy in 2010, the firm "told the Treasury that we would just move the balance sheet, and we did". This today means that "no non-British bank has got any balance sheet left [in the UK]" and as a result the levy "hits the British banks". This executive explained that "[the government] needed the money [and] domestic banks were a soft target".[89] While foreign (non-UK-headquartered) banks could strategically move debt-raising activity outside UK tax jurisdiction, the design of the levy made such tactics impossible for UK-headquartered banks. Indeed, firms had to pay the levy not just on their UK-based activity, but – unlike foreign banks – also on their global balance sheet. In the first year of operation, HSBC paid over 20% of the bank levy. At the levy's highest rate, in 2015, HSBC paid over £1bn or close to 30% of the levy.[90] The levy created higher costs for the banks with the weakest exit options from the UK economy.

[86] Interview UK#16, HM Treasury official, 24 June 2021.
[87] Interview UK#16, HM Treasury official, 24 June 2021.
[88] Interview UK#16, HM Treasury official, 24 June 2021.
[89] Interview UK#17, former Morgan Stanley International executive, 1 April 2022.
[90] Source: HSBC Annual Reports (2012, 2015). The currency conversion used for US Dollar (used in HSBC reports) to Pound Sterling (used in government tax data) in this calculation is that from the last day of the government's tax year.

Soon after achieving its highest return in 2015-16, it was announced that the UK Bank Levy would be phased out. This begs the question of what factors led to a policy which had taken a number of years to fine-tune being scrapped. Immediately after the Conservatives won the 2015 election, and less than two months after George Osborne had raised the Bank Levy rate for the nineth time since 2011, the financial press reported that foreign banks were "plotting a managed retreat from operations that expose them to the UK bank levy", especially in repo transactions, which can have the effect of artificially inflating balance sheets (Jenkins 2015). It was announced in the first post-election budget that the Bank Levy would gradually be phased out and replaced by a Corporation Tax Surcharge. Arguably, foreign banks have been able to arbitrage this at lower cost (Bergin 2016). Meanwhile, HSBC – the UK's largest bank, but one which had repeatedly threatened to move its headquarters to Hong Kong – achieved what in interview a trade association official called a "stunning lobbying coup." As well as reducing levy rates, Osborne changed the Bank Levy remit so that it would apply only to the domestic (and not the global) balance sheets of UK banking groups. As a result, after this announcement, "Lloyds woke up one morning and HSBC had taken £300m a year out of its bottom line".[91] While it is clear that this outcome came after the sustained lobbying campaign by HSBC, overall the firms that have been most effective in reducing their liabilities are large international players. Lloyds Banking Group, which was by this time almost exclusively active in UK domestic markets and possessed virtually nil exit option, bore the brunt of the post-2015 changes.

By 2015, the political climate had also shifted. In marked contrast to the political narrative of 2010-15, the Conservative Majority government was confident enough to deliver the message that the time for "banker-bashing" was over, amid fears that UK financial sector competitiveness was eroding due to the post-crisis policy response. Osborne soon also sacked the Financial Conduct Authority's founding CEO, Martin Wheatley, who had been known for his stringent regulatory philosophy of "shoot first, ask questions later" (Fortado et al. 2015). Symbolically, after Wheatley's departure, the FCA cancelled a probe into banking culture initiated after the Libor rate-rigging scandal.

While in 2010 the Bank Levy was announced as a permanent tax "to extract the maximum sustainable revenues from financial services" (BBC News 2010), by 2015 it was dramatically scaled back once two crucial factors came to pass. First, as the salience of post-crisis policymaking fell away, it was clear to banks that the IMF's vision of a Financial Stability Contribution in place across G20 and other countries would not be realised. In particular, major competitor financial centres such as New York and Hong Kong had not initiated a bank levy. By 2015, UK taxes were being successfully arbitraged, particularly by foreign banks. To be sure, the bank lobbying operation scaled up once it became clear that London was an outlier in imposing a levy. Industry showed policymakers that the levy was meaningfully eroding London's competitive edge. Second, the reformist Coalition Agreement signed at the high watermark of the reformist verve was no longer a political constraint. This gave the majority Conservative government greater scope to row back on choice post-crisis innovations. It is telling that the major adjustment made with that enhanced political agency was to further reduce the tax liability of the firms that possessed the strongest exit option, at

[91] Interview UK#20, UK bank trade association executive, 3 March 2021.

the expense of those that possessed the weakest. This policy evolution conforms with the theoretical expectation associated with constrained democracy set out in Table 3.3. On the other hand, no evidence was found that the shift away from a bank levy occurred after substantive economic findings that bank levies were not achieving, and may have even been eroding, promised financial stability benefits (e.g. Devereux, Johannesen, and Vella 2019). This policy was designed and later adjusted according to changing issue salience, while state-banking sector dependency remained a constant to policy decisions.

3.6.4.3 UK Opposition to EU-led bank tax initiatives

The second type of tax proposed by the IMF – a Financial Activities Tax (FAT) – initially found some support under the Labour Government, including from Gordon Brown. Over time, however, it became strongly opposed by the UK and a flashpoint in its souring relations with the EU. In January 2011, Treasury communications were still referring to its work "with international partners … exploring the costs and benefits of a Financial Activities Tax on profits and remuneration" (HM Treasury 2011). In fact, by then it had already become clear that, with no interest in a FAT among senior US policymakers, the UK would not support any tax on financial transactions. After José Manuel Barroso, the European Commission President, announced in his 2011 State of the Union address a proposal for an EU-wide FTT, the UK Government went on the offensive in Brussels. George Osborne wrote in London's *Evening Standard* that Barroso's proposal was "a bullet aimed at the heart of London" (Parker 2011) and "economic suicide for Britain and for Europe" if the US or China did not participate (London Evening Standard 2012a). David Cameron would soon label the EU FTT "quite simply madness" and promise to use the UK's veto to block any EU-wide initiative in this area (Giles, Parker, and Wiesmann 2012). The reaction from the UK-based financial services industry was similarly scathing. For example Ian Spencer, then CEO of the foreign exchange company ICAP (now NEX Group), stated that an FTT would mean that ICAP "would have to shift the centre of gravity of our business totally towards New York", that it would "decimate London's position as a leading trading centre" and benefit Asian economies such as Singapore and Hong Kong (Wood 2012). An FTT was seen as economically unviable for the UK and a clear threat to its international competitiveness.

Despite the UK's opposition, the EU's FTT proposals continued to make ground in the Eurozone bloc (but not the wider EU), leading the UK to oppose the policy in the courts. 11 Eurozone states decided to proceed with an FTT through the established procedure of "enhanced cooperation", after which the UK took the case to the European Court of Justice, arguing that the FTT was "extraterritorial" in scope and would negatively affect trading in London. While the ECJ threw out the UK's case, due to lack of political momentum the EU FTT has never been implemented. These events show that, even before the Brexit era, the UK was willing to adopt an approach that would substantially damage its reputation among EU counterparts when policy initiatives threatened the competitiveness of its financial sector (Barker, Fleming, and Rigby 2014).

The UK's negotiating position also stood in marked contrast to the clear domestic public support for the tax, as the data from a 2010 survey presented in Table 3.13 showed. A 2012 survey also conducted by YouGov found a tax "on financial transactions by investment banks"

attracting 61% total support.[92] The UK is also home to the global campaign The Robin Hood Tax, run by a slate of global charities and organisations, whose proposals helped inform the European Commission's agenda on an FTT. Unlike post-crisis bank levies, FTTs gained limited traction as a policy outside a small group of European states.

Despite similarly high public support for both types of tax in the UK, British policymakers proceeded with a levy but not an FTT. The orthogonal stance of the UK government towards these two policies had less to do with their relative popularity among voters, than with the costs that each would impose on the financial sector, and in turn the UK economy. An FTT would place costs on exactly the global financial activities in which the UK sought to sustain its comparative advantage. It was plain to policymakers that implementing such a tax would lead to firms exiting London and erode the City's position as a global financial centre. In contrast, the Bank Levy discussed in Section 3.6.4.2 was implemented unilaterally by the UK and targeted domestic firms which possessed a weak exit option, while the firms most crucial to the City's international activities and which possessed a strong exit option could act strategically to reduce their liabilities.

The second major EU tax and pay issue on which UK public opinion and the British negotiating position were at odds was banker bonuses. As detailed in Section 3.6.4.1, the UK had been a first mover among competitor economies in putting a tax on bonuses in 2009/10. However, it became clear to UK policymakers, once executive remuneration practices had largely returned to pre-crisis norms, that such a policy could not become a fixture of the domestic policy landscape without significant competitiveness costs to the City of London. Already, banks were able to demonstrate to government that their workers in London earned far less than in competitor centres such as New York and Hong Kong.[93] Mandated taxes or caps on executive pay and bonuses became fiercely resisted by UK policymakers when proposed at the EU level.

However, the British public's antipathy towards high pay in the sector continued well beyond the crisis period, and it was a topic regularly covered in the media, especially during bonus rounds.[94] In interview, a senior adviser to the Conservative Government identified the "poisonous political culture every January and February [that] was very, very difficult to manage … we'd have to get through each bonus round somehow"". They further identified the British public's perception as being: "we owned these banks and know people in these banks were being paid astronomical sums". They concluded that, among voters, "no one could understand" the fairness of this situation.[95] Bonuses at the bailed out banks RBS and Lloyds caused particular controversy, and the government has used its shareholding in RBS to mandate a cap on cash bonuses of £2,000 – far below what competitor firms pay – which is a policy that remains in place to this day (Falloon 2012; Kleinman 2020). In the domestic

[92] N=1,727 British adults. Total opposition ("tend to" and "strongly" oppose) was 19%; while "don't knows" was 21% (YouGov 2012).
[93] Interview UK#21, Giles Wilkes, former adviser to Vince Cable, 29 September 2021.
[94] This media attention is observable in quantitative media trends. Figure 2.1 showed that in the years after the GFC (2010-14), UK newspapers saw a higher share of articles covering executive pay issues relative to other issues than in France, Germany, Switzerland, Australia and the United States. The number of articles referring to executive pay in the UK during 2010-2014 also increases in magnitude in absolute terms during the period of bank bonus announcements (January-February) each year compared to in these five countries.
[95] Interview UK#2, Conservative Government adviser, 24 September 2021.

political forum, politicians simply had to respond. For example, when in 2012 it was disclosed that RBS CEO Stephen Hester would receive a bonus of up to £1.5m, David Cameron publicly admonished that "bonus culture … has got out of control" (Falloon 2012).

This rhetoric did not, however, carry through to the UK's policy engagement on these issues at the EU. When the European Parliament voted in favour of bonus caps in 2013, as with the FTT, the UK again staunchly opposed its introduction. It became the only EU country to vote against the measure at the Economic and Financial Affairs Council (ECOFIN). Unlike the EU's FTT, the UK eventually capitulated on its challenge to the bankers' bonus cap. This was a reflection of how salient the executive pay issue remained among UK voters.

In the first instance, the EU bonus cap – which restricts bonuses to 100% of bankers' basic pay, or 200% subject to shareholder approval – was challenged by the UK at the ECJ. The UK's arguments were that it would drive talent out of Europe, that it would lead to banks inflating salaries (which were not capped under the EU policy), and that the European Banking Authority was overstepping its authority. However, unlike on issues such as the EU FTT, to which UK politicians were generally opposed, the Labour opposition led by Ed Miliband capitalised on the Conservative Government's muscular opposition to the EU policy. He denounced David Cameron as "out of touch" and "straining every muscle" to help the wealthy (BBC News 2013). Reflecting on the failure of the government's opposition to the EU policy, an adviser from the Coalition years stated:

> In the constant battle [with the EU] of securing red lines … the only one of those that we actually ended up losing on was the bonus cap … [T]hat's the sort of exception that proves the rule that, largely the kind of high level impetus to reform the financial system was a response, partly to popular pressure, [whereas] the details of doing that were largely done … in smoke-filled rooms, because just the complexity meant that the public were just not getting exorcised about [these issues] … But then the bonus cap was the … one issue where it became a *cause célèbre*, where just both domestically and in Europe, it became impossible to resist.[96]

Bowing to popular and political pressure, the UK was forced to implement the EU bonus cap. British politicians and regulators alike continued to oppose the policy. The Bank of England, for example, undertook analysis which showed that the policy was simply leading to banks increasing salaries, creating higher fixed costs that could lead to financial instability and procyclicality during a downturn (Sakalauskaite and Harris 2022).

After the UK voted to leave the EU, the bonus cap was among the first policies to be identified by the otherwise Brexit-sceptical Mark Carney as one that could be reviewed under new Brexit freedoms. However, the political decision to abolish it came only in late 2022, under the short-lived Truss-Kwarteng government. The decision received widespread press attention, and polls showed it to be among the most unpopular of the disastrous "mini-Budget" which led the government to fall.[97] It was nonetheless one of the only mini-Budget

[96] Interview UK#2, Conservative Government adviser, 24 September 2021.

[97] In a September 2022 survey by YouGov conducted immediately after the mini-Budget was announced, 71% of respondents stated that removing the bonus cap was the "wrong priority" – with just 14% thinking it a "good

decisions not to be overturned by Truss as part of the attempt to reduce the market turmoil, and was a policy in Jeremy Hunt's 2023 Edinburgh Reforms.

The Bank of England has consistently opposed the bank bonus cap because of its distortionary effects (Dorrell 2023). It has however taken concerted political action, as part of a broader strategy to bolster UK financial sector competitiveness, for the policy to be scrapped. The unpopularity of that move when it was announced suggests an ongoing mismatch between voter preferences and policymaker action. Given the pressures on UK policymakers to bolster economic growth, and because the financial sector remains the country's prized industrial sector, it is not surprising that politicians have chosen to nail their colours to this mast despite its unpopularity. A policy that the UK was forced into by high democratic pressure was cancelled at the earliest possible moment due to the competitiveness costs for global banks.

3.7 Conclusion: UK Policy Reform as Constrained Democracy

This chapter has provided an in-depth empirical account of four major areas of policy reform that the UK has undertaken since the GFC. Two involved a response that primarily entailed policymaking in national political institutions: bank structural reform and tax and pay issues in the sector. The public demands for financial reform in the post-2008 period, and the particular salience of reforming bank structure and remuneration practices, saw policymakers face strong democratic pressures to pass reforms in these areas. As a result, policymakers were correspondingly less responsive to the demands made by the banking industry, which was generally against reform that diverged from international standards. On the other hand, the chapter showed that the reform of bank capital requirements and markets in financial instruments (MFIs) primarily played out in multilateral fora. Overall, these reforms also entailed more technical understanding of the financial system, and they did not achieve the same salience with the British public as the structure and tax issues. It was shown that the democratic pressure faced by policymakers on these issues was lower, and the willingness of policymakers to design reforms that protected City of London competitiveness higher.

However, even where policymakers sought to respond to strong and persistent democratic demands on the structural as well as tax and pay reforms, it was shown that the UK's asymmetric dependence on its internationalised banking sector led to a constrained democratic response. Notably, those advocating for a stronger response were rebuffed by politicians due to concerns about the competitiveness costs of unilateral reforms.

Among the regulatory issues discussed in this chapter, bank structural reform has drawn by far the greatest attention from scholars. The UK outcome – ringfencing – led to a regulation that has widely been characterised as atypical for British financial policymaking, given the history of financial sector deregulation and the assumed deference of UK politicians to financial sector interests (Kynaston 2002). In fact, going further than most other ACDs, the UK opted for a unilateral reform that led to significant incursions into the business model of some of its largest banks. The theory offers a clear explanation for why this occurred. When subject to strong democratic demands, the UK lacks the cooperative public policy institutions

idea" (Smith 2022). In another YouGov poll, 67% of respondents stated that the bonus cap should remain in place, with just 15% believing it should be scrapped (YouGov 2022).

possessed by many European states, which often instil cooperative behaviours among industry and policy elites, even when there exist strong public demands for change. Incentivised to respond to these public demands, and resisting the pull of the bank lobby, UK policymakers could nonetheless deliver only a constrained democratic response. Indeed, it constitutes significant evidence in support of this explanation that ringfencing has had no noticeable impact on the internationalisation of the City of London as a financial centre, and that the two firms threatening to exit UK markets (HSBC and Barclays) have not done so. The chapter showed that ringfencing was, and continues to be, a carefully calibrated exercise that deliberately sought to mitigate such competitiveness costs.

The constraints faced by British policymakers become even more stark when brought into comparative relief with the US reform process. Similarly lacking cooperative elite institutions, US policymakers did not however operate under the same constraints as British policymakers. Specifically, they had to consider neither the effect reforms would have on financial sector internationalisation nor the potency of firm exit threats when evaluating the costs of reform. The process by which it arrived at the Volcker Rule and the Intermediate Holding Company (IHC) framework, discussed in Chapter 5, reflects US policymakers' unique ability to deliver unconstrained responsiveness when responding to strong democratic pressures. The most similar outcome to the UK's ringfencing option has been in Switzerland. The crucial difference from that country, as outlined in Chapter 4, is that its two large banks possessed a weak exit option. This allowed Switzerland to pursue reforms which had the effect of significantly reducing the size of these two banks' global operations, while largely maintaining Swiss comparative advantage in private wealth management.

The difference between the British and Swiss policy responses also opens the door to a critical reflection about possible pathways to more wholesale change in the governance of global finance. While both achieved meaningful policy responses which put in place genuine constraints on banks, none of their reforms have ultimately moved the dial on the dominant role that international finance plays in each of these economies. After the crisis, research in both policymaking and academic institutions opened up a debate about whether some countries might suffer from having "too much finance" (Venables 2018). This was distinct from the TBTF debate, which related to whether very large firms create risks for the state, to which both the UK and Switzerland initiated significant policy responses. The "too much finance" or "finance curse" hypothesis states that there is a threshold above which financial sector size acts as a drag on economic growth, either due to the increased probability of large economic crashes, or resource misallocation. Even implicitly, this was a consideration made by the UK's ICB: the ringfence sought to make investment banking stand on its own two feet by removing the implicit taxpayer subsidies these services were seen to have exploited before the GFC. If firms could not remain profitable without that subsidy, the ringfence would in principle allow these services to be run down safely. This is, however, a far cry from a hypothetical policy that might actively put limits on the size of an international financial sector. No policymaking institution in either the UK or Switzerland, either expert or lawmaker-led, seriously considered such a policy. The difference between the post-crisis responses that were enacted and what such a policy would entail are significant.

This may on first appearances point to an 'ideational capture' of policymakers who are unable to go down a route to policy reform which might genuinely do harm to an internationally

competitive industry. Such ideational capture is difficult to observe empirically: given that no ACD has to date actively taken steps to reduce the size of its financial sector, there is no variation to exploit to test what it would take for these alternative regulatory frameworks to be built. What did emerge from interviews conducted in the UK was a pronounced cynicism among many public servants about the inner workings of the global finance, especially in relation to firms' executive pay cultures and their propensity to engage in regulatory arbitrage. These policy elites certainly did not see themselves as beholden to a pre-crisis orthodoxy about self-correcting financial markets and the intrinsic benefits of supply-side reform. Intellectually, British policymakers have a lot in common with Swiss policymakers, who also tended to express scepticism about the merits of Swiss banks continuing to compete in global capital markets. In neither country were policymakers convinced that their global banks were competing at the frontiers of innovation to solve real world problems. Yet the appetite for the structural economic adjustment that shrinking the financial sector would entail was at best marginal. British policymakers did not take up the "too much finance" argument because the short-term costs of doing so were either far too high, or essentially incalculable. Looking to the next election rather than an alternative vision of how the economy might be run, the ringfence represented the hard constraints of reforming a highly internationalised sector using the tools available to a constrained democracy.

This chapter concludes, then, by drawing policy parallels between policymaking in two countries more often contrasted than grouped together in comparative political economy scholarship. Yet such is the structural importance of international finance within Switzerland and the UK, and such the magnitude of public antipathy towards the industry after the GFC, that the positioning of these two key independent variables produced some strikingly similar outcomes.

For George Osborne, ringfencing was the answer to the "British dilemma" of housing both a global financial sector and TBTF banks, a combination which had exposed British taxpayers to untenable financial risk during the GFC. The continued public antipathy towards bankers and banking in the UK today (Culpepper, Jung, and Lee 2023) suggests that the political resolution to that dilemma, which took the form of a constrained democratic response, was deemed insufficient. Indeed, the political earthquake that occurred with the Brexit vote can be put in the context of the policymaking of the years prior. The constrained response delivered after 2008 was deemed an insufficient challenge to the interests of a highly resourced sector which in the UK epitomises core-periphery inequalities. Brexit was to a great extent a challenge to elites, finding far more support in areas distant from wealthy urban agglomerations such as London (Ansell and Adler 2019). While of course dealing with a broader spectrum of issues, the vote achieved something of the unconstrained response that policymakers had not after 2008. Leaving the EU has not as yet produced the costs to the City of London that many analysts predicted (Fraccaroli, Regan, and Blyth 2023; Kalaitzake 2022). Yet direct democracy brought policymakers into far more uncomfortable proximity to the force of structural business power that they had sought to bypass after 2008. If policy after both 2008 and 2016 has been made under the constraints of the UK's asymmetric dependence on finance, it reveals the struggle that policymakers will continue to have to deliver a response to the public demand for change in financial sector governance. Chapter 6 returns to this issue in light of the evidence presented in a further three highly financialised democracies, beginning with Switzerland.

4. Post-Crisis Reform in Switzerland

4.1 Explaining Cases of Swiss Post-Crisis Reform

The previous chapter examined the policy process of a democracy that is asymmetrically dependent on global banking, and which as a result delivered constrained responsiveness to democratic pressures for reform after the GFC. This chapter studies a country context in which one of the two key variables of banking sector dependency – firm exit options – is dialled back substantially. At the highest level, while Switzerland, like the UK, exists in asymmetric dependency on global banking, the expectation is that this difference should periodically be observable through less constrained democratic responsiveness. This chapter accordingly studies policy reforms on the four same issues in an effort to test whether this variation in structural power changed policy decision-making in the way that the theory predicts.

Chapter 2 identified that Swiss reforms are especially puzzling for social scientists given established expectations of policymaking in this type of political economy: coordinated and ultimately business-friendly reforms which are sustained through highly institutionalised cooperation among policy elites (Campbell and Hall 2017; Katzenstein 1985). Indeed, Table 2.2 identified that three dominant frameworks for understanding Swiss regulatory policymaking – deriving from bureaucratic, lobbying and political institutionalist literatures – all do an especially poor job predicting the country's bank structural reform, which saw an outcome which significantly altered the universal banking model. Table 4.1 shows that these frameworks better predict aspects of Switzerland's capital and derivatives reforms, but given their difficulties explaining bank tax and pay outcomes, bank structural reform is not just an anomalous outcome of post-GFC regulatory policy in Switzerland. The four policy reforms studied in this chapter are identified in Table 4.2.

The following chapter analyses the process by which these four outcomes were achieved in Switzerland, demonstrating where gaps in existing theory are particularly marked, and testing whether an application of the theory of democracy under constraint to the Swiss case accounts for the observed pattern of variation. Specifically, while global firms in the Swiss financial sector do not enjoy such strong exit options as they do in the British case, cross-border banking is still a sector whose competitiveness is a cornerstone of Swiss economic strength. The model expects this to create significant state-banking sector dependencies, which will constrain Swiss policymakers when they go about delivering democratic responses to high salience issues.

Table 4.1: Explanatory Power of Competing Explanations for Swiss Regulatory Reform

Predictions of Existing Literature		**Evidence Base for Competing Explanation by Policy Issue**			
Explanatory Variable	**Expectation Associated with Explanatory Variable**	**Bank Structural Reform**	**Derivatives Reform**	**Capital Standards**	**Bank Tax and Pay Issues**
Bureaucratic Autonomy	Federal bureaucracy leads reform	✗	✓✓	✓	✗
Financial Resource of Bank Lobby	Some lobbying expenditure; some challenges to industry	✗	-	✓	✗
Political Institutionalist	Tight elite network coordinates business-friendly reform	✗	-	✓	✗

Key: ✓✓ evidence in support; ✓ limited evidence in support; ✗ evidence against; **-** insufficient evidence

Table 4.2: Summary of Swiss Policy Reforms Studied in Chapter

Feature of Policy	Bank Structural Reform	Capital Standards	Derivatives Reform	Bank Tax and Pay Issues
Level(s) of Policymaking in sequential order	Swiss-national	1. Swiss-national 2. Multilateral	Multilateral	Swiss-national
Policy Outcome	Ex-ante separation of big Swiss banks	Swiss Finish	Central Clearing Mandate	Shareholder "say-on-pay" and other executive pay restrictions after referendum Bonus tax and pay ratio caps rejected
Policy Scope and Policy Impact	Two big Swiss banks subject to significant new regulatory burden	Higher capital requirements for two big Swiss banks Swiss regime updated over time to reflect multilateral changes	Reforms bring Swiss regulation into alignment with multilateral regulation	Mandatory say-on-pay and other executive pay restrictions apply to whole Swiss corporate sector

A political-institutionalist account of Swiss policymaking can be used as an exemplar to further unpack the gaps that Table 4.1 (column 1, row 5) identifies. Swiss policymaking has long been explained as shaped by the country's position as a "small state in world markets" (Katzenstein 1985). This status brings specific expectations of how policymaking institutions will respond to global economic change. Policymaking, according to this theoretical approach, will see "voluntary and informal coordination of conflicting objectives through continuous political bargaining between interest groups, state bureaucracies, and political parties" (Katzenstein 1984, 27). Outcomes from this cooperative process will generally sustain the competitiveness of big firms in world markets. In this chapter, the closest alignment between the policy processes observed and these institutionalist expectations of small state behaviour is shown to be Swiss reforms to bank capital requirements. Even here, however, there have been some important challenges to the big Swiss banks. Yet when this theory is traced against post-GFC bank structure and tax and pay reforms, this chapter shows the fit to be far poorer. While, as is shown, cooperative and ultimately pro-business policymaking typifies cultural modes of interaction between policy elites, it is not a good predictor of actual policy outcomes. In crucial instances, Swiss politicians pushed for decisive policy interventions that went against

the preferences of the big Swiss banks, in so doing marking a clear fault line between the interests of the state and cross-border industry.

Table 4.3 recaps the outcomes predicted by the theory of democracy under constraint in the Swiss case. Where democratic pressures are low, policy outcomes are expected to align closely with the commercial interests of Switzerland's highly internationalised financial sector. Policymaking in a low salience equilibrium should thus produce outcomes that broadly align with some of the core expectations of the "small states in world markets" framework. However, these cooperative policymaking networks will be disrupted when policymakers experience strong democratic pressures to reform industry. In these circumstances – of which the bank structure and tax and pay debates analysed in this chapter provide key examples – policymakers are expected to respond to the content of democratic demands. This can lead to greater discrepancy between the preferences of policymakers and the interests of industry, which brings more conflictual interactions between elites as policy is negotiated.

Table 4.3: Expected Empirical Observations of Swiss Policymaking Given State-Bank Dependence and Level of Democratic Pressure

Drivers of Policymaking		*Policymaking Outcomes*	
State-Bank Dependence	**Democratic Pressure for Reform**	***Expected Empirical Observations***	**Policy Outcome**
Asymmetric ++ Financial Sector Internationalisation ++ Bank Exit Options +	High Democratic Pressure →	*Policymakers mitigating costs to international finance* →	Constrained democratic responsiveness
	Low Democratic Pressure →	*Policymakers supporting global banks' commercial interests* →	State-Bank Symbiosis / Alliance

Key: ++ high/very high; **+** mid/high; **-** low/insignificant
Note: Democratic Pressure for Reform can change temporally

However, while outcomes from policy environments characterised by high democratic pressure will slant against industry's interests, these outcomes are not expected to significantly undercut the competitiveness of Switzerland's internationalised financial sector. While the two largest banks competing in the Swiss financial centre possess weaker exit options than the firms active in the UK's financial centre, just like the UK Switzerland remains highly dependent on its internationalised financial sector. Cross-border banking is the economic powerhouse of Swiss cross-border trade. Thus, under high democratic pressure, when the democratic demands made of policymakers stand in conflict to the regulatory regime that would be conducive to global banking competitiveness, the policy response will be constrained.

If in Switzerland policymakers face strong dependency constraints, this chapter shows how they also experience a highly institutionalised outlet for the exercise of voter demands. The *Volksinitiative* or popular initiative, which can lead to a referendum, often bears down on the policy process after a high salience event such as a crisis or scandal. In key instances, the popular initiative can exert democratic pressure on policymakers, and further adjusts how they engage on reform issues compared to in a low salience equilibrium. The chapter shows how the institutionalised referendum device particularly altered elite behaviour on the issues of bank structural and tax and pay reform. This institution is not only useful for understanding the Swiss case of reform; as outlined in Chapter 2.3.3.1, its role is also important for theory testing. This chapter argues that Switzerland passed stronger reforms than many other European democracies also characterised by high elite cooperation, such as France and the Netherlands, because the referendum acted as a particularly direct outlet for the exertion of democratic pressure. If this is true, studying the Swiss *Volksinitiative* mechanism is particularly fertile ground for showcasing how democratic demands act as the initiating force of reform in a high salience environment.

Analysing these four outcomes of Swiss policy reform in parallel, this chapter showcases some significant change in the regulatory governance of global banking in Switzerland. These reforms led to policy processes that were far more conflictual and costly to Switzerland's big banks than established explanations of the Swiss policy process would predict. The focal instance of a policy outcome hurting the global interests of Switzerland's big banks – structural reform – has nonetheless done little to harm these firms' competitive edge in global wealth management. The comparative advantage of the Swiss financial centre remains intact despite a significant reform agenda. As the chapter further details, the crisis at Credit Suisse in 2023 shows that while post-GFC reforms in Switzerland allowed its biggest firms to continue competing in global markets after 2008, they also failed to reduce many of the risks associated with a small country housing a global industry. This chapter's findings, and broader application of the theory, therefore have important implications for the future of the Swiss political economy.

The chapter proceeds as follows. Section 4.2 details the industrial contexts of Swiss post-GFC reform, in particular explaining the role of the two big Swiss banks in the political economy. Section 4.3 identifies how the instrumental power of global banks in Switzerland is sustained and erodes. Section 4.4 examines the interaction between multilateral and unilateral policymaking in Swiss financial regulation. Section 4.5 sets out the existing public opinion data on Swiss attitudes towards financial regulation. Section 4.6 elaborates policy reforms in four issue areas, describing how each outcome unfolded and the fit of the competing explanations alongside the causal account presented in Table 4.3. Section 4.7 concludes, summarising the fit of the theory and the implications for the study of Swiss politics and policymaking.

4.2 Global Banking and the Swiss Economy

Finance has long been a dominant industry in Switzerland. Its added value as a share of the overall Swiss economy is the highest of any country incorporated as a case in the present study, which has held true since standardised data was first collected by the OECD in the mid-1990s. The sector has consistently created the highest domestic economic value compared to any OECD country except the highly specialised Luxembourg economy. That said, a decline

has occurred in Switzerland since the GFC, with 2022 figures showing that the Swiss financial sector created about 0.7 times the value of its peak in 2007. Finance nonetheless creates far more value than almost every other major Swiss industry, including pharmaceuticals, healthcare and real estate. In 2018, it added about SwF63.2bn to the Swiss economy, when only public administration and the broad category of 'wholesale' created more value (BAK Economics 2009).

Table 4.4 presents data painting a similar picture of relative decline in a preeminent industry. Swiss financial sector exports (excluding insurance) have gone down by approximately a third since their pre-crisis peak. The trade surplus of the sector has reduced by a similar amount: in 2007, on the eve of the GFC, the financial services trade surplus constituted well over half of the total Swiss trade surplus, while by 2016, this figure had declined to just under a third. In 2019, just before the Covid-19 pandemic, the lower Swiss trade surplus meant that while the Swiss financial sector was exporting significantly less in dollar terms, the sector nonetheless remained a major overall source of the Swiss trade balance.

Table 4.4: Structural Importance of Swiss Financial Services Exports[98]
Source: Swiss National Bank

Year	Financial Sector Exports	Financial Sector Imports	Financial Sector Trade Balance	Overall Swiss Trade Balance
	(SwFbn)			
2007	34.1	6.2	28	49.4
2010	23.5	5.2	18.4	81
2013	20.3	3.3	17	63.1
2016	19.4	3.5	15.9	49.3
2019	21.5	3.4	18.2	28.3

Table 4.5 meanwhile offers some key employment statistics. Switzerland's financial sector is mostly located in two globally significant centres, Geneva and Zurich. The data show that Swiss financial jobs have consistently been significantly better paid than manufacturing jobs. There is a clear upward trend in that pay differential between 2002 and 2018, although both the absolute difference and the relative increase over time are not so pronounced as for London and the UK (see Table 3.6). In 2017, the financial services sector provided 5.3% of overall employment in Switzerland. Swiss financial sector jobs are highly concentrated in the two major agglomerations. Of all Swiss finance jobs, 41% were in Zurich, with about one in ten workers in that city employed in the sector. In 2017, Zurich was also creating 45% of the added value of the entire Swiss financial sector, making it the largest centre by some margin, with Geneva a distant second. A smaller and more specialist financial centre also exists in Lugano, in Italian-speaking Switzerland.

[98] NB: All data exclude insurance sector.

Table 4.5: Switzerland, Geneva and Zurich Average Weekly Earnings By Sector
Source: Swiss Federal Statistic Office[99]

Geography	Average Gross Weekly Pay by Sector (SwF)	2002	2006	2010	2018
Switzerland-wide	Manufacturing	-	-	1419	1481
	Financial and Insurance Activities	-	-	2024	2164
	Average additional earnings in finance jobs (%)	-	-	43%	46%
Lake Geneva region only	Manufacturing	1322	1392	1518	1538
	Financial and Insurance Activities	1789	2023	2196	2273
	Average additional earnings in finance jobs (%)	35%	45%	45%	48%
Zurich only	Manufacturing	1414	1426	1492	1583
	Financial and Insurance Activities	1746	1954	2166	2341
	Average additional earnings in finance jobs (%)	23%	37%	45%	48%

Swiss financial jobs are among the most productive in the Swiss economy, but have experienced two sharp declines since standardised data was first publicly reported in 1995: in the early 2000s recession and the post-2008 recession. Despite the first of these shocks, by 2007, financial sector jobs (excluding insurance) had seen the sharpest cumulative increases in both added value and productivity relative to any other sector when indexed to 1995 levels (Swiss Federal Statistical Office 2021). However, the effects of the GFC and Eurozone crisis, together with growth in other sectors, meant that by 2019 the financial sector had been eclipsed by several other sectors, especially mining and quarrying, manufacturing and insurance, all of which grew faster and had become more productive than finance when indexed to 1995 levels. This differentiates Switzerland from the UK, whose financial sector recovered swiftly after the GFC, while productivity in almost all other British industrial sectors has remained lacklustre.

Cumulatively, the value created by the Swiss financial industry makes it the single largest contributor to Swiss state coffers. Using Finma, SNB and Swiss Banking Association data, one economic consultancy estimates that in 2018 the financial sector contributed SwF17.6bn in tax (BAK Economics 2009). This corresponds to around 12% of the entire fiscal revenue of the Swiss Confederation, cantons and communes combined.

4.2.1 The Commercial Landscape: Internationalised Activity and Two-Bank Dominance

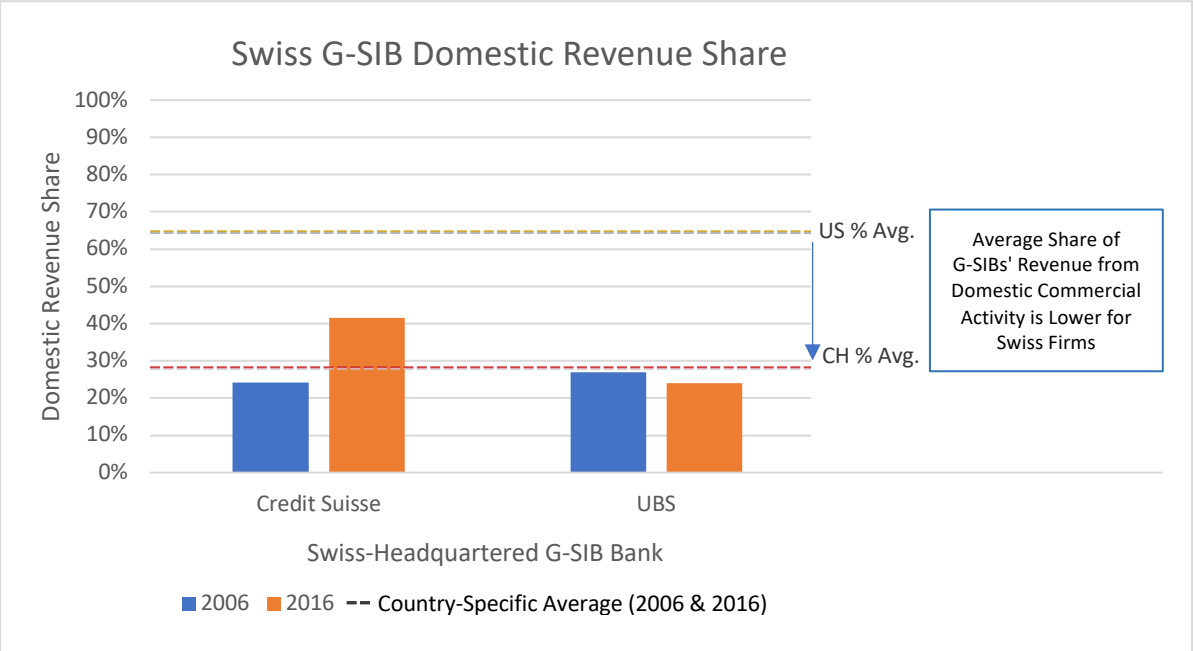
Given the size of Swiss financial sector revenues relative to the national economy, this industry is heavily slanted towards international activity. A high share of overall value is created through international operations, which makes it similar to the UK but different from Australia and the United States. As shown in Table 2.10, just prior to the GFC, the cross-border

[99] Gross monthly wage (median) by economic branch and major regions datasets. Note that classification codes change from “Banking; insurance” to “Financial and insurance activities” for the data from 2010 onwards. Prior to 2010, data are reported by region and not aggregated to the national level.

positions of the Swiss banking sector (regardless of country of bank headquarters) were higher relative to GDP than any other country in this study, standing at 324% of GDP. The overall international activity of Swiss-headquartered banks both in absolute terms and relative to GDP is even more striking. In late 2006, Swiss banks' international positions stood at nearly $3tn, a figure higher than both the UK and the US. These international positions equated to 847% of Swiss GDP.

UBS and Credit Suisse have long dominated both domestic and cross-border Swiss financial sector activity.[100] In 2014, Credit Suisse and UBS together accounted for 43% of Swiss banking sector deposits, while also holding about one-half of the global assets of the Swiss banking system (International Monetary Fund 2014). Given the size of Swiss global financial sector activity, this made for very large balance sheets: at their pre-crisis peak, the combined size of the two banks stood at about 4.6 times Swiss GDP. By 2014, substantial deleveraging had reduced their combined size to 2.3 times GDP, but nonetheless these firms remained by far the largest players both in Swiss-based domestic and international banking. A relatively low share of Credit Suisse and UBS's activity therefore relates to domestic activity, especially compared to banks in a country such as the United States. Figure 4.1 visualises this US-Switzerland difference. It shows that while Credit Suisse in particular has become more domestic in orientation since the GFC, the two major Swiss banks remain far more internationalised than their American peers. However, while similarly internationalised compared to UK banks in 2006, Credit Suisse's consolidation means that Swiss G-SIBs have emerged from the GFC era as less internationalised than their UK equivalents (see Figure 3.1).

Figure 4.1: Share of Swiss Bank Domestic Revenues to Overall Revenues
Source: Bank Annual Reports



[100] Credit Suisse is referred to in the present tense throughout this chapter, as at the time of writing it remains an operational bank.

There are two broad commercial areas in which Credit Suisse and UBS have pursued international market strategies: investment banking and private wealth management. Swiss banks' expansion into investment banking as well as global asset management began in earnest in the 1980s, with the acquisition of several large US and British firms.[101] Assessing global or cross-border market share in investment banking with quality and comparable data is notoriously difficult (Augar 2006). One publicly available metric uses data on mergers and acquisitions and offerings transactions in which investment banks are key participants. UBS and Credit Suisse are among only a handful of non-US firms to consistently feature in these transactions league tables for the largest value deals in the UK and US, being two of the biggest securities markets.[102]

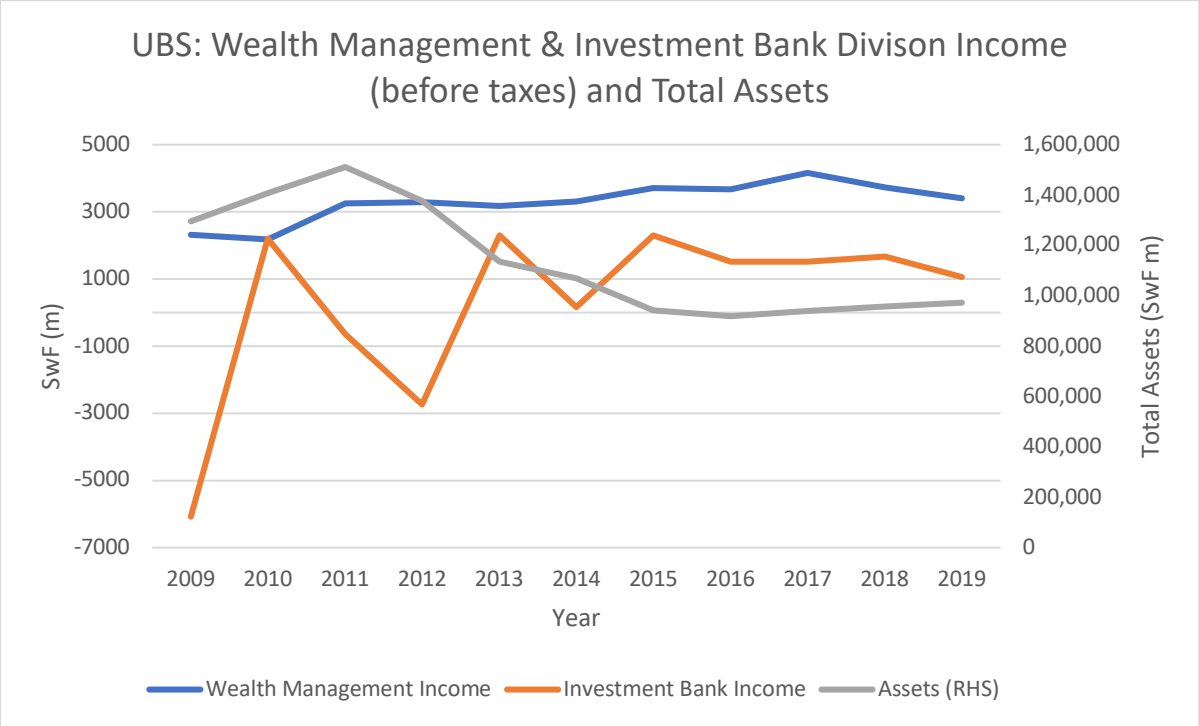
While undoubtedly global players, Swiss banks have had varying fortunes in investment banking, especially since the GFC. UBS suffered enormous losses in its US operations during the GFC. After first shutting down its loss-making US-based hedge fund Dillon Read Capital Management in March 2007, it then haemorrhaged approximately $40bn in the US subprime mortgage crisis, which led to a government bailout and the creation of a "bad bank" by the Swiss National Bank (SNB). Even after the transfer of these assets to the bad bank, investment banking remained a highly variable source of profit for UBS in the post-crisis years. As Figure 4.2 shows, from 2009 UBS's investment bank returned extremely varying profit, with losses registered in 2009, 2011 and 2012.[103] The standard deviation in UBS's investment banking annual profitability is over four times that of wealth management, which in contrast has been a consistent and growing source of profit for the bank since 2008. Equivalent data are not available for Credit Suisse, which avoided a government bailout after raising money from Qatar, but still reported losses of over $7bn in early 2009, mainly in its investment banking division. UBS's total assets are included in the graph (measured on the right-hand axis) for later analysis.

[101] For Credit Suisse, this included acquisitions of the US companies First Boston (1988), Warburg, Pincus & Co. Asset Management (1999) and Donaldson, Lufkin & Jenrette (2000); and of the UK company Buckmaster & Moore (1987). Meanwhile, UBS was created from a merger between the Swiss Bank Corporation and Union Bank of Switzerland in 1988. Before the merger that created UBS, the Swiss Bank Corporation had acquired or merged with the US companies O'Connor & Associates (1992), Brinson Partners (1994), Dillon, Read & Co. (1997) and Paine Webber (2000); as well as the UK company S.G. Warburg & Co. (1995).

[102] The database used was S&P Global's Transactions League Tables. Searches were made of total "Offerings" and "M&A" transactions during 24-month periods in the US and UK from 2004 through 2014. In both types of transaction, either one or both of UBS and Credit Suisse was ranked among the top 20 service providers when measured by deal credit/value in every 24-month period, acting in the spectrum of formal capacities which the League Tables measure (e.g. Financial Advisory; Book Manager; Exchange Agent).

[103] Standardised data of divisional reporting is only publicly available for the years shown at UBS, and is not available for Credit Suisse.

Figure 4.2: Variation in Income By Market Segment at UBS
Source: Bank Annual Reports; Refinitiv Data



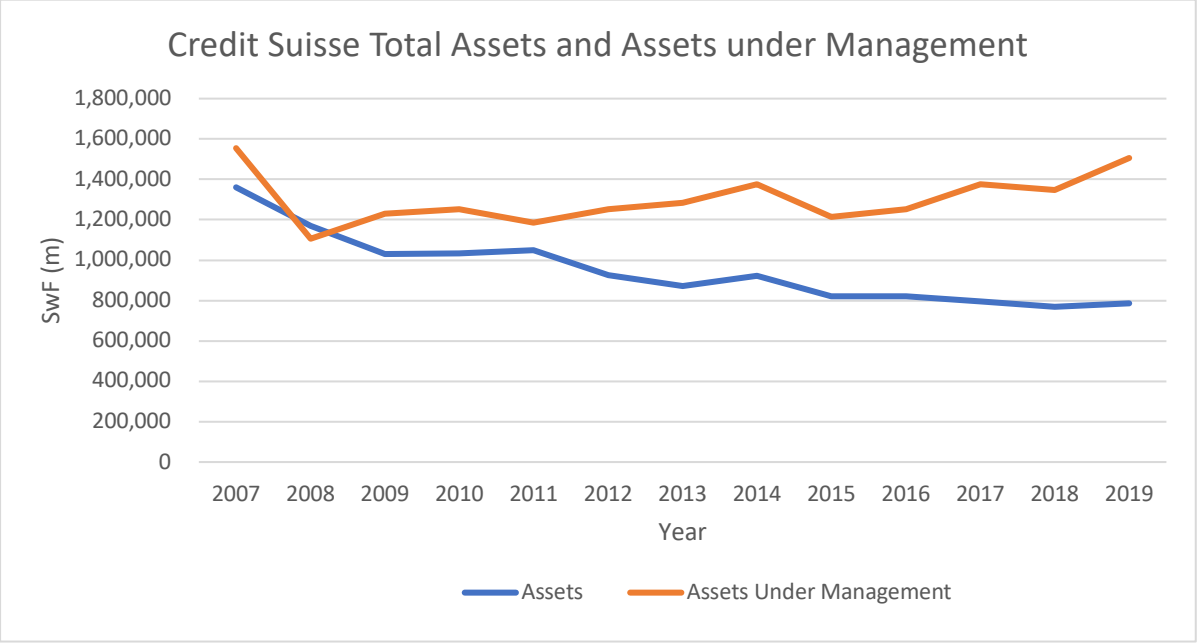
In contrast to their more chequered histories in investment banking, UBS and Credit Suisse have long been preeminent players in global wealth management. As a country, Switzerland is the globally dominant force in private banking, backed by the country's bank secrecy laws and its historic role as a haven for investment. Its position in cross-border wealth management grew from the 1920s onwards. As of 2006, using official data from the SNB, it has been estimated that about half of all global cross-border wealth management (measured as global amount of offshore wealth) was hosted in Switzerland (Alstadsæter, Johannesen, and Zucman 2017). That share declined substantially after the GFC, to about a quarter of overall offshore wealth by 2015, in part due to a crackdown on banking secrecy led by the United States (Emmenegger and Eggenberger 2018). Official statistics show that non-Swiss clients nonetheless still owned about $2.4tn in Swiss banks as of April 2017.

While in aggregate Swiss private banking has declined since the GFC, UBS and Credit Suisse have themselves increased their presence in this market segment. Figure 4.3 shows that despite an over 40% decline in Credit Suisse's total balance sheet between 2007 and 2019, its assets under management – a key indicator of amount of wealth managed – had almost recovered to pre-crisis size over the same period. Data related to this measure are not publicly available for UBS, but as shown in Figure 4.2 above, a notable decline in its balance sheet cooccurred with a sustained increase in wealth management income over a similar period.

Thus while the aggregate global private wealth managed in Swiss bank accounts has declined, the two big Swiss banks have expanded in this area. Unlike smaller firms, they have benefited from the increase in foreign institutional investor funds, which rose by 30% between 2007 and 2016 (Straumann 2018). From early 2020, macroeconomic effects associated with the Covid-19 pandemic also brought significant growth to both UBS and Credit Suisse's wealth

management arms. UBS, having held around $2.5tn in invested assets since 2017, saw an increase in invested assets to $3tn by the end 2020. In the middle of that year, one league table which ranks firms in the wealth management segment by assets and net income put UBS and Credit Suisse as the world's first and second largest wealth managers respectively (Burton 2021). UBS's dominance in global wealth management is likely to increase after the Credit Suisse acquisition.

Figure 4.3: Declining Assets and Rising Assets Under Management at Credit Suisse
Source: Refinitiv Data



4.2.2 Foreign Banks and their Role in the Swiss Banking Sector

Amid this evolution in the market activities of the two big Swiss banks – smaller balance sheets, less profitable investment banking, and increased wealth management activity – foreign banks play a notable but declining role in Swiss financial markets. This, it will be argued, significantly changes the political economy dynamics associated with financial regulation, especially when compared to a country such as the UK. Foreign banks are significant investors in Switzerland, as the data shown in Table 2.10 showed. Figures from the same database also show that investment by foreign banks declined by over a third between 2006 and 2019. The number of foreign-controlled banks in Switzerland also fell by a third between 2007 and 2016, with staff numbers falling to the levels of the late 1990s (Straumann 2018). The number of branches of foreign banks (e.g. large US and European firms) also went down, albeit by smaller amounts. Cumulatively, this has meant that the share of foreign bank assets to total bank assets in Switzerland has declined significantly. As Table 4.6 shows, the ratio of foreign bank assets to total banking sector assets in the Swiss economy has been consistently lower than the UK, US and OECD averages; and by 2013 was the same as that of the highly domestic Australian banking market. Foreign banks have never been as significant in Swiss markets as in UK markets but, since the GFC, the disparity between these countries on this metric has widened. The Swiss banking sector is dominated by the two big Swiss banks.

Table 4.6: Percentage of Foreign Bank Assets to Total Bank Assets in Switzerland and Other Jurisdictions
Source: Bankscope Data; Claessens and van Horen (2014)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013
Australia	-	4	5	4	3	3	2	2	2
Switzerland	4	4	5	5	6	6	5	2	2
United Kingdom	12	12	13	19	15	15	15	15	14
United States	21	21	22	18	19	16	14	14	10
OECD Average	11	11	12	12	12	11	11	10	9

High financial sector internationalisation and the limited role for foreign banks combine with a third variable – high domestic market concentration – to make for a banking sector in which Credit Suisse and UBS occupy uniquely important roles in the Swiss economy. While the asset share of these two banks in the overall banking sector decreased from about two-thirds to one-half between 2007 and 2018, the Swiss banking system nonetheless remains highly concentrated. In 2018, Credit Suisse and UBS together provided 33% of loans, 27% of mortgages and 33% of consumer deposits. The balance sheets of these two firms have contracted, but remain enormous relative to the size of the Swiss economy: having peaked at 400% of Swiss GDP in 2008, they were nonetheless still 250% of GDP by 2018 (International Monetary Fund 2019). This does not include off-balance sheet items managed by banks, which include the assets held by global wealth management divisions. While firm-specific data is not available, these were reported to be CHF 6.6 trillion (about 950 percent of GDP) by 2018.

In terms of employment, Credit Suisse and UBS employed 50% of all banking system staff in 2007, but this figure had dropped to 35% by 2018. This corresponds with the observed decline in their balance sheets over this period. Nonetheless, taking the various data together, Credit Suisse and UBS continue to occupy focal positions in the Swiss national economy. Given the secular decline in Swiss private banking, these two firms are today even more instrumental to value creation in Switzerland's internationalised financial sector.[104]

4.2.3 The Swiss Financial Centre in Context

As in the UK, a highly internationalised financial sector remains the powerhouse of the Swiss economy. The data presented in the foregoing pages show, however, that the sector's position in the Swiss political economy differs on the key variable of bank exit options. This offers a distinction which can be leveraged in theory testing, for this variation in structural power should be observable in policy outcomes.

[104] This analysis does not take account of the Swiss insurance sector, which is also a significant component of the Swiss financial sector. Official statistics show that an increasing share of financial sector exports related to insurance services, at least prior to the Covid-19 pandemic. Between 2011 and 2016, financial services exports decreased from SwF21.4bn to 19.4bn, while insurance services exports increased from SwF5.4bn to 7.7bn (Swiss Federal Department of Finance 2023).

One on hand, the UK and Switzerland share the common feature of possessing large financial sectors which both create a high share of total value through activity that occurs outside of the national or "home" jurisdiction. The exit options of key value-adding firms in the Swiss economy are weaker than they are for big banks in the UK. Whereas the UK is one of the world's most significant host regulators of foreign banks, the Swiss financial sector is instead dominated by its two G-SIB firms, with the role of foreign banks insignificant and progressively less important since the GFC. Moreover, while the UK's largest firms have long struggled to compete in the City of London's key area of competitive advantage – investment and wholesale banking – in the crucial Swiss market segment of wealth management, UBS and Credit Suisse have been indisputable global leaders.

The competitive advantages of these two financial centres also differ substantially. London has long vied with New York as the world's centre for global investment banking, which has traditionally created a dynamic of regulatory competition between the UK and the US (Helleiner 1994). Switzerland, in contrast, has never vied to become a globally significant centre for investment banking, and has focused instead on its long-standing competitive advantage in cross-border private banking. While wealth management can hardly be immune to the dynamics of regulatory competition, factors inherent to the industry make it less prone to such dynamics compared to investment banking. For example, the commercial efficacy of investment banking is highly dependent on policymaker decisions about the regulatory treatment of complex and innovative financial products, which necessitates ongoing agility by regulators (J. Black 2012; see also Armour et al. 2016 Part D, Part E). Wealth management is both less transactional and less innovative, instead being generally characterised by long-term client relationships and traditional commercial banking. To this extent, it is less amenable to regulatory competition than investment banking.

These broad characterisations are borne out in interviews conducted for the research. Investment banks in the UK regularly threaten to relocate activity in response to stringent regulation after the GFC; while far less evidence was found of banks focused on wealth management in Switzerland making equivalent threats. Aside from the focus on investment banking reform after the GFC, there is good reason to think that the absence of such threats at least in part relates to core differences in these types of financial service. Long-standing institutional arrangements, including tax and legal regimes, have led Switzerland to occupy a central position in the global wealth chain (Garcia-Bernardo et al. 2017). Economists have consistently found that 90%+ of wealth held by non-Swiss citizens in Switzerland is non-disclosed, with offshore wealth typically structured in a way that seeks to disconnect assets from beneficial ownership (Alstadsæter, Johannesen, and Zucman 2017, 15). It is unlikely that these complex wealth-holding structures could easily be made to bypass Switzerland. In consequence, it can be concluded that wealth management is less amenable to the logics of 'footloose capital' and regulatory arbitrage often attributed to the transactional culture of investment banking (Augar 2006).

While wealth management is a line of business in which Swiss banks dominate, on the other hand, Credit Suisse and UBS, as the two systemic firms of the Swiss banking system, already conduct the bulk of their trading activities in London and New York. A substantial share of the value they create in these activities is distributed among employees who are resident in the UK and US, including via bonus payments, and are as such not channelled back to Swiss-

headquartered parent companies.[105] The remaining activities they conduct in Switzerland – mainly retail and commercial banking and wealth management – are less amenable to relocation than are the key activities adding value in the UK economy. Switzerland is to this extent not akin to Wall Street or the City of London as a financial centre. The Swiss Open in Gstaad does not have the same global status as Wimbledon. It is a significant tournament in the tennis calendar, but not one on which Swiss champion Roger Federer's global reputation is based.

This section has identified that Switzerland remains an economy highly dependent on the economic value created by its global banks in their cross-border commercial activity. Swiss and UK dependency on finance is similar on this variable. Just as investment banking is a substantial source of revenue for global banks operating in the UK, in Switzerland cross-border wealth management conducted by Credit Suisse and UBS has continued to bring considerable added value to Switzerland. Swiss and British dependencies on finance differ due to the strength of exit option available to firms, which is lower in Switzerland than in the UK. Both political economies are asymmetrically dependent on large global banks, but for Switzerland the predominant driver of that dependency is more singularly the added value the state derives from being home to two globally active banks. For the UK, financial sector internationalisation is sustained by a more heterogenous group of global firms which also possess strong exit options from the domestic economy.

4.3 Instrumental Bank Power in Switzerland: Tight Elite Networks Meet Direct Democracy

The theory chapter identified existing scholarship which has found that some political economies, including many European countries such as France and the Netherlands, possess institutions which incentivise tight cooperation between policy and industry elites, leading to policy outcomes which sustain industry interests even after a major crisis. In the broader comparative capitalisms literature, Switzerland is one of the paradigmatic cases of neo-corporatist cooperation where such proximate elite networks would be expected to similarly persist even as democratic demands for reform increase.

The research process, however, yielded evidence of why such cooperative behaviour among Swiss elites fails to limit the exertion of democratic demands on policymaking. The institutionalised device of the popular initiative, which can lead to a referendum, affects how

[105] Banks do not publicly reveal the performance of each market segment (e.g. retail vs. investment banking) in a way that would identify various fixed costs and staff remuneration. However, it can be assumed that a country derives more added value from financial activities occurring in the home jurisdiction, in particular through a combination of receipts from employee, corporate and consumption-based (e.g. Value-Added) taxes, compared to activities that take abroad. Employment and value-added tax receipts are mostly accrued to the treasury of the country in which the activity has taken place, rather than being channeled back to the home jurisdiction where it would add value through corporation taxes and shareholder dividends. Limited country-by-country data reporting is available for banks' activities in the EU. In 2014, for example, Credit Suisse disclosed having close to 6,000 employees in the United Kingdom, nearly 5,000 of whom were employed in the investment bank (Credit Suisse Securities [Europe] Limited) (Credit Suisse 2014). Credit Suisse's various UK operations were also reported to have by far the highest turnover of any EU country, totally $2.9bn. The data on UK financial sector taxation cited in Chapter 3 similarly shows that employment taxes are the dominant source of UK treasury receipts from foreign banks.

policymakers interact with business in high salience environments. A referendum occurring, but also its ready availability to voters as an option, can work to disrupt the tight cooperative elite networks that characterise Swiss policymaking at a low salience equilibrium. The popular initiative is thus an institutionalised device through which voter interests take shape and influence policymaking. It can lead to policymakers taking on those demands despite the coexistence of institutions in the political economy which, under a low salience equilibrium, incentivise a cooperative relationship with industry.

As the following sections show, referendums are not held on every issue that becomes salient in Switzerland; not least because for one to be held via a popular initiative requires 100,000 signatures. Most of the time, it remains the job of Swiss politicians to initiate and pursue a reform agenda. Voters, for whom a popular initiative remains a plausible alternative avenue to reform, assess the extent to which policymaker proposals align with their preferences. Policymakers will incorporate voter preferences more when public demands are higher, for the referendum device remains an implicit threat that their own proposals can be challenged by voters if they fail to do so. While policymakers can seek to influence the outcome of a popular initiative, it is often in their interests for it to remain an issue for representative democracy because this allows them to maintain greater control over the policy process.

Swiss business, too, will tend to prefer that regulatory issues do not get taken up in a popular initiative. Whether a referendum eventually succeeds or not, the process will generally create uncertainty for business, and often lead to politicians competing to develop counter-proposals that take on aspects of the popular initiative. A popular initiative can also put considerable costs on business, for example through the public campaigning required if a referendum does occur. As Culpepper (2011) has shown, business generally prefers policymaking to remain in the world of “quiet” politics.

The referendum threat affects how policymakers and business elites coordinate, even if they continue to participate in the same tight elite networks that characterise low salience environments and usually produce cooperative behaviour and outcomes favourable to big business (Katzenstein 1985). If a high salience environment makes a popular initiative a plausible outcome, policymakers will opt to design reforms that go against big business interests. As a result they become more responsive to democratic rather than industry demands. While industry is likely to face higher costs given these incentives, firms typically engage proactively with policymakers in the design of a policy response, rather than taking an adversarial stance. The referendum threat similarly makes business wary of the possible alternatives to the democratic reform process led by politicians. This approach differentiates Swiss elite behaviour from the more adversarial modes of interaction seen in UK and US policymaking under equivalent high salience (Ganderson 2020a; James 2018). As the analysis of reforms below shows, outcomes from policymaking in high salience environments are nonetheless sometimes remarkably similar in the UK and Switzerland. Indeed, as Chapter 2 set out, an animating puzzle of this study has been to understand what led several democracies to reach some similar policy outcomes despite possessing very different institutions of political economy (cf. Hall and Soskice 2001; Zysman 1983).

Overall, Swiss direct democracy – whether it is activated via a popular initiative or remains an implicit threat – widens the channel through which democratic demands influence the reform

agenda on high salience issues. It prizes open the tight networks of cooperative policymaking that characterise low salience environments in Switzerland, and which precluded democratic reform processes in other countries such as France and the Netherlands. As the cases of specific reforms that follow reveal, the challenge for Swiss policymakers during post-GFC reform has been to design a set of policies which delivers a sufficient response to democratic demands. In the case of structural reform, the referendum remained an implicit threat, while on the executive pay issue two referendums ultimately took place on what became a hotly contested policy issue. In both instances, the availability of the referendum pushed policymakers to undertake reforms more against business, and more aligned to democratic demands, than might be expected given the otherwise cooperative elite behaviour that characterises Swiss regulatory governance.

4.4 Rules of the Game in Swiss Policymaking: Small State Reforms of a Global Industry

Table 2.8 identified that national policymaking institutions were the primary forum in which Switzerland achieved many of its post-GFC reforms. This contrasts Switzerland with the UK, which during the period under study was a member of the European Union, meaning that EU policymaking often took precedence over domestic policymaking. Swiss policymaking is in this respect more like the United States, where national policymaking similarly predominates. The primacy of domestic policymaking in Switzerland means that policymakers responded to a spectrum of reforms, encompassing both low and high salience issues.

Given the prevalence of national policymaking, it is often the default expectation that Swiss policymakers will respond to high salience issues unilaterally, rather than defer to a multilateral body. The especially high salience issues in Switzerland after the GFC were structural reform and executive pay. It is here that the theory would predict there to be significant dependency constraints to a democratic response. The national policymaking on these issues therefore presents especially fertile grounds for theory testing.

On the other hand, some regulatory issues that national policymakers consider will be less salient to the public, and in turn the democratic pressures they experience are expected to be weaker. On such issues, the prediction is that policymakers will face few incentives to pass reforms which would conflict with the commercial interests of large banks, given the symbiotic relationship with business that characterises Swiss policymaking. Instead, on these low salience issues, there will be strong incentives for Swiss policymakers to broadly align outcomes with the rules and standards decided in multilateral institutions, such as the BCBS and the FSB. Switzerland, like the UK, has considerable influence in these multilateral bodies. This scenario is expected to apply to the regulation of markets in financial instruments (MFIs). This was an issue that attracted far less public attention after the GFC, and where a multilateral regime was developed by the FSB, among other actors.

Finally, a more tentative conclusion can be reached on the interaction of multi-level institutions and salience on the issue of capital standards. This is in part due to the ambiguity about the issue salience of this reform in Switzerland. Capital is a highly technical area of public policy that is mostly the preserve of regulators and on which there is a mature international regime. It was also an issue which parties on the left actively supported. As the discussion below shows, Switzerland took early unilateral steps to bolster capital

requirements, but was also a leading country in multilateral reform in this area. Given uncertainty about its issue salience, it is more difficult to use Swiss capital reform as a case with which to test the theory. It nonetheless demonstrates some of the tensions faced when a small country undertakes to reform global banks, including how policymakers balance between adopting unilateral versus incorporating multilateral standards. Swiss capital reforms can also usefully show how alternative explanations, particularly from the bureaucratic literature, may help explain outcomes in this more technical area of regulation.

4.5 Banks and Banking Reform in the Swiss Public Eye

Public opinion data about financial regulation in Switzerland is limited. Characterisation of Swiss public demands for reform herein mostly relies on collating judgements made by policymakers and other interview participants. These insights were triangulated through a review of the news coverage of specific reforms from the period. There are also some useful data points about overall Swiss attitudes towards banking. These reveal that while attitudes towards banks became far more negative after the GFC, Swiss people are certainly not "anti-finance" or "pro-regulation" in general.

Figure 4.4 and Figure *4.5* show data from annual surveys investigating Swiss attitudes towards banking. Figure 4.4 shows individual attitudes to banking over time. It shows that between 2008-2009 – the year in which the UBS bailout occurred – there was a 22% drop in the share of respondents with positive and very positive attitudes towards banks.[106] There was also a 45% increase in the share of people with negative and very negative attitudes towards banks. This general trend is replicated in Figure 4.5, which shows perceived opinion about Swiss people's attitudes towards banks, arguably an even more important measure of the political climate after 2008.[107] On this measure there was a 45% drop in positive and very positive perceived attitudes towards banks, and a 147% increase in negative and very negative perceived attitudes towards banks. Measures of personal and perceived attitudes towards banks stayed deflated and relatively constant on both measures until the 2015 annual surveys, but never recovered to pre-crisis levels.

[106] The question asked was: "How would you describe your attitude towards Swiss banks in general?"
[107] The question asked was: "How do you think most Swiss people feel about the banks?"

Figure 4.4: Swiss Individual Attitudes About Banking[108]
Source: Swiss Bankers Association and M.I.S. Trend (2017), N=c.1,000 each survey

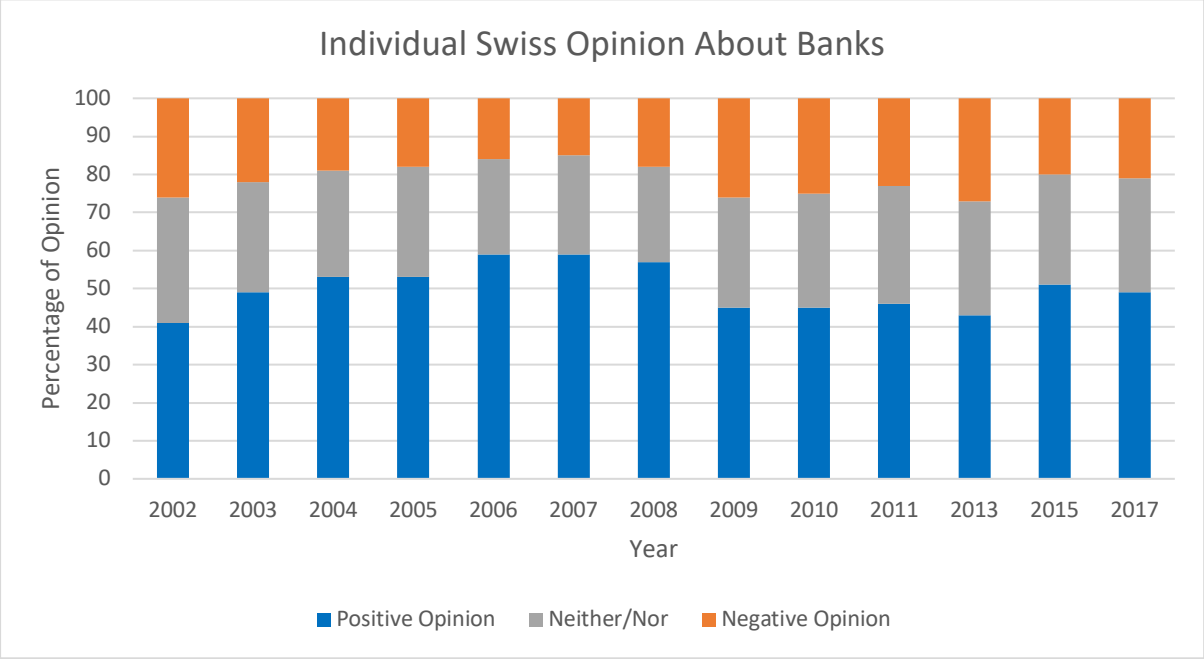
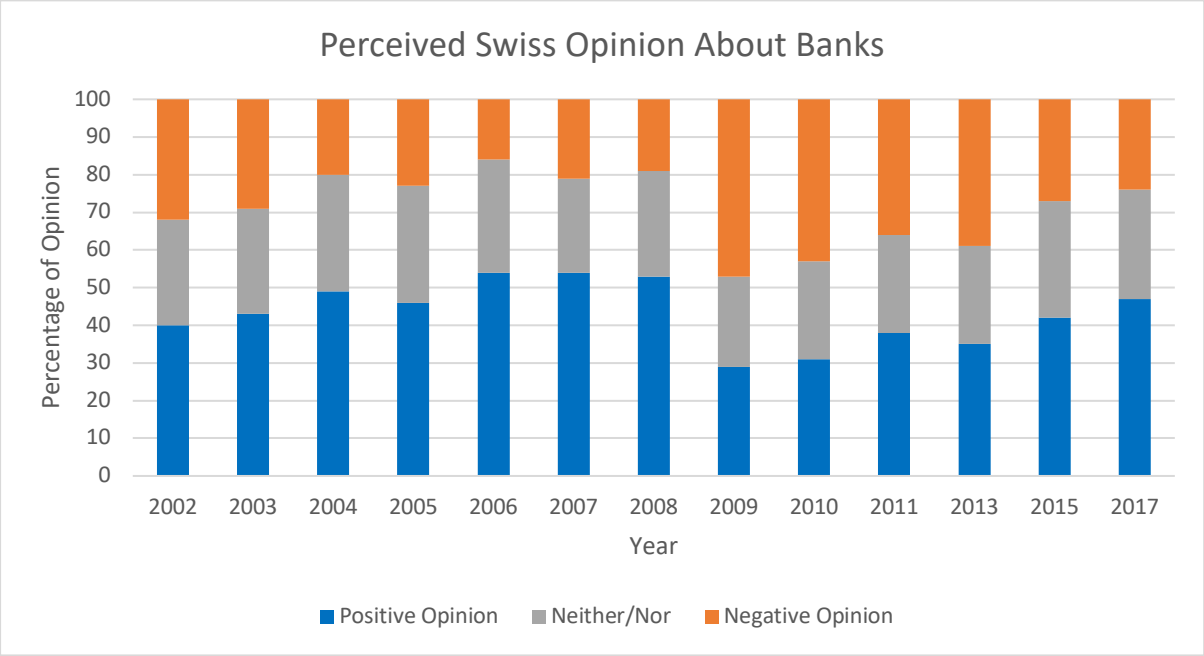


Figure 4.5: Swiss Perceived Attitudes About Banking
Source: Swiss Bankers Association and M.I.S. Trend (2017), N=c.1,000 each survey



More negative attitudes towards banks in the period after the GFC do not mean that Swiss people were or are especially in favour of higher financial regulation. In fact, the available data suggests that Swiss people are favourable towards a type of regulation that is arguably a defining feature of the Swiss financial sector: bank privacy or "secrecy" laws. During the

[108] Neither/nor combines responses of "neither/nor" and "I don't know", with the latter rarely being the response of more than 2 or 3 percent of people surveyed.

GFC, changes to bank secrecy animated a lot of debate in Swiss politics (Emmenegger 2015; Emmenegger and Eggenberger 2018). In 2009, after a long-standing conflict with the US government, the Swiss government agreed that 4,450 client files relating to US nationals with bank accounts in Switzerland would be shared with the US Internal Revenue Service. As part of the deal, UBS also paid a $780m fine and admitted to helping US clients evade taxation.

Overall, despite what might be assumed to constitute negative coverage of bank secrecy and offshore wealth, the Swiss people are shown to be consistently supportive of the overall tenets of bank secrecy. In 2009, among the same panel as that surveyed in Figure 4.4, 78% wanted to keep bank secrecy laws (M.I.S. Trend and Swiss Bankers Association 2017). The most cited response for those favourable to bank secrecy was that it protects one's financial privacy. Meanwhile, those with neutral or critical attitudes were most likely to state that they believed it to be a way of concealing wealth from Swiss/domestic (i.e. not foreign) tax authorities. In 2009, a Gallup poll found similar attitudes: 56% wanted to "fiercely defend" bank secrecy, but around the same number also wanted to help foreign authorities pursue their nationals with Swiss accounts suspected of tax evasion (Reuters Staff 2009a). In terms of political support, the SVP, which has been the most successful Swiss party in recent decades, has supported policies and pushed for a referendum seeking to give banking secrecy constitutional status. The Swiss appear generally supportive of bank secrecy, which is often cited as a key reason why the country's financial sector became a global centre for private wealth management (Straumann 2018).

More recently, through a number of survey experiments conducted in 2020, Culpepper, Jung and Lee (2023) found that the Swiss are more trusting of and warm towards big banks than respondents from Australia, France, Germany, the UK and US. Among these countries, Swiss people were also the only group whose regulatory preferences did not increase (to the level of statistical significance) after they were primed with media treatments about big banks being involved in high-profile corporate governance scandals. While these surveys were conducted over a decade after the GFC – and the catalysing event of the UBS bailout – these data do overall suggest that Swiss people are generally less inclined to support regulatory incursions by the state than, for example, British voters and at least Democrat voters in the US.

Culpepper, Jung and Lee suggest that the low preferences among Swiss people for higher financial regulation could relate to the dominant role of big banks in the Swiss economy and politics. While this may be true, it is also clear that after the events of 2008, there was a climate of high public anger directed at banks. The following sections show that on some policy issues, policymakers were responsive to strong democratic demands that existed in favour of banking reform. Absent surveys on attitudes toward specific policy reforms, in interviews and secondary research the two components of the reform agenda where the democratic pressures experienced by policymakers appeared particularly pronounced were global banks' international risk exposures and their executive pay practices.

An anecdotal but revealing insight into how Swiss attitudes manifested on these policy issues relates to the campaigning of the most famous Swiss policy entrepreneur on the banking reform issue, Thomas Minder. Minder, whose highly successful "Against Rip-Off" initiative is discussed at length in Section 4.6.4, fought and eventually won a long campaign to reform

executive pay policies. One of Minder's most widely publicised stunts from this time took place at UBS's 2008 Annual General Meeting, when he stormed the podium to deliver its beleaguered CEO a copy of the Swiss Code of Obligations. Minder's demands encapsulated the anger of many Swiss people at the time: "What happened here is a scandal … You're responsible for the biggest loss in the history of the Swiss economy. Put an end to the Americanisation of the Swiss economy!" (N. D. Schwartz 2008). The perceived "Americanisation" of Swiss finance, especially associated with the transactional, risk-prone culture of investment banking, was seen to have caused UBS's financial woes. As the next section shows, these demands manifested in the most notable unilateral reform passed in Switzerland after the crisis: the structural reform of Switzerland's global banks. Eventually, the outcome saw policymakers mandate a divide between UBS and Credit Suisse's Swiss and non-Swiss-related balance sheets.

4.6 Four Cases of Swiss Post-Crisis Reform: Policymaking under Asymmetric Dependency

4.6.1 Structural Reform: The "Ex-Ante" Separation of Swiss Global Banks

Table 4.7: Overview of Possible Swiss Structural Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Breaking up big banks	Quantitative limits on bank size	*No limits on bank size*
Glass-Steagall-type separation	Separation of commercial and investment banking	*No separation of activities*
Balance sheet ringfencing	Ringfencing of balance sheets	*No ringfencing of balance sheets*
"Narrow" or "limited purpose" banking	Narrow banking	*No narrow banking*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

This section explains the process by which Switzerland achieved bank structural reform in the years after the GFC. It begins by examining the role of the country's expert commission, which reported its findings in 2010, and which unequivocally rejected structural reform measures. The section then turns to post-2010 developments, in which these findings were effectively

overturned, and a version of structural reform very similar to the UK was eventually achieved. While big Swiss banks were nominally given latitude to design their own version of structural reform, this section shows that their agency was in fact negligible. Banks were never explicitly directed to implement structural reform by policymakers, but it was made all but impossible for them not to do so. The key question to address is what factors led their options to close down so significantly, in seeming contradiction to Switzerland's "subsidiarity principle" which generally gives industry agency to structure itself according to its own commercial preferences.

The Swiss policy debate on structural reform began in the heat of the crisis, and was initiated by the Swiss Parliament even before the bailouts.[109] The motion submitted by the Swiss People's Party (SVP) that instigated the Swiss Commission of Experts explicitly pointed to the possible use of structural measures as a way to reduce Switzerland's global market exposures. It stated that commissioners should examine:

> …possibilities for how risks to the economy can be reduced by structuring the banks (and possibly insurance companies) by organisational area (subsidiaries in a group to prevent chain reactions across different activities) as well as by the structure of risk in business (diversification of business activities by country or industry). The aim must be that, in the event of a total failure of a large Swiss company, Switzerland does not have to bear any risks that cause such enormous damage to the economy that the state has to intervene and cannot bear those risks.
>
> (Swiss National Council 2008)[110]

This motion originated in Parliament, and shows some well-developed ideas from the SVP about what type of structural reform might be necessary to resolve the Swiss TBTF problem. Authority to recommend outcomes was however delegated to an expert commission. Howarth and James hypothesise that bank structural reform will be less politicised when policymakers deploy venue shifting to a non-majoritarian institution like an expert commission (2023, 20). In the context of "cooperative financial power" – where, as in Switzerland, business usually builds a united stance on regulatory issues – their model (Table 2.3) predicts that the outcome will produce no reform.

Howarth and James' comparative financial power model predicts the dynamics that played out during the venue shift quite well. While the Commission of Experts recommended a number of measures – highlighting, as is discussed in Section 4.6.2, the importance of raising capital requirements – it rejected structural reform measures. The group assessed an array of structural options, including direct quantitative restrictions on the size of banks, dismantling large banks, "narrow" banking, proprietary trading bans, and a holding structure with subsidiaries in each country of operation. The commissioners identified various inadequacies in each. On the proposal to reduce the size of firms, for example, their view was that such

[109] Structural reform gained broad traction as an issue early on in Switzerland. As early as April 2008, UBS's former CEO (and significant investor) Luqman Arnold recommended that UBS separate the investment bank he considered risky from the wealth management division that he saw as core to the franchise (Slater 2008).

[110] Unless stated, all primary (e.g. interview) and secondary (e.g. official documents) sources are translated from the original German by a research assistant, with the exception of the Swiss Commission of Experts reports which are available online in English in an official translation.

steps would not deal effectively with the TBTF issue, notably because it would most likely bring about a greater number of smaller, but potentially riskier, firms. A holding company structure, which is sometimes referred to in the regulatory community as "geographic ringfencing" – and bears close similarities to the outcome later achieved – was rejected by the commission because of the legal difficulties that they perceived might arise if a parent company were to allow a subsidiary to collapse.[111] They also repeatedly stressed that size restrictions – which they referred to as "breaking up the large banks" – would "largely eliminate the economies of scale enjoyed by banking groups with global operations" and "rule out … exploitation of the benefits of national and international diversification" (Swiss Commission of Experts 2010, 46, 114). This is the prototypical defence of universal banking that won the day in many ACDs after 2008 (Hardie 2016; Massoc 2020).

Had the Swiss Commission's findings drawn a line under the structural reform debate, then it would have shown Swiss policymakers opting for a reform broadly in line with the preferences of the big Swiss banks. With senior UBS and Credit Suisse executives having formal seats as commissioners, it would have been a clear case of the "conflict contraction" that Howarth and James (2023) predict will allow business to avoid costly reform. However, the commission was just the beginning of a protracted and far more conflict-ridden policy process. Specifically, the alternative option to structural reform recommended by the Swiss Commission soon became the object of intense political debate, revolving around a specific recommendation it had made. Rather than structural reforms, the commissioners instead referred to "organisational measures" which they deemed necessary to deal with Switzerland's TBTF problem. UBS and Credit Suisse, they concluded, are systemically important because they "provide services which are essential to the functioning of the Swiss economy and [which] could not be substituted within a reasonable period of time in the event of insolvency". They noted domestic lending, retail consumer deposits, and payment systems as key examples of services that had to be guaranteed in an emergency so that "the state [will] no longer be forced to save the company as a whole simply to ensure the continuation of these functions". An "emergency plan" was necessary to ensure "the transfer of these functions to an independent and new corporate entity ("bridge bank") endowed with sufficient capital funds" (Swiss Commission of Experts 2010, 36–39).

Policy debate continued to be animated by the question of whether the Swiss economy could withstand a major financial shock given the risks of housing two global banks. In line with the cooperative foundations of Swiss policymaking, however, it would nominally remain up to banks to decide *how* systemically important functions would be protected from market risk. The commission had argued that it was not for the state to decide what policy measures were necessary bar "in exceptional cases", because "this often entails substantial interference in the institution's economic freedom and guarantee of ownership" (Swiss Commission of

[111] The Commission of Experts point out both Swiss legal and geopolitical issues with such a holding company structure. Swiss law, they explain, entails "enforced solidarity" between firms, meaning that no company within the group structure can simply be left to collapse without associated entities experiencing some liability. The Commission also refers to "political pressure from foreign authorities" which could create "*de facto* enforcement of solidarity" (Swiss Commission of Experts 2010, 118). That is to say, even if Swiss law were amended, the experts saw it as "likely" that policymakers from other countries would exert pressure on Swiss policymakers to step in and save an ailing subsidiary (2010, 46).

Experts 2010, 77).[112] With the Swiss Federal Council swiftly approving the expert recommendations, and Parliament approving its draft bill, the Banking Act based on this essentially liberal market philosophy entered force in March 2012 (Bundesgesetz über die Banken und Sparkassen 2011).[113]

The freedom granted to banks to design a viable emergency plan, and thus avoid structural reform, was soon ceded by them. Ultimately, Swiss structural reform came to look much more like the UK's ringfencing plan than it did France and Germany's limited reforms which essentially protected their global banks (Hardie and Macartney 2016). Conflict *expansion* after the Commission of Experts renders problematic the argument of Howarth and James that such venue-shifts precipitate conflict *contraction*. What is less immediately clear, however, is what motivated this policy about-turn. On the one hand, an argument made by James and Quaglia (2020) is that after a crisis bureaucrats will seek to close "cross-border externalities" in order to avoid further political censure. Alternatively, the theory of democracy under constraint tested in this dissertation looks to political actors motivated by high democratic pressure as the fulcrum of reform challenging to business interests. One of the challenges of parsing these competing explanations is that the Swiss subsidiarity principle is both culturally and legally engrained, which usually frustrates the search for "smoking gun" evidence that is more easily found in US and British regulatory reform. Close attention must be paid to both political and bureaucratic activity in the years after the expert commission to understand from where the momentum for structural reform originated.

On the bureaucratic side of the argument, the financial regulator Finma was given responsibility for assessing the credibility of emergency plans submitted by Credit Suisse and UBS (Swiss Federal Council 2020, Chapter 7). Per the subsidiarity principle, over the course of 2012-13, it was the task of Credit Suisse and UBS to consider various changes in bank structure that would create a viable emergency plan. They did so in close consultation with regulators. In interview, representatives from both industry and Finma explained that a high bar was set for demonstrating credibility.[114] Ultimately, it was found that the organisational measure identified by the expert commission, which involved the creation of a "bridge bank" into which systemically important functions would be transferred in an emergency, was unviable. Among policy actors, that plan became known as "ex-post separation", because it would only occur in the event of bankruptcy or resolution.

While the big banks had nominal responsibility for designing this emergency plan, in reality it was Finma who decided whether it was a sound one. One former UBS official stated in interview: "We analysed [ex-post separation] in detail and simply came to the conclusion that if we were to build a plan on this basis, then it is very likely that it would not be credible [to Finma]".[115] They further noted that as the bank developed its emergency plan, Finma never

[112] A similar point was made by a representative of the Commission of Experts, who noted that during deliberations commissioners were "very sceptical" about "intervening directly in the sphere of responsibility of a private enterprise". This he identified as "a basic liberal conviction" among commissioners about "arbitrary state intervention". Interview #CH7, representative of the 2010 Swiss Commission of Experts, 5 February 2021.
[113] This was accompanied by revisions to Swiss Banking Ordinance, which contains more practical guidelines for firms.
[114] Interview #CH2, UBS executive, 12 February 2021; #CH3 with two Finma officials, 2 March 2021; #CH4 with Credit Suisse executive, 15 March 2021.
[115] Interview #CH2, UBS executive, 12 February 2021.

gave "crystal-clear signals" via written or verbal instructions, but instead "verbal signals" about what type of emergency plan it preferred. They would say: "okay, in this and that direction, this seems to be plausible". Two different Finma officials also stated that the agency exerted some pressure to opt for so-called "ex-ante" separation.[116] This involved banks creating new entities in which the systemically important activities would take place. In interview, these Finma officials further stated that they would not have approved an emergency plan that did not require ex-ante separation.

As a result, the outcome of nearly two years of negotiation between Finma and the big banks was a version of structural reform that had been unequivocally rejected by the earlier expert commission. By the end of 2013, UBS established UBS Switzerland AG, which would undertake financial services on behalf of Swiss customers only and be the entity in which systemically important activities took place. A holding company – UBS Group AG – was established as the ultimate parent of all UBS companies, both in Switzerland and other jurisdictions. Credit Suisse soon achieved a similar plan of ex-ante separation.[117] Nonetheless, even after both banks repeatedly submitted their emergency plans based on ex-ante separation, it was not until 2019 that Finma confirmed that Credit Suisse and UBS's emergency plans were effective (Swiss Financial Market Supervisory Authority (Finma) 2016, 2019). This evidences just how high a bar was set by the regulator.

The new structure of Credit Suisse and UBS differs in the detail, but has many similarities with the UK's chosen structural reform of ringfencing, which was sharply opposed by the big British banks.[118] Both the bailed out Swiss bank and the firm that had stayed in private hands thus failed to prevent major incursions into their established business models, despite their proximal access to policy elites throughout the reform process.[119] One UBS official interviewed identified that over 2,500 employees were involved in the "monster project" of structural reform, which reportedly involved the biggest ever asset transfer in Swiss history. This was a sequence of policymaking orthogonal to the interests of the big Swiss banks, including years of more limited concessions to avoid major structural reform.

This evidence shows that Finma was without doubt an important player pushing for Swiss structural reform. Yet bureaucratic explanations cannot account for what led to a collapse in the usually cooperative, business-friendly elite networks underpinning Swiss regulatory governance. Indeed, senior Swiss regulators had sat on the expert commission which earlier

[116] Interview #CH3, two Finma officials, 2 March 2021

[117] In the publicly available asset transfer agreement, Credit Suisse noted that Swiss TBTF rules "require systemically important banks to design an emergency plan. With the transfer of the [systemically important functions] to and the continuation of [their] operation … substantial parts of the Swiss emergency plan of the group are implemented ex ante". The corporate document is quoted in and translated by Oppolzer (2019, 277).

[118] In interview, Prof. Sir John Vickers identified the similarities of the UK and Swiss reform processes, stating: "it was probably the UK and Switzerland which had … very large universal banks with global balance sheets, and yet total dependence of the domestic economy on those institutions … And in the Swiss case, you had two very big banks like that; and that was the other country that had a banking commission. A totally different modus operandi and a different kind of outcome from ours, but they were, I think, if anything ahead of us". Interview with Sir John Vickers, 8 November 2021.

[119] In particular, Credit Suisse (the global bank that had not been bailed out) had pushed heavily for the "bridge-bank" concept (Credit Suisse, Too Big to Fail - Explained in a Few Steps 2010).

rejected this type of reform outright. Their newfound support was certainly not preordained.[120]

A model of financial regulation that puts democratic demands as the fulcrum of change better predicts what led to the change in typical elite policymaking behaviour. Indeed, interviews yielded evidence providing a rather different interpretation of Swiss elite behaviour during the TBTF expert commission. One official from the Swiss Department of Economic Affairs explained of this institution:

> But this expert commission is something very special … you knew you had a very difficult problem where you had to change a lot … And the sector knows something has to change, that it is under pressure … And the banks were afraid that even more extreme measures would be taken in the direction of separating banking systems. And that's why the banks … were thrilled to be part of it.[121]

As this insight shows, the integral position of Credit Suisse and UBS in the expert-led process did not mean the banks had successfully "captured" the politicians who had mandated it, but rather that they were the chief targets of reform. Trade associations – which are traditionally key actors fostering cooperation between actors (Hall and Soskice 2001) – had in contrast a very limited role in this policy process. This expert commission was more specifically the opportunity for the big firms to cooperate with policymakers to design a reform that would be "referendum-proof" (cf. Kriesi and Trechsel 2008).[122] One public official involved further explained: "The threat of a referendum plays a very central role. I mean that was the simple instrument, it was never pronounced. Everyone in Switzerland knows that. It is clear … if they had not played along" (i.e., by participating proactively in the reform process).[123] In other words, policy elites – the Federal Council and the expert commission – knew that some notable reform was required given public demands for enhanced financial regulation of big banks. They sought to design a reform strong enough to head off a popular initiative.

The expert proposals were "referendum-proof", but only in the sense that no popular initiative came to pass. Their recommendation was however far from the last word on structural reform. The force that subsequently brought the shift from ex-post to ex-ante separation came neither from the Federal Council nor from bureaucrats, and certainly not from banks, but rather from the Swiss Parliament who persistently demanded it in the years after the crisis. They pushed for ex-ante separation from the moment that the Swiss expert commission rejected structural reform to the day the banks settled on it.

In particular, it was the right-wing populist SVP which became the most vocal and longstanding proponent of bank structural reform, and despite being seen as a cantankerous

[120] Representatives from the Swiss authorities who were members of the commission included its Vice-Chair Thomas Jordan, who was also Vice-Chair of the Governing Board of the Swiss National Bank. The second Vice-Chair was Patrick Raaflaub, who was Director of Finma. The Chair of the commission was Peter Siegenthaler, who by the time of the Final Report's publication was Chair of the Association of Swiss Cantonal Banks, but was previously Director of the Federal Finance Administration, part of the Swiss Federal Department of Finance.

[121] Interview #CH6, Senior Policymaker at Swiss Department of Economic Affairs Official, confidential date in 2021.

[122] The direct quotation is from an interview (#CH1) with a representative of the 2014 Swiss Group of Experts, 15 January 2021.

[123] Interview #CH1, representative of the 2014 Swiss Group of Experts, 15 January 2021.

opposition party, they joined forced with parties on the left to achieve it. As early as September 2009, for example, the president of the Social Democrats (SP) Christian Levat joined the de facto SVP leader Christoph Blocher in a public conference, stating that the UBS bailout had shown that big banks were "too big to die", that they should have their "wings clipped", and that if multilateral agreements were not forthcoming then Switzerland should "examine the split of big banks" (Neue Zürcher Zeitung 2009). When the bill based on the Commission of Experts' recommendations was introduced into the Swiss Parliament in December 2010, it was unsurprising that the SVP rejected it and instead pushed for a version of structural reform that would divide up domestic and international balance sheets. Its proposed alternative is remarkably similar to the ex-ante separation Credit Suisse and UBS later proceeded with, based – at least notionally – on the banks' own analysis of the structure which would create the strongest emergency plan.

There was little consensus among other parties on the SVP's specific proposal, however, which made it difficult for an alternative reform to the Federal Council version to emerge at the legislative stage. The two large centrist parties (the Liberals [FDP] and the Christian Democratic People's Party [CVP]) quickly supported the Federal Council bill based on the expert commission's recommendations. Meanwhile, the two main left parties (the SP and the Greens) sought significant revisions, both advocating US-style proprietary trading bans. The SP also argued in favour of structural separation, while the Greens called more specifically for separation of retail from investment banking. Despite the parties recommending structural reform constituting a majority of seats in the National Council (but not the upper chamber, the Council of States), the bill passed substantially unchanged; politicians feared that further delay would make it "almost impossible to get [any reform] through".[124]

The legislative debate demonstrated strong political support for the structural reform that the expert group had rejected. That support came at a moment when public trust in banks was at an historic low (see Figure 4.4 and Figure *4.5*). Parliamentary pressure did not abate, nor did public trust return to pre-crisis levels, after the legislation passed. In fact, Parliament returned its attention to this issue as new evidence came to light demonstrating ongoing vulnerabilities of the Swiss economy to global banking.

On the one hand, the principle of subsidiarity – that the state should only force banks to change structure in extreme circumstances – brought a generally cautious approach about prescribing banks with a required new structure. Yet evidence from two years of Swiss parliamentary debate reveals how political demands on this issue persisted. For many politicians, it is clear that strong structural reform was always the endgame. In September 2011 – the day before the updated revised Banking Act was passed – the SP submitted a motion in the National Council entitled "Big Banks without Investment Banking Risk", proposing that "systemically important banks [should] basically limit their activities to those of a commercial bank … proprietary trading is to be limited … they are prohibited from investment banking, whereby Finma has to make the appropriate delimitation". One of the key stated justifications (*Begründung*) the SP offered for this proposal was that:

> Investment banking is associated with great risks. As the current case at UBS in London shows, neither the bank nor the regulator can really monitor and control

[124] Interview #CH1, representative of the 2014 Swiss Group of Experts, 15 January 2021.

> these … this has major financial and political implications, because ultimately the entire population shares these risks without being asked and unwillingly.
>
> (Swiss National Council 2011)

This intervention occurred just two weeks after the arrest of a rogue trader at UBS's London-based investment bank, Kweku Adoboli, whose unauthorised trading resulted in $2.3bn losses for the firm (Croft 2012). In its formal response, which is submitted as standard in Swiss politics, the Federal Council conceded that "it is conceivable … that [systemically important] functions are managed by a separate bank from the outset, or that they are transferred to a bridge bank or an external bank in the event of a crisis" and that "the business areas to be delineated in the contingency plan will include investment banking and possibly proprietary trading" (Swiss National Council 2011). This was a clear public identification of ex-ante separation as an alternative to the plan favoured by experts and industry. It also occurred ahead of any public indication that bureaucrats were headed in this direction. While the Federal Council continued to maintain that "it would not be proportionate to prohibit systemically important banks from certain transactions from the outset", the political steer in favour of structural reform only became stronger, while still showing some cultural deference to the subsidiarity principle.

Indeed, political focus on the risks brought to Switzerland by Credit Suisse and UBS's global operations redoubled as their global activities were the source of fresh sandal and crisis: throughout 2010-12 UBS's losses in investment banking were stacking up (see Figure 4.2); from mid-2012 the Swiss economy was buffeted by the Eurozone crisis (Lleo and Ziemba 2015); and in December that year UBS was fined a record-breaking $1.5bn for its involvement in the Libor scandal. After the publication of the UK's ringfencing plan by the ICB in September 2011, Swiss policymakers also had an alternative version of structural reform that they could look to as an alternative to the Swiss expert plan. The Federal Department of Finance soon explicitly cited the "advantage" of a UK-style ringfence over the ex-post approach favoured by the Swiss experts and banks.[125]

Parliamentarians became progressively blunter in their advocacy of stronger structural reform, and it is here that the pressure facing banks to choose ex-ante separation is most palpable. In June 2012, the de facto SVP leader Christoph Blocher submitted an "urgent interpellation" on the "possibly profound European banking crisis on Switzerland", demanding that:

> …an intensive conversation, a request or even a demand – it cannot be ordered – is made to our banks, which operate internationally, so that the international interconnectedness here is broken up or stopped … Unfortunately, with the "too-

[125] The full text reads: "The bank essentially has three options to choose from – without wanting to make final specifications here: it can set up an independent, functional legal entity domiciled in Switzerland with a license to conduct banking business, to which in the event of impending insolvency the system-relevant functions are transferred. Alternatively, it can merge the systemically important functions in advance, i.e. within the framework of the existing business model, in a legal entity domiciled in Switzerland. In the latter case, this has the advantage that the systemically important functions have already proven themselves in day-to-day business and thus there is certainty that their continuation will work if necessary. Finally, the bank can have a bankruptcy-resistant agreement with a third party according to which, in the event of impending insolvency, the systemically important functions will be transferred onto said third party" (Swiss Federal Department of Finance 2012, 10).

> big-to-fail" problem, we have not done the work to separate investment banking from other banking.
>
> (Swiss National Council 2012)

The parties that had in late 2011 shown scepticism of the expert commission plan now expressed exasperation. In the urgent interpellation, the Greens also expressed support of "a separation of the banking system" along the lines of the US Glass-Steagall Act. In 2013, together with the SP and Green Liberals,[126] these parties continued to demand a policy rethink. The Green Liberals declared that "financial incentives encouraging excesses in the banking sector remain essentially in place" and that "experts are telling us that [the TBTF legislation] is not enough and that the proposed emergency plans cannot be implemented easily and in an internationally networked world" (Swiss Council of States 2013). It was after this final set of motions were submitted in parliament – which, due to continued disagreement on the preferred type of structural reform, again did not attract enough votes to pass – that UBS and Credit Suisse decided to create new ringfenced entities in which Swiss balance sheets were separated from global balance sheets. Political demands for ex-ante separation eventually won the day.

This political process exhibits neither the coordinated, business-friendly elite process expected of an institutionalist framework, nor the expert-led process conveyed by bureaucratic accounts. Rather, it shows sustained support by politicians from across the political spectrum – but less from centrist, "bourgeois" parties – for significant structural reform to banks throughout the 2008-2013 period. As the extracts from parliamentary debates show, their demands only increased as further market events impacted the banking sector. The demands of the SVP were explicitly cited in interviews with Finma officials as evidence of the political pressure the agency faced to go for ex-ante separation.[127] This again casts doubt that Swiss bureaucrats would have pursued stronger reform unless they had experienced high political pressure to do so. This process also did not occur in a policy vacuum: while a referendum did not occur on this particular issue, the "Against Rip-Off" referendum campaign seeking to crack down on executive pay took place during the same period, and as Section 4.6.4 highlights it achieved historically high support. This was a reformist political environment in which policymakers were responding to clear democratic demands for banking reform across a range of policy areas.

The debates between the Swiss Parliament and Federal Council are as relevant for what they explicitly ruled out as for what they advocated. As Table 4.7 identifies, there were certainly versions of structural reform which would have been more costly to Credit Suisse and UBS, not least narrow banking – in which retail deposits are backed by safe assets, such as government bonds – or a Glass-Steagall-type split, both of which were also rejected in the UK and US. The latter type of reform was in fact proposed by the Greens, but was rejected out of hand by the SVP, the biggest party and arguably the one most vociferous in its support of structural reform. In debate with the Greens, the SVP stated that it opposed this option because "investment banking abroad, primarily in the USA, is important for the big banks" (Swiss National Council 2012). The SVP was not per se "anti-bank", even if it supported a

[126] Note that the Greens and the Green Liberals are two separate parties, with the latter formed in 2007 from four cantonal branches of the Green Party. They are considered to sit more in the political centre.
[127] Interview #CH3, two Finma officials, 2 March 2021.

version of structural reform experts had rejected as a "very extreme form of intervention" (Swiss Commission of Experts 2010, 118). In 2009, for example, when the Swiss President made concessions to international actors on bank secrecy (a regime which Section 4.5 identified is widely supported by the Swiss public), the SVP pushed for a popular referendum to stop the government doing so.

While there was majority political support for some kind of structural reform, support for more sweeping interventions in global banking always remained an agenda of the left. The political mandate given to the Swiss expert commission stated explicitly that it should take "appropriate account of profitability and competitiveness" of the Swiss financial sector in its recommendations. According to its chair, the earliest option to be ruled out was therefore full separation of the Swiss banking system (i.e. Glass-Stegall-style splits).[128] As ex-ante separation gained in popularity, the Swiss government remained clear that "no (complete) separation of business areas can be required as part of the emergency plan" (Swiss Federal Department of Finance 2012, 11). While the Swiss government was mostly cautious about revealing what type of reform it wanted, it was much clearer when it came to saying what was off the cards.

Banks were clearly the main beneficiaries of this resistance to Glass-Steagall-type reform. Yet the evidence presented has also discredited the hypothesis that the bank lobby had a significant role on this policy issue. It was also found that bureaucrats were mostly reactive to demands made by politicians who favoured stronger structural reform. Bureaucrats may well have opposed splitting up banking groups, but no evidence was presented that they either drove or constrained this reform agenda. Rather, stronger structural reform was not pursued because there was not majority political demand. While Swiss politicians wanted to ensure that Swiss taxpayers were protected from the "contagion [that] can be spread from the remaining bank" (Swiss Federal Department of Finance 2012, 11), they also wanted banks that remained commercially viable as global firms.

The holdback to Swiss policymakers pushing for a stronger version of structural reform was not, per some structural power accounts, that Credit Suisse and UBS had a strong exit option from Switzerland (Culpepper and Reinke 2014; Lindblom 1982; Winters 1996). In fact, their exit option was weak on this issue. By 2011, Swiss regulators had made it clear that they *preferred* UBS and Credit Suisse to have their investment banks separately incorporated, capitalised and supervised in the US or UK (Enrich and Chon 2011; Reuters Staff 2011). Investment banking was something policymakers wanted to take place outside Swiss jurisdiction. When, in 2009, the head of UBS did publicly threaten to relocate its headquarters if regulation became too stringent, this was not a comment anyone took seriously, and he was quickly forced to backtrack.[129]

Rather, the main constraint facing policymakers was that many of the more sweeping structural reforms to UBS and Credit Suisse would undercut their competitiveness in global markets. A Glass-Steagall-type reform would have had much more serious consequences for

[128] Interview #CH7, representative of the 2010 Swiss Commission of Experts, 5 February 2021.

[129] Private comments came to light that he would consider a relocation of headquarters if Swiss regulation became too stringent (New York Times Dealbook 2009; Reuters Staff 2009b). The comments were considered bad publicity given the recentness of the UBS bailout.

their ability to compete with other G-SIBs. Narrow banking and other major proposals would have required a fundamental review of their entire business proposition, including their highly profitable wealth management arms. In fact, the only concession that Finma made on the more limited ex-ante separation option was to allow Swiss wealth management to be brought within the ringfenced entity in which systemically important activities took place.[130] Overall, designing a reform that pushed investment banking outside of Switzerland, but kept wealth management in, produced the two key differences between the UK and Swiss versions of structural reform (see Section 3.6.1). The structural reform Switzerland opted for was one that allowed the big banks to remain globally competitive in the services from which the country derived the most value.

This section has shown how Swiss politicians responded to sustained democratic pressure in favour of reform by pushing for a policy response stronger than the option recommended by the expert commission and preferred by banks. This was shown to be a surprising outcome given that Swiss policy institutions are usually cooperative and yield beneficial outcomes for big business. While the policy process remained nominally cooperative, in that big banks supposedly chose the stronger reform themselves, banks were in fact given little option but to opt for a structure that went decisively against their established interests as universal banks. Nonetheless, while the two big Swiss banks did not possess strong exit options, Switzerland does remain highly dependent on its internationalised financial sector. Swiss structural reform thus delivered a constrained democratic response: the salience of TBTF banking after the GFC led to policymakers pushing a structural reform agenda, but they did so in a way that allowed the big banks to remain globally competitive cross-border firms. The more recent failure of Credit Suisse's global strategy, which precipitated a further bailout and coordinated buyout by UBS, shows how a constrained democratic response after 2008 ultimately failed to insulate Swiss taxpayers from global market risk. This issue is returned to in Section 4.7.

[130] According to one UBS official, the bank had protested that it "can't separate the deposit business and the wealth management business from each other" without jeopardising its business model. Interview with UBS executive, 12 February 2021.

4.6.2 Capital Reforms: The "Swiss Finish"

Table 4.8: Overview of Possible Swiss Bank Capital Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Capital Rules	Far higher capital requirements than Basel III	***De minimus application of Basel III rules***
Capital Incentives	***Incentives to reduce balance sheet size/risk***	No incentives to reduce balance sheet size

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Switzerland was among the first countries to pass significant post-GFC capital reforms. These requirements went further than reforms that had been agreed to in multilateral fora, in which the country was also a leading advocate pushing for stronger reform. The Swiss regime, which became known as the "Swiss Finish" for how it gold-plated international standards, did not attract the same level of political or public interest as the bank structure or executive pay reforms. For many experts – in both Switzerland and elsewhere – stronger capital requirements were however the preferable way of responding to the TBTF phenomenon. Given the scale of the TBTF challenge in Switzerland, politicians gave regulators authority to consider much stronger reforms than had been possible prior to the crisis. Ultimately, many of the unilateral policies that created much stronger requirements for UBS and Credit Suisse were eclipsed by new rules for G-SIBs decided at the FSB. Nonetheless, one of the more significant rules that remains in place to this date is a "progressive component" which creates strong incentives for banks to shrink their global balance sheets. This today remains the most significant addition to Basel III requirements. It shows how, when the technical solution of increasing capital standards was applied to the focal topic of political debate – TBTF banking in Switzerland – it produced a reform that specifically targeted Switzerland's two global banks.

Switzerland's reforms were spearheaded by the Swiss Commission of Experts, whose rejection of structural reform was discussed extensively in Section 4.6.1. Experts on the other hand saw strong capital reforms as the crucial reform to deal with TBTF banking in Switzerland. Its *Final Report*, published in September 2010, came in the weeks after the BCBS agreed to the Basel III package. Since 2008, Swiss regulators had already taken a lead on capital reform both unilaterally and at Basel, for example by doubling the capital requirements of the big Swiss banks in the midst of the crisis (Swiss Commission of Experts 2010, 9). Given that some experts on the Swiss Commission were also career bureaucrats, it was not surprising that the expert commission came to see stronger capital standards as a central component of the reform package.

The expert commission's enhanced rules specifically targeted Credit Suisse and UBS, and were framed as being more stringent than those that had just been agreed to in the Basel III package. A summary of these differences – based on the Swiss Commission's own comparative analysis – is shown in Table 4.9. The two most important technical differences between the Swiss and multilateral standards are the Swiss reliance on contingent convertible bonds (CoCos) as well as a "systemic surcharge" (in Switzerland the "progressive component"). The surcharge was "progressive" in the sense that it would increase if bank balance sheets increased, and be reduced if balance sheets became smaller. It was seen by experts as a means to reduce the risks associated with Switzerland housing global banks which were also crucial in supporting systemically important activities to the Swiss economy, such as retail banking and payments. Cumulatively, the Swiss Commission's recommendations would see the total capital requirement (including hybrid and convertible capital) for Credit Suisse and UBS set at 19%, of which 10% would be CET1. Using the same definition of capital, Basel III's total capital requirement was lower, at 10.5%, of which 7% could be CET1.

Table 4.9: Swiss Commission of Experts' Comparison of Basel III Capital Requirements and Own Recommendations for Credit Suisse and UBS
Source: Swiss Commission of Experts (2010, 59, Table 4)

Component	**Type of Capital**	**Basel III Standards**	**Swiss Commission of Expert's calibration**
	(%)		
Minimum Requirement	CET1	4.5 (Min.)	**4.5** (Min.)
	Other	6 (Min.)	6 (Min.)
	Total	**8**	8
Buffer	CET1	2.5	Min. 5.5
	Other	None	3 (Max., in CoCos)
	Total	**2.5**	**8.5**
Systemic Surcharge	CET1	None	None
	Other		6 (in CoCos)
	Total		**6**
Totals	CET1	7	10
	Other	3.5	9
	Total	**10.5**	**19**

Key: Numbers cited in **bold** are the basis of Commission's calculation*s of total requirements.*

These were eye-catchingly high capital requirements from the Swiss Commission, with a headline recommendation far closer to that proposed by economists who saw increasing capital as the first best option for reducing systemic risk (e.g. Admati and Hellwig 2014). Given that the expert commission's recommendations were swiftly passed into law, the group clearly had an important role in shaping the technical content of these reforms.

It is however much less clear that the institutional environment of the expert group had any notable effect in changing Switzerland's overall approach to capital reform. Among policymakers, the "Swiss Finish" was widely supported and in practice meant that big Swiss banks would always be subject to some of highest capital requirements in the world. Howarth

and James' (2023) theory, which is that ad-hoc non-majoritarian policy venues can serve to either expand or contract conflict between business and policy actors depending on whether banks cooperate or conflict with one another as rules are developed (see Table 2.3), is very difficult to apply to this case of reform. While the literature would suggest that Swiss industry is highly cooperative, interviews in fact reflected that UBS and Credit Suisse mostly behaved according to their individual preferences. It was identified among participants in the expert commission, for example, that Credit Suisse was more successful than UBS on the capital issue, particularly through the emphasis that the commission gave to CoCo (rather the common equity) requirements. Credit Suisse "had practically overcome the financial crisis with such an instrument … it was certainly a vested interest that led them to [be supportive]".[131] However, while this shows that one bank may have gained more out of the expert commission than the other – which arguably constitutes "competitive" behaviour – this misses out the more important overall outcome of Swiss capital reform. Among both elected officials and bureaucrats, the lodestar of capital reform quickly became that the capital requirements applied to Credit Suisse and UBS should be consistently higher than that applied to systemic banks in most other countries. The venue-shift to an expert committee, and the strategies used by industry to gain small concessions, have limited explanatory power for this outcome.

Compared to the issue of structural reform, evidence of a political debate on higher capital standards is sparser. From the outset, though, the SP was the most vocal sponsor of higher capital, and in the September 2009 conference with Christoph Blocher (cited in Section 4.6.1), its leader proposed that capital and structural policies should be the two key pillars of Swiss reform (Neue Zürcher Zeitung 2009). After, the parliamentary records suggest that the most significant debate on capital during this period occurred when the Federal Council brought the bill based on the recommendations of the Commission of Experts to parliament, when both the SP and the Greens voiced concerns that the bill did not go far enough on capital reform, and specifically on the bank leverage ratio. The limited political debate is not surprising, and is broadly consistent with what was observed in primary research in other countries. Bank capital is a highly technical domain of financial regulation requiring subject-matter expertise; it is not an issue on which politicians or their voters strike up debates in the same way as they might on bank structure or executive pay.

That said, an issue which did periodically concern politicians in other countries is that higher capital standards might dampen economic growth. As Section 3.6.2 showed, in the UK, the costs of implementing expert recommendations on capital spawned a major debate among both bureaucrats and politicians. This ultimately saw British politicians' preferences for a less stringent approach win the day on the grounds that higher requirements might harm economic recovery. In the Swiss case, meanwhile, there was no significant opposition among policy elites for much higher capital applied to UBS and Credit Suisse. Where in the UK case bureaucrats were divided on the merits of capital reform beyond Basel III requirements, their Swiss equivalents showed unqualified support for the "Swiss Finish". Given the sheer size of the big Swiss banks relative to the Swiss economy, this could plausibly be an instance of regulators seeking to reduce "cross-border externalities" after a major crisis (James and Quaglia 2020).

[131] Interview #CH7, representative of the 2010 Swiss Commission of Experts, 5 February 2021.

Swiss bureaucrats were indeed a leading voice on capital reform both domestically and in multilateral institutions. They began pushing for an international rethink on capital standards from the earliest days of the crisis. In July 2008, before the collapse of Lehman Brothers, Swiss policymakers had lobbied international bureaucrats working at Basel for "something radically different"; they saw that "something very radical, more stringent" would be necessary.[132] Interviewees from the Swiss bureaucracy regularly cited the small size of the Swiss economy relative to its banks – and thus the scale of the TBTF problem the country faced – as the key reason why they pushed earlier and harder on capital reform. Swiss bureaucrats saw this as such an urgent task that the unilateral standards that were agreed (Table 4.9) for G-SIBs were achieved before the FSB had developed its multilateral regime for global banks. Indeed, the speed of Swiss policymaking became an Achilles heel because CoCos did not later find favour among international regulators. One involved in the expert commission emphasised the urgency on capital reform in light of the GFC: "I think we would not have introduced the CoCos if we had been on the FSB timetable. We simply wanted to have something as quickly as possible".[133]

While Swiss bureaucrats were proactive in pushing for stronger capital requirements, however, their role in this area of reform appears neither a necessary nor a sufficient condition driving the outcome achieved. Officials at the SNB had noted before the crisis that there was a problem of excessive bank leverage, in particular at UBS, but those warnings had fallen on deaf ears.[134] The GFC acted as a catalyst and brought a widely held sense of urgency to reforms specifically targeting UBS and Credit Suisse. Even more crucially, after the bank bailouts politicians were willing to go against the big banks, with parties on the left pushing for even higher requirements than those proposed by the expert commission. In the following years, the Federal Council instigated a second expert commission to assess whether the Swiss TBTF reforms needed updating, where increasing capital again became the chief focus. This second expert group concluded that higher requirements were again required, writing: "Switzerland should be one of the countries with the highest going concern capital requirements for G-SIBs" (Swiss 'Group of Experts' 2014, 44). This approach redoubled the common consensus achieved among Swiss policymakers since the GFC.

The willingness of Swiss policymakers to apply higher capital standards to its G-SIBs than those required by Basel and FSB standards becomes more surprising when its real-world effects on these firms are considered. While the CoCo innovation was phased out to better align Switzerland to multilateral standards, the second key component of Switzerland's post-crisis capital reform package – the progressive component, which ties capital requirements to the wider issue of TBTF banking in Switzerland – remains in place today. This is labelled in Table 4.9 as the Systemic Surcharge, which is the FSB term for the additional capital required for G-SIBs. Switzerland's 2011 expert commission argued that this progressive rate "takes into account the serious repercussions of a systemically important bank's insolvency in Switzerland and abroad [and] … should create the leeway during a crisis to ensure that systemically important functions are maintained in the event of insolvency" (Swiss

[132] Interview #CH5, Finma official, 29 January 2021.
[133] Interview #CH1, representative of the 2014 Swiss Group of Experts, 15 January 2021.
[134] Interview #CH5, Finma official, 29 January 2021.

Commission of Experts 2010, 76). The commission recommended that "provided the big bank status quo is preserved", the capital requirement should be set at 6% of RWA (2010, 33).

By 2014, the second expert commission was far more explicit about both the intent and the effect of the progressive component. It noted that it "has the effect of incentivising the banks to reduce both their size and market share of systemically important services" (Swiss 'Group of Experts' 2014, 61). It cited the example of UBS, which in 2013 announced an accelerated strategy to reduce its balance sheet size, predicting that this would discount its systemic surcharge by a quarter (Swiss 'Group of Experts' 2014, 23). Recently, Finma has stated that after Credit Suisse has been folded into UBS, the new bank will be subject to the highest possible progressive component of 9%. There will thus be a strong regulatory incentive for the merged bank to further reduce its balance sheet size.

The explicitness with which Swiss bureaucrats write about the intent of the progressive component – to make big Swiss banks become smaller – is remarkable, especially when compared to the equivalent debate in the UK. As Chapter 3.6.2 showed, in the British debate on capital reform, its expert commission rejected the option of applying capital requirements "super-equivalent" to Basel to all big banks in the UK (including foreign firms), citing concerns about global regulatory arbitrage. Meanwhile, the much smaller increases in capital requirements that the UK's ICB recommended for the ringfenced entities of big UK banks remained controversial and were later watered down by the Bank of England to bring the rules more in line with the FSB framework. If the theory positions both Switzerland and the UK as asymmetrically dependent on global banks, this raises the question of what conditions allowed Swiss policymakers to design capital reforms with the explicit aim of reducing the balance sheets of UBS and Credit Suisse, while in the UK that was deemed too costly to the big banks.

This had nothing to do with differences in elite behaviour between countries: by that measure Switzerland, where there was tight elite cooperation over bank capital reform, would have achieved the *less* stringent outcome of the two countries. Variation in lobbying power also does little to predict the overall shape reforms took, and instead is a constant across cases which saw individual firms periodically achieve marginal concessions. An explanation with far greater explanatory power is one that foregrounds the constraints policymakers face when undertaking reforms that create higher costs for firms. When going about capital reform, UK policymakers must factor in the effects on both its global financial centre as well as on some big UK banks. This is a mix of firms inhered with very high structural power, particularly in terms of their exit options. While the Swiss financial sector is also highly internationalised, it is not constituted by the same mix of international firms, but is rather dominated by these two big banks, for whose global capital requirements Swiss authorities have chief responsibility as "home" supervisor . In this Swiss context, it is perfectly reasonable for Swiss policymakers to apply capital reforms only to Credit Suisse and UBS. These banks had little choice but to accept the enhanced capital regime applied in Switzerland, even if it would entail them significantly shrinking their balance sheets. Swiss regulators were able to target UBS and Credit Suisse only in a way that was not possible in the UK for Barclays and HSBC (see Chapter 3.6).

The Swiss capital reforms have had similar effects to structural reform on the business model of Credit Suisse and UBS. In Section 4.6.1, it was shown how the thrust of political debate on structural reform came to be about reducing the exposures of the Swiss economy to global investment banking. Swiss policymakers cited the benefits of the capital reforms for similar reasons: they would make it much more costly for UBS and Credit Suisse to engage in principal trading "since the high trading volumes are mainly financed by borrowed capital", which would be subject to an especially high capital charge (Committee for Economic Affairs and Taxation of the Swiss National Council 2010). Second, while the Swiss G-SIBs have substantially reduced their balance sheet size, this has not prevented them from expanding their activities in global wealth management, as the clear trends in Figure 4.2 and Figure 4.3 show. The far more technical issue of capital reform thus yielded a similar outcome to the structural reform issue: it allowed the Swiss financial centre to remain in the global game of cross-border finance, while changing the rules to mean that it brought fewer risks for Swiss taxpayers. The long-standing champions of Swiss cross-border banking had little choice but to accept these new rules of the game.

As with the structural reform issue, while Switzerland's TBTF capital reforms may have had the effect of making UBS and Credit Suisse smaller banks, they ultimately proved ineffective in preventing the 2023 Credit Suisse crisis. Indeed, it is ironic that during its collapse Credit Suisse *exceeded* the capital requirements that Switzerland had been at pains to ensure were higher than other countries. Indeed, Credit Suisse's compliance with these requirements have been cited by regulators as a reason why they did not intervene earlier. As the SNB put it, "the experience made [*sic*] with Credit Suisse has shown that, in a period of stress, regulatory metrics are relatively narrow and may delay corrective action" (Swiss National Bank 2023). Despite its efforts to de-risk Credit Suisse and UBS through capital reform, Switzerland has again been highly exposed to the risks that can come with housing global banks.

4.6.3 Swiss Reform of Markets in Financial Instruments

Table 4.10: Overview of Possible Swiss Reforms to Markets in Financial Instruments

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Central Clearing Mandate	*Compliance with multilateral rules*	*Compliance with multilateral rules*

Key*:* Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

In Chapter 5 on US reform it is identified how the regulation of derivatives markets became a key component of Dodd-Frank, with banks' speculative behaviour a focal topic of public debate. In Switzerland meanwhile, derivatives reform was marginal to the political debate. It

was not an issue that either the first or second expert commissions on TBTF banking gave attention to. The closest the first commission came to discussing derivatives was in relation to the related but distinct issue of bank proprietary trading, which its experts concluded was not a significant regulatory issue for Switzerland, but rather one for the "Anglo-Saxon world" of finance (Swiss Commission of Experts 2010, 117). The reform of Swiss derivatives infrastructure, which in the context of the global derivatives market was insignificant, remained a low salience issue. Indeed, while Switzerland was home to one domestically-oriented clearing house – SIX Interbank Clearing – it was CCPs in other countries, regulated by other authorities, that the Swiss banks primarily used for their trading activity. As a result, derivatives reform was a task left to bureaucrats, who designed a regime in a way that would be assessed as equivalent to global – and more specifically US and EU – standards. As Table 2.8 outlined, unlike the other three areas of reform assessed in this chapter, multilateral frameworks have been far more decisive for the shape that Swiss reforms took in this area.

Swiss banks are certainly active participants in global derivatives markets, and UBS in particular was highly exposed to the US subprime crisis involving mortgage-backed securities. Both Credit Suisse and UBS are part of the "G-16" global core of derivatives dealers. Unlike the US, however, the primary regulators of Credit Suisse and UBS's derivatives trading operations are foreign authorities, especially US and European regulators. Given that an insubstantial share of derivatives trading is conducted within Swiss jurisdiction, Swiss agencies are themselves responsible for regulating a very small percentage of the global derivatives market. As a result, Swiss policymakers had limited scope to influence global derivatives reform. Instead, their primary interest was not in making new rules for derivatives markets, but reducing the country's exposure to these global markets should a major crisis to recur. This primarily led to them addressing the TBTF issue via structural and capital reform, not direct product regulation or other unilateral reform of derivatives markets.

With derivatives reform being a highly technical issue, and one that remained of low salience, Swiss regulators designed policy reforms with minimal steer from politicians. The tenor of their response can be measured by both its timing and primary output. Table 4.11 compares the timing of the policy response in Switzerland with the US and EU/UK. It shows that the US was by some margin the first of these jurisdictions to pass key legislation reforming derivatives. As Chapter 5 will show, the Dodd-Frank package set the terms of global derivatives reform. The FSB used US reform as the barometer to assess progress in other countries (Financial Stability Board n.d.). As Chapter 3 on British reform showed, EU reforms were mostly reactive to these US reforms, with the relevant EU directives passed between 2012-14. Finally, Switzerland passed its reform package in 2016, via its Financial Market Infrastructure Act and an associated ordinance, after which the FSB assessed its reforms as equivalent to global standards.

Table 4.11: Timing of Derivatives Markets Reforms By Jurisdiction

Jurisdiction	Year(s) Key Legislation Passed	Reforms Equivalent[135] to United States Since
United States	2010	-
European Union/United Kingdom	2012-14	2014
Switzerland	2016	2016

Unlike the capital reform issue, which was deemed so urgent that a unilateral response was required before multilateral standards had been finalised, there was no strong push for Swiss regulators to pass MFI reforms divergent from multilateral standards. For regulators, the default preference was for national reforms to be designed in a way that ensured Swiss regulatory equivalence with global standards. This also fitted with the preferences of Credit Suisse and UBS, which were together the largest shareholders in the SIX clearing house, and major participants in global derivatives trading. No serious consideration was given to making it more difficult for Credit Suisse and UBS to participate in these markets, for example via direct product regulation of derivatives. Absent either strong democratic pressure or global regulatory influence in this area, Swiss derivatives reform mostly conformed to multilateral standards. This was not an issue that became subject to democratic contestation in Switzerland. Its unilateral reforms represent a continuity package.

[135] "Equivalent" by the assessment of the Financial Stability Board in their annual progress reports on implementation of OTC Derivatives Markets Reforms.

4.6.4 Tax and Pay Reform in the Swiss Banking Sector: The Salience Effect under Direct Democracy

Table 4.12: Overview of Possible Swiss Tax and Pay Reforms

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
"Say-on-pay" for shareholders	*Mandated say-on-pay for shareholders*	Minimal or no say-on-pay
"Golden handshakes" and "parachutes"	*Bans of golden handshakes and parachutes*	No bans on golden handshakes and parachutes
Quantitative executive pay controls	Quantitative limit to highest v. lowest employee pay ratio	*No quantitative limits to executive pay*
Bonus tax	Bonus tax	*No bonus tax*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Unlike the other reforms analysed in this chapter, executive pay in Switzerland preceded the GFC as an issue animating significant political debate. The events of 2007-9, and the high bonuses that persisted at big banks despite their failures, upended the reforms that had been underway since the early 2000s. Instead, executive pay – not just at banks but all big corporations – was thrust into the world of "noisy politics", with Swiss voters being given a say on the issue via two referendums. Despite surveys from the time showing high public support for major reform of executive pay practices, direct democracy did not see Swiss voters always opting for the most sweeping option available. Executive pay reforms went far further than they would have absent the shock of the GFC, but even under direct democracy the outcome has hardly been radical.

From 2003 onwards, Switzerland underwent a significant episode of corporate governance reform, instigated after the dramatic collapse of the Swiss flag carrier Swissair. While this event prompted a broad investigation into the causes of failure and possible policy reforms, an issue that caused particular public indignation was that the airline's chief executive had received a "golden parachute" payment of SwF12.5m just months before the bankruptcy. This scandal prompted a month-long campaign by the highest-selling newspaper in Switzerland – *Blick* – against "greedy managers". While this was clearly an issue that animated popular attention, as in the case of bank structure, the reform process began as one typical of Swiss elite bargaining. An expert commission was appointed to consider a variety of corporate

governance reforms, including on executive pay. Among other recommendations was a significant reform to pay disclosure, requiring "economically important" companies to publicly disclose the remuneration of top executives (Böckli, Huguenin, and Dessemontet 2003). In 2005, the Federal Council followed up with various other proposals, such as a "say-on-pay" policy that would give private and public stockholders the statutory right to vote on the pay granted to corporate boards and top management. Actors in this process responded in a predictable way: stronger disclosure and say-on-pay requirements were opposed by the business associations; while in Parliament, left parties sought stronger reform and right parties were more restrained.

While some executive pay reform would almost certainly have passed regardless, the policy debate was transformed by the events of the GFC. Soon after the collapse of Swissair, an entrepreneur who had been financially affected by the airline's failure, Thomas Minder, launched the "*gegen die Abzockerei"* or "Against Rip-Off" campaign.[136] Minder proposed a ban on "golden handshakes" and "parachutes" (i.e. termination pay and advanced payments); mandatory shareholder votes on the pay granted to companies' boards, senior managers and advisory board; mandatory annual elections for every board member; an end to proxy voting by depository banks; and enforced exercise of voting rights by pension schemes. The plan would see companies that failed to comply facing significant penalties. These proposals went far further than the reforms being debated in Parliament, but until the GFC Minder was mostly ignored by policymakers.

Just as politicians were bargaining over a well-established set of policies, the events of the GFC thrust executive pay back to the very centre of public debate. It made the reforms being debated in parliament appear weak and insufficient. As a result, Minder's personal campaign, which had launched a *Volksinitiative* in late 2006, was thrown into the public limelight as a more robust alternative. The Minder initiative took off just as UBS's losses stacked up, and reached the requisite 100,000 signatures soon after the bank announced that it would need a $11.9bn capital injection. In the media, the crisis at UBS was rhetorically linked to the executive pay debate, with the pay of individual UBS executives front-page news as the bank's prospects worsened. In February 2008, the Swiss President took the unusual step of denouncing UBS's Chair, who he stated had "earned Pharaoh-like salaries for four to five years … [yet] when the bank wobbles, he can keep it all" (Lehmann 2008). Even the traditionally pro-business bourgeois parties called on bank executives to return their bonuses. By 2010, this public campaign had led UBS executives to return a total SwFr70m in pay (J. Beck 2008). As occurred in the UK and the US, banks tried to temper the public outcry by strategically reducing their annual bonus pools. Yet shareholders at both UBS and Credit Suisse, of whom a significant share are private Swiss citizens, began revolting in significant numbers. Pay proposals often passed by a whisker in the years after the crisis (Bart 2012; Simonian 2010). During this period, Occupy-type protests took place on Paradeplatz, dubbed "Piratenplatz" given the proximity of the two banks' headquarters.

[136] The French (*contre les rémunérations abusives*) and Italian (*contro le retribuzioni abusive*) titles of the initiative reference abusive executive pay practices more directly than the German title. *Abzockerei* ("Rip-Off") was a word initially popularised by the SP [Social Democratic Party] to refer to the executive compensation issue.

In this acrimonious atmosphere, no politician was about to take a strong position against the Minder initiative.[137] Instead, the Federal Council sought to taper back the parts of Minder's initiative that were deemed too painful for big business, in particular by submitting an "indirect counterproposal" that did not contain bans on golden handshakes and parachutes. However, rather than reaching a consensus on how to respond to Minder's initiative in consultation with business groups – the typical outcome in cooperative Swiss politics – the debate became highly conflictual, dragging on for an extraordinary three years, until mid-2012.[138] Left parties pushed for reforms that went even further than Minder's initiative. For example, the SP and the Christian Democrats (one of the "bourgeois" parties) proposed a bonus tax on earnings in excess of SwF3m – the precise amount of the CEO of UBS's base pay in 2009 – which passed in both parliamentary chambers, but failed in a final vote (Neue Zürcher Zeitung 2010). A senior representative of Economiesuisse identified that they were in a lose-lose situation regardless of whether Minder's initiative or an alternative parliamentary plan won the day: "We are forced to choose between the plague and the cholera. That's the price we have to pay to the public and to the political parties, who can no longer tolerate this situation" (Buchs 2013).[139] Ultimately, parliament failed to reach a consensus, meaning that Minder's initiative was sent to the people in March 2013 without a voting recommendation or counterproposal from parliament.

Passing with 68% support, the Against Rip-Off vote was the second-best result ever achieved in a Swiss popular initiative. It represented a serious failure for the business lobby, which had poured significant resources into its campaign against the initiative.[140] The conflictual state of Swiss politics at this time, and the more pronounced left-right cleavage that a policy with clear redistributive implications produced, can to some extent explain why political bargaining broke down and no politically negotiated alternative policy emerged (Church and Vatter 2009). Yet the key change in the scope of executive pay reform negotiated by parliament had come in 2008, when banker bonuses became a front-page news item and everyday voters demanded reform. When this happened, even the usually pro-business bourgeois parties clamoured for major change. The established parliamentary process already underway was upended, and Minder's policies, which had previously been rejected by politicians as radical, were now debated as moderate responses.

A second referendum on executive pay, which occurred just nine months later, was however rejected. Its result yields evidence about how far Swiss democracy was willing to go to change executive pay culture. This *Volksinitiative*, which was put forward by the youth wing of the SP, sought to reduce the salary pay gap to a 1:12 ratio by limiting the salaries of top executives based on the annual minimum wage of the lowest paid employee of the same company. It was supported by the main left parties and largest trade unions, but opposed by the centre and right parties, as well as the main trade associations. Prior to the referendum, it had been

[137] See, for example, the SVP politician Christoph Blocher's public position on the reform in question (Blocher 2013).

[138] Politicians had several options, for example they could vote to support the initiative, or they could submit a counterproposal which would either be put to a popular vote at the same time (via a "direct" counterproposal) or become a law (rather than a constitutional amendment) if the popular initiative failed (via an "indirect" counterproposal).

[139] Translated from the original French by the author.

[140] Economiesuisse alone invested up to SwF8m in the campaign; some of its senior executives resigned in the wake of its failure.

rejected by the Federal Council and Federal Assembly. Surveys conducted at this time suggest that there was high public support for the state capping private sector pay. One poll showed 76% of respondents in favour of pay caps, with 61% believing that it is the duty of the state to set limits to salaries. One annual survey also shows that during the 2009-13 period upper limits on executive pay were consistently supported by around three-quarters of respondents (Shotter 2013). Yet the "For Fair Wages" referendum was ultimately rejected by 65.3% of voters. This raises the question of why this second popular initiative was resoundingly rejected by both politicians and voters, despite the earlier support for Minder and voters in principle also supporting caps.

One plausible explanation is that the executive pay issue had fallen off the public agenda by the end of 2013, with the Minder initiative having sated the public demand for reform. Minder's campaign had also been helped by a high-profile scandal involving the pharmaceuticals giant Novartis just weeks prior to voters going to the polls.[141] While this is a straw in the wind, there is no conclusive evidence that varying issue salience alone shaped the different outcomes of these two referendums. One political scientist has argued that the Swiss voted "no" in the second referendum because it was an initiative backed by parties of the left, rather than one that found broad political support (Geiser and Swissinfo 2013). Another possible explanation is that the "no" campaign was led by the trade association representing small and medium-sized business, rather than Economiesuisse, and thus that voters perceived that the 1:12 proposal would be costly not just to big business, but also to the Swiss *Mittelstand*. Swiss voters may have been incensed at big banks and other global companies paying huge bonuses, but perhaps they were more wary about harming local business.

A final explanation to consider relates to the key drivers of economic dependency underpinning the theory – internationalisation and firm exit options – which the theory predicts will produce a constrained democratic response. Switzerland's economic strength is widely attributed to its being an attractive place for global companies to set up headquarters. After 2008, critics of the Minder initiative argued that the proposal would harm that competitive edge. One legal scholar supporting the "no" vote critiqued that it would "drive Switzerland into isolation over company law", and "threaten tax revenues … and jobs" (Kunz n.d.). While say-on-pay policies similar to Minder had been or were later introduced in many other jurisdictions, the 1:12 initiative would have been a genuinely radical policy. It was estimated that a "yes" vote would affect remuneration at about 1,300 Swiss companies. The largest Swiss multinationals were estimated to have executive-pay-to-lowest-earner ratios of more than 200:1. Companies such as Swiss Re and Glencore stated that they would move some or even all of their staff out of Switzerland in the event of a "yes" vote (Shotter 2013).

The stark effects of a 1:12 pay ratio on Switzerland's economy deterred most voters from a "yes" vote, even if contemporary surveys suggest that most in principle supported executive pay caps. The Minder initiative, on the other hand, introduced a set of reforms that came at lower quantifiable cost to the Swiss economy, despite the major "no" campaign run by business associations. In the year after the Minder policies were first in force, for example,

[141] The weight of public censure in this instance had forced the firm to withdraw a proposed $78m golden parachute for its chief executive, which the Swiss justice minister had referred to as "a huge blow to the social cohesion in our country" which "undermined public trust in the entire economy" (Hooper 2013).

relative increases in CEO compensation at big Swiss firms again outpaced both smaller and mid-cap firms and inflation (Siepmann and Kramarsch 2016).

The difference between these two referendum outcomes demonstrates that when voters were given a direct say on executive pay reform, they responded in similar ways to how politicians had on the structural reform issue, where a referendum had remained an implicit threat. On both issues, the GFC acted as a catalyst which moved the dial on what was considered an acceptable level of state intervention in private business. Yet policies which were perceived as being too costly for Switzerland's globally competitive firms remained firmly off the cards, even if voters in principle found both American-style investment banking and the culture of executive pay that came with it distasteful. Policymakers and voters alike rubbed up against the hard constraints of making policy in a democracy under constraint. Both chose policies that avoided major competitiveness costs for the Swiss economy.

4.7 Conclusion: Swiss Policy Reform as Constrained Democracy

Switzerland is a unique case for studying the influence of democratic pressures on policymaking, insofar as the institutional feature of regular and highly institutionalised referenda offers an especially direct outlet for the expression of public opinion. This chapter has shown that, on the issues of structural and executive pay reform, both the threat of a referendum and two polls occurring together produced outcomes that went against industry interests. Direct democracy pushed Swiss reform further than what would have occurred had these policies remained subject to negotiation among elites. These reforms showcase a policy process occurring in response to high democratic demand. They weigh heavily as evidence against the two key alternative explanations in the literature. The bank lobby was powerless to stop strong reform, despite its proximal access to policymakers and – on the executive pay issue – a well-funded lobbying campaign. Second, the bureaucracy had little part in either the design of, or the momentum that produced, these reforms. Together, the limited influence of these factors in instances of high democratic pressure saw a breakdown in what are typically highly cooperative relations among policy and industry elites.

The ex-ante separation policy that was pushed for by politicians allowed Switzerland's two global banks to continue their international activities, but with a ringfence in place that was intended as a buffer against international market risk. On the capital reform issue, policymakers acted in advance of most other countries and created strong incentives for these two firms to become smaller and less risky. On the executive pay issue, new controls were put in place on practices that had been the subject of scandal since the early 2000s. It is nonetheless shown that despite the regulatory costs imposed on its two global banks, these outcomes did not jeopardise Credit Suisse and UBS's position as global firms, particularly in the most profitable component of the Swiss financial centre, wealth management. This aligns with the theoretical expectation of how an economy asymmetrically dependent on industry will make policy: while these reforms were responsive to democratic demands to curb the risks associated with Swiss global banking, these firms were still able to remain active in global markets, in particular through further consolidation in wealth management.

In hindsight, neither the structural nor capital reforms have achieved what they set out to. The events of 2023 show that ex-ante separation failed to insulate the Swiss economy from

the risks associated with housing global banks. The Swiss government was forced to bailout Credit Suisse and facilitate a merger with UBS, in turn creating a bank that is arguably even more TBTF. In that same experience, Swiss policymakers have come under a barrage of criticism from foreign governments and international investors for ordering Credit Suisse to cancel $17bn of CoCo (or "AT1") bonds as a condition of the merger. The failure also occurred despite Credit Suisse holding capital in line with the high requirements of the Swiss Finish. There are of course multiple reasons for Credit Suisse's downfall, but if an aim of Swiss policy was to reduce the country's exposure to global finance, these policies have manifestly failed to achieve that.

As for the regulation of executive pay, the Minder reforms have also done little to reduce the salaries of Switzerland's senior corporate executives. Instead, policymakers have been forced to take ad-hoc action when corporate governance scandals have once again raised the salience of executive pay practices. In March 2023, for example, the Swiss government intervened to stop Credit Suisse paying out deferred bonuses to its staff. This move came immediately after the Credit Suisse bailout, and somewhat ironically just a month after the bank had designed a scheme to offer 500 senior managers $380m in bonuses if the bank's ambitious restructuring proved successful (Walker 2023).

While these reform outcomes undoubtedly stack up as *market* failures, the surveys and survey experiments cited in Section 4.5 seem to suggest that the *democratic* outcomes of the Swiss reforms were, at least before the Credit Suisse failure, quite successful. In particular, the Swiss are, compared to respondents from several countries including the UK and US, more trusting of and warm towards their big banks. From the available data, negative perceptions about banking seem more localised to periods where industry practice becomes a highly salient topic, such as after major crises.[142]

One interpretation of why Swiss voters are, on the basis of the available data, quite favourable towards banks is that they perceive it to be an important economic sector integral to the success of the Swiss economy. It is also possible that Swiss banking is not associated with the same economic inequalities as in the UK, the other country that is asymmetrically dependent on banking. As Table 4.5 and Table 3.6 show, Swiss financial sector jobs are not such outliers in terms of salary compared to jobs in the City of London within the context of the wider UK. Even if Switzerland's post-crisis reforms were constrained due to the country's reliance on international finance, there is no evidence of a subsequent backlash against elites in the way experienced in the UK and US in the years after post-GFC reform had taken shape. Swiss policymaking institutions appear quite successful at managing a social contract around the governance of a global industry. That appears to be due to differences in both the demand side of democracy and the supply side of policymaking.

Overall, Switzerland's choice reforms after the GFC led to significant change at Switzerland's two global banks, especially in investment banking which was widely perceived to be the main cause of UBS's woes. Meanwhile, post-crisis reform in Switzerland allowed these banks to pursue their international wealth management strategies mostly unchanged. Assessing Swiss

[142] While comparative data is not available, in the UK banking is shown to be a consistently untrusted industry (see Figure 3.2).

reforms alongside the available public opinion data, it seems that at least until the 2023 Credit Suisse crisis, Swiss voters were broadly content with the policy outcomes achieved. The case of Swiss post-crisis reform therefore suggests that political economies existing in asymmetric dependency can still produce significant democratic responses. Indeed, consistent with the theory, it was when democratic demands were highest that reforms went most decisively against industry interests. At the time of writing, Swiss policymakers are currently reassessing TBTF rules in light of Credit Suisse's collapse. What that reappraisal means for the future of UBS is surely contingent on whether the public once again takes a keen interest in reforming the rules of global banking in Switzerland.

5. Post-Crisis Reform in the United States

5.1 Explaining Cases of US Post-Crisis Reform

This chapter describes and explains post-GFC reform on four policy issues in the United States. It details the policymaking process for several regulatory issues, as well as reform of tax and pay in the banking sector. The theory chapter identified the inconsistent power of some of the key explanations in the political economy literature. Table 5.1 further substantiates that summary on a within-case basis, evaluating the fit of each competing explanation with the different policy outcomes that occurred. As is shown, no single overall explanation holds well across cases.

The following chapter pits existing approaches in the political economy literature against the post-GFC policy outcomes identified in Table 5.2. In each instance, gaps and inconsistencies in established literature are identified. It is demonstrated how the expectations of the theory, which is that US policymakers can deliver a policy response to democratic pressure unconstrained by the economic dependencies facing other countries, accounts for significant variation in observed outcomes.

Table 5.1 can be explicated through identifying how far accounts of the policy process according to a bureaucratic account (column 1, row 3) fit with observed within-case outcomes. Applied to the US political economy, arguments commonly associated with such an explanation suggest that the divided structure of the institutions responsible for US financial regulation weakens democratic law-making; and even that these institutions are captured by the industry they regulate. For example, research in this area has shown how agencies compete over reform, including by engaging in turf wars (Carpenter 2010a); as well as how agencies are overwhelmed by burdensome processes of regulatory administration that industry can exploit (Carpenter et al. n.d.; Mankad, Michailidis, and Kirilenko 2019). As sections of this chapter demonstrate, the explanation from this literature captures some dynamics of the US cases of bank structural and derivatives reforms, however, it struggles to explain the significant US-specific capital reform known as the Collins Amendment. Bureaucratic explanations also have little to say about policies that targeted banking sector tax and pay, given these never passed the hurdles of the US legislative process. All in all, an explanation emphasising autonomous activity in the US bureaucracy cannot explain the observed variation.

Table 5.1: Explanatory Power of Competing Explanations for US Regulatory Reform

Predictions of Existing Literature		**Evidence Base for Competing Explanation By Policy Area**			
Competing Explanation	**Plausible Expectation(s) Associated with Explanation**	**Bank Structural Reform**	**Derivatives Reform**	**Capital Standards**	**Bank Tax and Pay Issues**
Bureaucratic Autonomy	Divided bureaucracy yields weak reform	✓	✓	✗	✗
Financial Resource of Bank Lobby	High lobbying expenditure yields weak/no reform	✗	✗	✗	-
Political Institutionalist	Veto points stall strong reform	✓	✗	✗	✓
	Adversarial politics leads to high political conflict over reform	✓✓	✓	✗	✗

Key: ✓✓ = evidence in support ✓ = limited evidence in support ✗ = evidence against; **-** insufficient evidence

Table 5.2: Summary of US Policy Reforms Studied in Chapter

<table>
<tr><th>Feature of Policy</th><th>Bank Structural Reform</th><th>Capital Standards</th><th>Derivatives Reform</th><th>Bank Tax and Pay Issues</th></tr>
<tr><td>Level(s) of Policymaking in Sequential Order</td><td>US-national</td><td>1. US-national
2. Multilateral</td><td>1. US-national
2. Multilateral</td><td>None</td></tr>
<tr><td rowspan="2">Policy Outcome</td><td>Volcker Rule</td><td rowspan="2">Collins Amendment</td><td>Central Clearing Mandate</td><td rowspan="2">No major reform passed</td></tr>
<tr><td>Intermediate Holding Company Regime</td><td>Lincoln Amendment</td></tr>
<tr><td rowspan="2">Policy Scope & Impact</td><td>Volcker Rule impacts all global banks</td><td rowspan="2">Significant capital standards impact all global US banks</td><td>Broad clearing mandate impacts all global banks</td><td rowspan="2">Congressional and White House proposals not implemented</td></tr>
<tr><td>IHC Regime impacts all non-US global banks</td><td>Lincoln Amendment affected US global banks; later overturned</td></tr>
</table>

Table 5.3, meanwhile, recaps what a theory of democracy under constraint – in the US case, more pointedly democracy *without* constraints – predicts would occur in specific circumstances of US policymaking. In low salience scenarios, interest group politics are expected to predominate – a hypothesis which incorporates aspects of both lobbying and political institutionalist literatures. Interest group politics is indeed a standard lens applied to studies of US policymaking (Drutman 2015; Hacker and Pierson 2010). Meanwhile, in high salience scenarios, it is predicted that American *strategic independence* gives policymakers scope to deliver *unconstrained responsiveness* when lawmakers experience high democratic pressures for reform. US policymakers operate with strategic independence given how two crucial variables are set in the American political economy: bank exit options are low, and the US financial sector is weakly internationalised. Surprisingly, post-crisis studies of US financial regulation in the Comparative Political Economy literature have to date paid little causal attention to the US's position in the international political economy (Strange 1987). The two business power variables in the model position the United States as an uniquely powerful actor in the global economy. For most countries, American banks operate as global actors in the world economy; to US policymakers, these firms are first and foremost American. This grants American policymakers, in principle, unparalleled scope to shape public policy without

the constraints faced in most democracies which experience significant dependencies on the global banking industry.

Table 5.3: Expected Empirical Observations of US Policymaking Given State-Bank Dependence and Level of Democratic Pressure

Drivers of Policymaking		*Policymaking Outcomes*	
🇺🇸 **State-Bank Dependence**	**Democratic Pressure for Reform**	***Expected Empirical Observations***	**Policy Outcome**
Independence - Financial Sector Internationalisation - Bank Exit Options -	High Democratic Pressure →	*Policymakers do not mitigate costs to international finance; nor response to firm exit threats* →	Unconstrained democratic responsiveness
	Low Democratic Pressure →	*Policymakers respond to demands of best-resourced actors* →	Interest Group Politics

Key: ++ high/very high; **+** mid/high; **-** low/insignificant
Note: Democratic Pressure for Reform can change temporally

This is not to ignore the formidable resources available to the American bank lobby as it seeks to influence policy. The financial industry spent more than $750m lobbying the US government in 2009-10 alone. Many studies have shown that such expenditure often buys influence. Yet the cases presented in this chapter demonstrate how that influence can diminish precipitously. To date, scholars have sought to explain why this occurs by reference to the effectiveness of firms' lobbying strategies. For example, Table 2.3 presented Howarth and James' (2023) comparative financial power model, which hypothesises that the US bank lobby fails where there are divides in individual firms' lobbying positions. A democratic model of regulatory reform instead looks not to what business does, but to how voters respond after a major market event to explain the observed within-case variation. It hypothesises that the US bank lobby fails where the democratic demands for reform are strongest and sit most orthogonal to business interests. Without the structural business power constraints faced by other ACDs, even the best-resourced lobbying campaigns will fail to diffuse the pressures policymakers experience to respond to voter demands.

This characterisation of the US as unconstrained democracy may be surprising to some, given that post-crisis regulatory change in the US has not delivered some of the more sweeping proposals for reform put forward after 2008. There is, to be sure, a gap between the policies demanded and the regulatory regime that has been achieved. But this gap, it is argued, is less

to do with the influence of the US bank lobby than the overall contours of US public opinion. Section 2.5. presents data demonstrating the strong partisan divides among the US public on attitudes to state intervention in financial markets. State intervention is often a necessary condition for more sweeping or "market-shaping" regulatory proposals. A regulatory issue needs to be salient not just with some US voters, but with a broad coalition from both sides of the political aisle. This creates propitious conditions of issue salience that translate into strong democratic pressures being experienced by policymakers from both parties. A common political experience of democratic pressure is all the more important given the veto-laden US political process (Tsebelis 2002). It is when pressure is exerted in such a way that responses unconstrained by the state's structural dependency on big banks are predicted.

The next sections proceed as follows. Section 5.2 details the contexts of US banking reform, including the major players in the sector and US financial regulation prior to the GFC. Section 5.3 examines the comparative role of domestic versus multilateral policymaking institutions. Section 5.4 sets out how banks' instrumental power is secured and disrupted in the American political economy. Section 5.5 presents evidence of US public opinion towards financial regulation during the period under study. Section 5.6 analyses the process and outcomes in four areas of regulatory policy. 5.7 concludes by assessing the overall landscape of US global banking regulation since the GFC, and discusses the prospective scope for future regulatory reform.

5.2 Contexts of US Banking Sector Regulation and Reform

5.2.1 Structural and Regional Divides of US Banking

This section details the commercial landscape of the US banking sector, providing important context for the reform period under study. A first important feature, which informs the policy debate discussed in Section 5.6.1.1, is the history of bank structural regulation in the United States. During the twentieth century, the American financial sector grew to be especially large and sophisticated, tracking the growth of its domestic economy and the role of the US in the international economy. While banks have undoubtedly played an important role in the US financial sector, unlike in many European countries there is a more limited history of universal banking. In the twentieth century, the Glass-Steagall Act was passed in the wake of the Great Depression. This prohibited the involvement of commercial banks in securities trading and put an end to a short post-World War I period in which commercial banks had begun competing with independent broker-dealers (i.e. investment banks) (Kroszner and Rajan 1994). This regulation was gradually weakened in the 1980s until parts of it were eventually repealed in the Gramm-Leach-Bliley Act of 1999. President Bill Clinton stated that Glass-Steagall repeal was intended to "diversify [financial services firms'] product offerings and thus their sources of revenue … [and] be better equipped to compete in global financial markets" (Clinton 1999). Nonetheless, the key division that was in place during a period of significant growth in the US economy meant that the country came to be financed more through securities markets than most European economies (Herrigel 2008).

A second important feature of the US banking system is the division between national and regional financial markets. In tandem with its history of structural banking regulation, by the end of the nineteenth century the US had developed a "dual system" of national and state

banking. While this system has eroded in recent decades, national banks continue to be chartered by the national government, while state banks are regulated by each state (Corbae and D'Erasmo 2020). State-chartered banks continue to play an important role in specific markets (Hanauer et al. 2021). Together, the structural and regional segmentation of the American banking system produced a heterogenous financial landscape for much of the twentieth century. In some respects, this system of governance continues to shape American finance today, for example through the division of responsibilities among different regulators (Congressional Research Service 2022).

5.2.2 The Rise of Large US Banks

In recent decades, several factors have led a small group of large American banks to hold an increasingly dominant role in the US and the global economy. These developments are the result of both economic and regulatory change. First, the role of large banks has grown as that of smaller community banks has fallen. Having peaked in the early 1920s at over 30,000 firms, the number of US banks declined by about 86% over the following century, with just 4,377 banks surviving at the end of 2020 (Emmons 2021). In particular, when scores of banks failed during the Great Depression, the market share of the largest 25 US banks rose precipitously. Having held a relatively stable sub-20% of all US banking assets from the post-Civil War Reconstruction period until the late 1920s, by the Second World War the largest 25 US banks held roughly 40% of assets. After several peaks and troughs, the market share of these 25 firms grew swiftly from the 1990s onwards, reaching over 70% by the eve of the GFC.

Within this grouping of 25 large firms, the biggest five banks enjoyed particularly pronounced increases in market power. Their market share grew massively during the 1920s and from 1990 onwards. By the time of the GFC, the five largest banks held nearly 50% of all banking assets, a figure which has remained roughly consistent. The causes of this trend toward higher market concentration are debated among scholars: some argue that it is a product of the increased market power of large firms (Philippon 2019), while others conclude that regulatory change has made it increasingly difficult for small banks to compete (Corbae and D'Erasmo 2020). The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which liberalised inter-state banking markets, is often cited as a key example of pre-GFC regulation which favoured the biggest banks. As with the Glass-Steagall repeal, this is also identified as a clear case of their lobbying success (Crawford 2011).

Alongside these five firms' increased dominance in retail and commercial banking, the Glass-Steagall repeal and other changes saw these banks become increasingly dominant actors in securities markets. In 2000, in the years after parts of Glass-Steagall were repealed, JP Morgan and Citigroup were the only two large US-headquartered Federal Reserve-supervised bank holding companies to develop a significant position in securities markets. By the end of 2008, the market environment had changed substantially: five of the top ten largest financial advisory companies operated a bank holding company structure.[143] Firms including Citigroup, JP Morgan and Bank of America had consolidated within securities markets, including through

[143] Data cited are from S&P Global's Transactions League Tables, using search criteria for total deal value in 2008, aggregating deal value associated with the full spectrum of formal capacities which the League Tables measure (e.g. Financial Advisory; Book Manager; Exchange Agent).

GFC-era mergers with failing standalone investment banks. The two large US investment banks that did not fold during the crisis – Morgan Stanley and Goldman Sachs – themselves converted to bank holding companies and in so doing benefited from the public declaration of the Federal Reserve that they were financially strong firms. They have chosen to maintain this corporate form since the GFC, given the market's uncertainty about the long-term viability of the securities broker-dealer business model. Thus today, most of the largest US banks compete across retail, commercial and investment banking. The continued success of banks' securities business can be measured through publicly available data on mergers and acquisitions deals in the US. By the end of 2019, the largest US bank holding companies advised a full 52% of the biggest M&A deals.[144]

Despite this trend of higher consolidation and more universal banking, compared to many OECD economies, the US banking sector remains less concentrated and populated by firms with more heterogenous corporate models. Nonetheless, since the 1990s the US has been on a similar trajectory to those European countries, where a few large universal banks have come to occupy an increasingly focal role across a spectrum of financial markets.

A further difference from European banking is that in the US both the largest group of banks and the banking sector overall have remained far smaller relative to the overall size of individual national economies. In 2007, the size of all US banks' balance sheets reached a high of 96% of GDP. While quantitively large, this figure was far lower than the equivalent ratio in most other ACDs, where the assets of the single largest firm were often higher than national GDP (OECD 2012). This is partly a consequence of the relative size of the non-bank financial sector in the US, whose assets in 2007 stood at 159% of GDP (Federal Reserve Bank of St Louis n.d.). Since the early 2000s, the dominant share of financial assets in the US has been held by the broad category of "other financial intermediaries", rather than banks (Financial Stability Board 2021, 57–58).[145] The structure of the US financial sector is, in this respect, considerably different from most other ACDs. The reasons for this historical divergence continue to be debated by economic historians (Chandler 2002; Herrigel 2008; O'Sullivan 2001). The key implication for this research project is that large US banks continue to be smaller relative to the overall size of their national economy than banks in most other ACDs. The value this group of firms creates, which can in turn be extracted by the state through taxation and employment, is far less important to US policymakers than that of those in countries such as Switzerland and the UK, and indeed many other OECD economies.

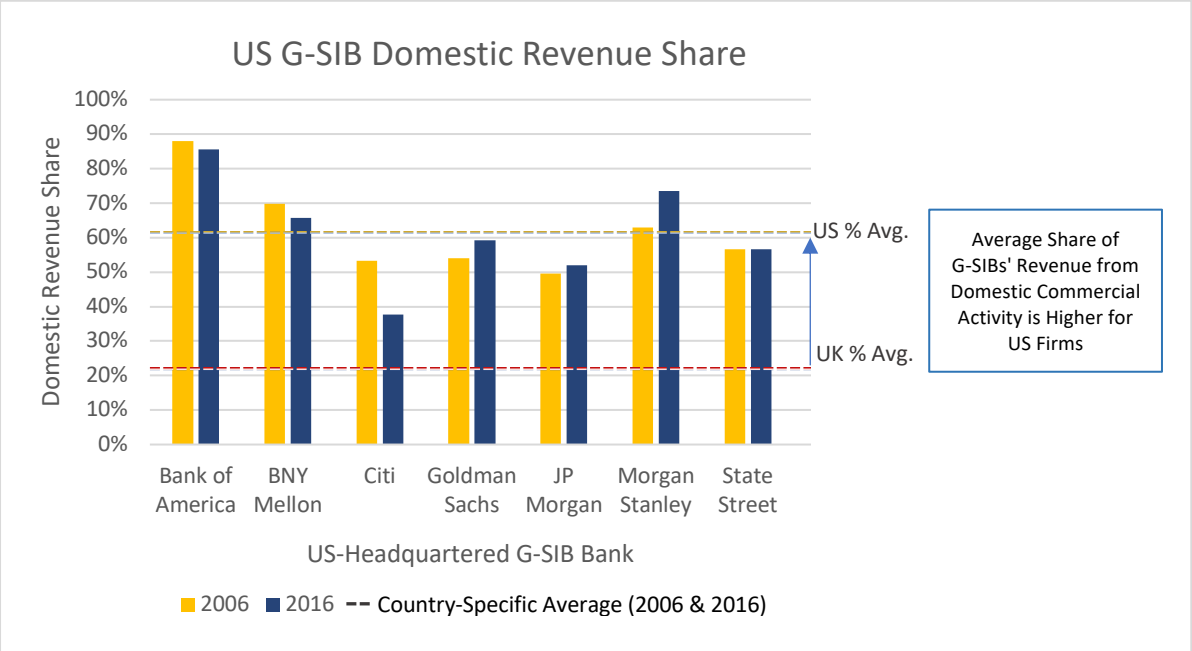
A second and related dynamic is the primacy of the US domestic economy for large American banks. It provides the most lucrative commercial opportunities for these firms, and therefore also a majority of their revenue. As is reflected in Figure 5.1, among the US's global banks (defined as G-SIBs by the FSB), aside from Citigroup all of these firms have consistently derived

[144] This figure is calculated by using data from S&P Global's Transactions League Tables, taking the total deal value advised by firms that are within the top 25 commercial banks by assets in 2019 and dividing this by the total deal value advised upon by the top 25 advisers measured by deal value (only some of which are commercial banks operating through bank holding companies). The firms that are both among the top 25 commercial banks and top 25 advisers are Goldman Sachs, JP Morgan, Bank of America, Morgan Stanley, Citigroup, Wells Fargo, TD Bank and Truist; in 2019 these firms conducted 52% of the deal value of the largest US M&A deals.

[145] The relevant comparative data on bank/non-bank assets were first collected in the early 2000s.

over half of their revenues from domestic commercial activity.[146] This rate has remained stable over time, standing at a constant mean share of 62% domestic revenue to total revenue both before the crisis (2006) and ten years later (2016). As was set out in Table 2.10, the large share of activity derived from domestic revenues makes US "global" banks far less internationalised than peer firms headquartered in other ACDs.

Figure 5.1: Share of US Domestic Revenues to Overall Revenues
Source: Bank Annual Reports



5.2.3 Foreign Banks and their Role in the US Banking Sector

Foreign banks are significant players in US markets, although the structural position this grants them in the political economy is qualified by several key dynamics. In the years prior to the crisis, foreign banks invested heavily in US markets (H. M. Schwartz 2015). This activity led the assets of foreign banks to constitute a considerable share of overall banking assets in the US. As Table 5.4 shows, however, within six years the share of foreign bank assets had roughly halved. This was a trend also seen in many ACDs after the GFC, as the high watermark of financial globalisation receded.

Table 5.4: Percentage of Foreign Bank Assets to Total Bank Assets
Source: Bankscope Data; Claessens and van Horen (2014)

Country/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013
United States	21	21	22	18	19	16	14	14	10
OECD Average	11	11	12	12	12	11	11	10	9

[146] Note that Wells Fargo is not included in Figure 5.1 because it does not report revenues by geography. However, Wells Fargo is the bank that would have consistently the highest share of domestic revenue to total revenue, since its overseas operations are minimal. As such, inclusion of Wells Fargo would only increase the US country average of G-SIB domestic revenue share. See also Culpepper and Reinke's (2014) analysis.

However, while foreign bank assets relative to overall banking sector assets were not insignificant – the ratio was higher than countries such as the UK, France, the Netherlands and Switzerland – they remained relatively unimportant in the context of the very large US economy. As Table 2.10 shows, by the end of 2006 foreign banks held financial positions amounting to about 34% of US GDP – an amount far lower than any other country bar Australia. By the end of 2019, these positions were higher in absolute terms, but significantly lower relative to GDP, standing at 22% of US GDP.

These features of American banking are crucial to the analysis that follows. Foreign (non-US) banks are far less important to investment in the national economy than is the case for the other countries studied in this dissertation. Second, global banks as a whole (US and non-US headquartered) are generally less important to the US economy than in these other countries. Global banks are, it is proposed, therefore a less structurally empowered industry in the US political economy. US policymakers will be less constrained when they look to apply domestic regulation to global banks because an internationalised financial sector is not a significant source of added value to American economy. They will as a result also be less influenced by prospective threats made by global banks to exit American markets.

The limits of bank structural power in the US political economy are further compounded by the uniquely important role the country has in the global economy. As a significant body of scholarship has shown, access to US markets has become a prerequisite for large foreign banks to be able to compete globally with American peers (M. Beck 2021; H. M. Schwartz 2015; Tooze 2018). No other country enjoys this unique position. Aside from the limited role that foreign banks have in American finance generally, it further weakens the exit options available to these firms. It is predicted that the freer hand of US policymakers to regulate global banks without major economic costs will be observable in a programme of regulatory reform.

Assessing these data on the US banking sector in parallel, American policymakers experience a particular structural dynamic between the state and the banking sector that is vastly different for their counterparts in Europe and other ACDs. In a trend that has continued a pre-GFC rise (Arnold 2018a), US banks have emerged as among the largest in the world. Yet, relative to the size and role of the US economy as a whole, these firms remain relatively small players. As for foreign banks operating in the US, these activities are small relative to the size of total investment in the US economy, and have become less significant since the GFC. The theory positions these as crucial factors shaping US reform. They grant policymakers strategic independence from the banking sector.

5.3 Rules of the Game in US Policymaking: The Dominance of Domestic Policymaking

In the theory chapter, it was identified that domestic rather than multilateral policymaking institutions are the key forum in which major US reforms were contested. For scholars who research domains of public policy such as climate and defence, the precedence of US domestic institutions is well-established (Purvis 2004). In the field of financial regulation, the US has long been an active player in multilateral institutions, yet still policy made in national institutions has often taken precedence (Goodhart 2011). Functionally, unlike for much of Europe, the US is not part of a supranational political and economic union. It is the rules

decided in domestic institutions which take precedence over those achieved elsewhere. Conversely for EU countries, for example the UK during the period under study, the rules of the EU single market meant that much financial regulation was decided in Brussels; where the UK diverged from EU rules it had to ensure that these rules were compliant with principles of single market membership. For the US, the absence of such an institutional arrangement means that almost all key reform processes take place via domestic political institutions; and even those in principle agreed to in multilateral fora need to be ratified and/or implemented in domestic policy. Basel II, for example, was never fully implemented in the US.

In addition to these functional realities of US policymaking, the country's status as the world's largest economy also grants it considerable regulatory power relative to other countries. US domestic regulation can carry particular influence over global markets, due to the size of the US domestic market and the policy diffusion that often occurs (Drezner 2008; Simmons and Elkins 2004). The decisions that the US takes domestically can thus influence regulatory decisions made by other jurisdictions and multilateral institutions. In contrast, the UK and Switzerland have often emphasised the importance of conforming to multilateral rules and standards. Despite very large domestic financial sectors, both possess weaker regulatory power to influence global regulation (cf. James and Quaglia 2020). Across the slate of regulatory issues discussed in this chapter, the regulatory decisions US policymakers reached in domestic institutions always took precedence over multilateral agendas.

The predominance of domestic policymaking in the US affects how political issues are mediated. Table 2.7 set out the prediction that the pressures policymakers experience to respond to salient voter issues will be felt most strongly when domestic institutions are the chosen venue of policymaking. In the US, domestic institutions are the default venues that debate reform proposals. The influence and participation of multilateral institutions almost always remains more marginal. Where the democratic pressures experienced by US policymakers are especially high, it is expected that the response to those pressures will be refracted through domestic institutions. Given the low structural-economic constraints to US policymaking, the democratic response should as a result be easily observed.

5.4 Instrumental Bank Power: Special Interests and the Salience Effect in the US

Table 5.1 identified that the explanation associated with the US lobbying literature – that the best-resourced industry actors will predictably win contests of policymaking – struggles to explain almost every within-case outcome of US reform. This is a puzzling outcome which challenges mainstay analyses of US policymaking which generally conclude that the US business lobby is particularly powerful (Drutman 2015; Hacker and Pierson 2010). Indeed, this observation of lobbying failure also appears a curious reversal, given the general thrust of financial deregulation that occurred from the 1980s until the GFC (Helleiner 1994). When assessed against outcomes in European post-crisis banking reform, the failures of the US bank lobby also contrast with the successes of European banks on some key policies (Ganderson 2020b; Hardie and Macartney 2016; Massoc 2020).

Chapter 3 identified that the British political economy lacks the cooperative institutions that generally allowed European banks to sustain their influence in countries such as France and the Netherlands. The US shares much in common with the UK in this regard. A well-resourced

bank lobby allows banks to maintain high influence over the policy process at a low salience equilibrium, when voters do not pay much attention to financial regulation. Indeed, in the US the scale of lobbying activity, including campaign donations, suggests that big banks pay for the privilege of policy access. This policymaking environment – where firms must vie for influence – is set out in Table 5.3, which identifies that interest group politics are expected to predominate in settings of low democratic pressure. Given the resources available to big banks, they often succeed in outcompeting other interests, thus achieving favourable regulation. When issue salience goes up, however, the influence of the business lobby can swiftly weaken. US policymakers, operating in an adversarial political system which lacks cooperative policymaking institutions, compete to make policy that aligns with the demands of those voters who may in future choose to re-elect them.

The collapse of lobbying influence under strong democratic pressure is to this extent a common expectation of the three countries under study: each possesses democratic institutions that incentivise responsiveness to voter demands, which in turn serve to destabilise established modes of cooperation between policy and industry elites. This is where the commonalities between the US on the one hand, and the UK and Switzerland on the other, begin and end. Faced with high democratic pressure, the US response is expected to remain unconstrained by the structural-economic barriers that limit democratic responsiveness in the British and Swiss cases. If banks' instrumental power over policymaking breaks down, US policymakers are able to deliver notably strong reforms. A breakdown in lobbying influence can thus have particularly stark effects on US policymaking: the political environment can swing from one in which big banks exert particularly strong influence, to one where policymakers act decisively against these firms. Democratic pressure is predicted to be the force that will disrupt industry's otherwise strong influence over US policymaking.

5.5 Banks and Banking Reform in the American Public Eye

For a regulatory issue to become both broadly salient to voters and to sustain strong democratic pressure for reform, a broad coalition of voters needs to develop preferences which oppose industry interests. In each of the three countries under study, there exists some degree of left-right divide on attitudes towards financial regulation. Surveys generally show that right voters are more likely to favour less government intervention and freer markets, while left voters will favour more government intervention and more "market-shaping" policies (Culpepper, Jung, and Lee 2023; Young and Yagci 2019). In the US, this partisan divide is far more pronounced. Table 5.5 provides summary data from several polls conducted during the 2008-2010 period. Republicans are shown to be consistently less in favour of financial reform than Democrats.

Table 5.5: Summary of polls on US public attitudes towards stronger financial regulation

Poll	Date	Sample Size	Support-Opposition (%)		
			Overall	Republicans	Democrats
Gallup/USA Today	September 2008	1056	59-30	47-42	68-20
Time	October 2009	1003	59-13	-	-
Pew Financial Reform	March 2010	1000	40-29	-	-
CNN	Mar 2010	1030	53-43	35-62	68-27
NBC/WSJ	June 2010	1000	57-15	37-25	73-7
CNN	July 2010	1018	58-39	42-53	53-47

The partisan divide is even more pronounced in polls from this period that asked respondents more nuanced questions about the state's role in financial reform. Table 5.6 presents data from a May 2010 survey, collected during the apogee of the Dodd-Frank negotiations. It shows that while voters from both parties were consistently supportive of legislation to "more strictly regulate" financial institutions, there were very different attitudes about what the role of government intervention should be. Republicans were much more likely to worry that government "will go too far" than that they would "not go far enough" in regulating firms (66% - 28%); whereas Democrats were far more likely to take the opposite stance (25% - 63%). This was also the period when the Tea Party grew into a national political force. One notable study found that its members broadly self-identify as "proud capitalists" highly sceptical of government regulation (Skocpol and Williamson 2012, 57).[147]

[147] In November 2010, in the same year that Dodd-Frank and the Affordable Care Act were passed, Tea Party-linked candidates won 39 of 129 races in the House of Representatives and 5 of 9 in the Senate. They became a powerful electoral force during the period when the Democratic Administration pushed through reforms that gave significant new regulatory authority to state actors.

Table 5.6: Priority of Stronger Financial Regulation
Source: Pew Survey, 11-13 May 2010, N = 1002

Responses	Total	Democrat	Republican	Independent	DK/Refused
"Is passing legislation to more strictly regulate financial institutions…"					
Very/somewhat important	81	92	74	81	73
Not too/not at all important	13	5	19	16	17
Oppose / Not Needed	1	0	2	1	0
Don't know / Refused	4	3	5	3	10
"Thinking about financial regulation, what worries you more?"					
Government will go too far	47	25	66	52	47
Government will not go far enough	43	63	28	39	38
Don't know/ Refused	9	12	6	9	15

Given these divided attitudes towards financial regulation, it will take a particularly strong wave of attention to a reform issue among both left and right voters for strong democratic pressure to be experienced by lawmakers on both sides of the political aisle. Indeed, in the analysis of policy reforms below, it is shown that the Democratic Administration often struggled to find support in the Senate to overcome filibusters repeatedly threatened by Republicans. When developing a policy response to high salience issues, Democrats often had to tailor reforms to attract the pivotal votes of a few moderate Republicans. Republican voters are much more cautious about policies which entail significant new state intervention in markets. To give one notable example, as Section 4.6.4 discusses, despite President Obama being sympathetic towards a financial transactions tax, this was not a popular policy among Republican or moderate voters, and was very unlikely to attract the support of even the few swing Republican lawmakers. In the absence of a public opinion survey on FTTs from the post-2008 period, a poll conducted in 2021 shows pronounced opposition from Republicans to such a tax, and equivocal support among Democrats.[148] The support of the supermajority of Congressmen required to make policy in the US is likely only when they face democratic pressures from a broad swathe of voters who take interest in and are supportive of prospective state-led reforms. As the following sections show, this coalescing of salience and public support in the US occurred only on some policy issues during the post-GFC reform period.

[148] The survey found that 80% of Republicans opposed an FTT (US Chamber of Commerce and Teneo 2021) (conducted online, 23-25 February 2021, N = 2000). A further 69% of independent voters, and 51% of Democrats, also opposed an FTT. Interestingly, this is starkly different from a 2010 poll conducted in the UK which showed broad voter support for an FTT (see Table 3.13).

When these conditions did arise, pathways were opened up to significant policy reform against industry interests. The following sections advance the case that when this happened, the road to reform in the US is far less encumbered by the structural-economic constraints faced by most other ACDs. Without those blockages, it is predicted that there is scope for US policymakers to deliver an *unconstrained democratic response*.

5.6 Four Cases of US Post-Crisis Reform: Policymaking in an Unconstrained Democracy

This section describes and explains three policy areas in which the US achieved notable reforms, and one – tax and pay issues in the banking sector – in which outcomes did not mark a major departure from the status quo.

5.6.1 US Structural Reform

Structural reform became a focal issue of the US reform process. Proposals were initiated by reform-minded individuals and organisations in the years after the GFC, including two pre-Dodd-Frank bills introduced in Congress seeking to reinstate the relevant parts of Glass-Steagall (Drawbaugh 2009). This section examines two of the most structural reforms which were ultimately passed and implemented in the US: the Volcker Rule and the Intermediate Holding Company (IHC) rule for foreign banks.

Table 5.7: Overview of Possible Bank Structural Reforms in the United States

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Glass-Steagall-type separation	Glass-Steagall-type separation	*No separation*
Proprietary trading ban	*Proprietary trading ban with few exemptions*	No proprietary trading ban
Enhanced supervision of foreign banks' activities	*Structural reform to enhance supervision*	No structural reform and no enhanced supervision

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

5.6.1.1 Volcker Rule

Table 5.1 identified that, of the three competing explanations for the US bank structural reform outcome, arguments associated with the literature on US lobbying find limited support, while there is evidence consistent with bureaucratic and political institutionalist

arguments. After a summary is provided of the main tenets of the Volcker Rule, evidence consistent with and challenging to these explanations is assessed, followed by an application of the theory to the case.

The Volcker Rule has its roots in the intellectual work of the former Chair of the Federal Reserve, Paul Volcker. With colleagues at the Group of Thirty, in January 2009 Volcker published a report entitled *Financial Reform: A Framework for Financial Stability*. In this he stated that:

> Large, systemically important banking institutions should be restricted in undertaking proprietary activities that present particularly high risks and serious conflicts of interest. Sponsorship and management of commingled private pools of capital (that is, hedge and private equity funds in which the banking institutions own capital is commingled with client funds) should ordinarily be prohibited and large proprietary trading should be limited by strict capital and liquidity requirements. Participation in packaging and sale of collective debt instruments should require the retention of a meaningful part of the credit risk.
>
> (Volcker, Padoa-Schioppa, and Fraga Neto 2009)

A year after this report was published, the White House announced its intention to enact such a proprietary trading ban. In January 2010, President Obama announced a "simple and common-sense reform", which was referred to as the "Volcker Rule" for the first time. In his words:

> We simply cannot accept a system in which hedge funds or private equity firms inside banks can place huge, risky bets that are subsidized by taxpayers and that could pose a conflict of interest. And we cannot accept a system in which shareholders make money on these operations if the bank wins but taxpayers foot the bill if the bank loses.
>
> (Obama 2010)

The rule incorporated into the Dodd-Frank Act was faithful to the overall thrust of the White House version, but somewhat different in detail. Most crucially, the version enacted prevents banking institutions from engaging in most proprietary trading activity, and drastically limits their investments in hedge funds and private equity funds. In the case of proprietary trading, the definition used is broad, and covers most securities, derivatives, and futures products. Importantly, there are exceptions for market-making activities (i.e., trading on a client's behalf) and underwriting services. The law contains a *de minimus* exception allowing banks to invest up to 3% of their capital in hedge funds, private equity funds and similar entities (collectively known as "covered funds"). The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (EGRRCPA) introduced some exemptions for smaller banks, but Volcker still applies to the largest banks which are the focus of this study.

As an explanation for this outcome, the baldest summary of the literature of US lobbying – that the financial resources of the US business lobby will consistently produce outcomes that slant in its favour – clearly fails at an early hurdle. The major consequence of the Volcker Rule was that proprietary trading desks at major banks, which had grown at the largest conglomerate banking groups before the crisis – and in the case of Goldman Sachs, generated

about 10% of revenue – were closed.[149] The big banks with the largest trading operations lobbied most vociferously against the Volcker Rule. Both before and after enactment, they have argued that the rule makes an impossible distinction between short-term "on account" or "principal" trading and market-making. Jamie Dimon, the long-term head of JP Morgan, stated publicly that Paul Volcker "doesn't understand capital markets" and quipped that it would require every trader to be accompanied by "a lawyer, [a] compliance officer, [and a] doctor to see what their testosterone levels are, and a shrink asking 'What's your intent?'" (Foley 2012). There are periodic media reports that banks have found innovative ways of circumventing the Volcker Rule, which was substantiated in interviews conducted for this research (Lewis 2010). Nonetheless, banks have put enormous time and resource into complying with the main thrust of the Volcker Rule, and the largest banks have singularly failed to convince policymakers to rollback reforms since they were implemented.

Seeking to explain why the US bank lobby failed, the hybrid account from Howarth and James (2023) highlights "competitive" behaviour among firms which weakened their collective voice (see Table 2.3). They highlight that industry engaged in lobbying competitively, with a few large banks lobbying aggressively against the Rule, but the US community bank association coming out in support. The authors present a wealth of interview and media evidence on the different stances taken by these banks, and causally attribute the competitive interactions among firms as reason for the passage of stronger reform. While plausible, their study – which concerns bank structural reform only as a policy issue – raises the question of why the same competitive style of interaction among US banks often did not lead to strategic failures for the bank lobby. As the authors' note of the Dodd-Frank legislation, "Bank lobbyists were instructed to resist the administration's *entire regulatory agenda, including those reforms that enjoyed some degree of bipartisan consensus* (2023, 116, emphasis added).

The strength of Howarth and James' theory rests on the effect of bank lobbying style remaining a constant, not a variable, to the US policy process. Yet it struggles to explain the clear evidence that politicians are only periodically unresponsive to that expression of instrumental power. In other words, the model faces explanatory challenges when applied to a wider universe of regulatory issues in which competitive lobbying does not seem to prevent big banks from securing their interests. Overall, it seems reasonable to reach a more tentative conclusion on the role of lobbying: the concerted efforts to resist the Volcker Rule from the likes of Goldman Sachs and JP Morgan is evidence that the banks facing the highest costs lobbied the hardest. The failure of their efforts is evidence that the lobbying effect was, in this case, weak. The most these firms achieved in the last stages of the bill was the 3% *de minimus* exception.

The second dominant explanation for US regulatory outcomes derives from insights in the literature on bureaucratic politics. There are two dominant arguments associated with a bureaucratic account. Both accord with the diagnosis of Barth, Caprio and Levine that "*the* central financial regulatory challenge" is "how to get regulators to act in society's best interests" (Barth, Caprio, and Levine 2012). The first of these, deriving in particular from the work of Lawrence Jacobs and Desmond King (2016), is that the post-crisis era saw a dramatic

[149] The 10% figure is based on Goldman Sachs' own public declaration in 2010, and was widely quoted (although disputed by some) at the time (e.g. Kishan and Harper 2010).

increase in regulatory power, especially for the Federal Reserve. The expectation based on that core claim would be that post-crisis reform is designed in a way that increases the power of the major regulatory agencies – or in King and Jacobs' words "the Fed's drive to help itself" (Jacobs and King 2016, 32).

A second type of claim relates to the multi-institutional nature and decentralised decision-making of the US bureaucracy. It instead explains policy outcomes with reference to failures of coordination among different regulatory authorities. To quote Daniel Carpenter, the Dodd-Frank Act demonstrated that "much of the action in financial politics has occurred neither in the legislature, nor in the press, but in the existing regulatory arena". According to Carpenter, agencies such as the Federal Reserve, Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) compete for turf (2010a, 831). Carpenter's archetypal case of what he calls "institutional strangulation" is the highly contested Consumer Financial Protection Bureau. Applying this account more broadly to the Volcker Rule, a plausible argument is that the divided interests of different agencies precluded stronger versions of structural reform. Howarth and James similarly cite the "fragmented character of the US political and regulatory system … through which outside interests could try to shape the rule-writing process" as an explanation for the contested implementation of Volcker (Howarth and James 2023, 128).

These characterisations certainly capture elements of policymaking on this issue. However, no evidence was found, per a regulatory capture account, that industry was able to exploit the bureaucratic process to reduce the regulatory burden. The Volcker implementation process was protracted because of a divided agency structure, not because of a pro-business bias among regulators. In interview, a former regulator described the challenge facing US regulators as such: "we were coming at that rule and designing the rules after the statute was enacted from essentially five different points of view".[150] Elaborating these diverse inter-agency approaches, they identified that the SEC "wanted to preserve the ability of broker dealers to do their traditional brokerage activities … which includes proprietary trading", which its commissioners "thought was a vital part of the securities system". The *modus operandi* of the Office of the Comptroller of the Currency (OCC), meanwhile, was to "enhance the National Bank Charter", which was in competition with state charters. The OCC was resultingly "more tolerant of new activities as markets develop" and therefore "open to bank trading activities as much as possible". The Federal Deposit Insurance Corporation (FDIC), which insures bank deposits but also regulates aspects of bank activity and resolves failing institutions, was more "risk averse" and preferred to implement the Volcker Rule in a way that would maximally constrain trading activity in firms whose deposits it insured.[151] The CFTC had less cause to involve itself in the Volcker Rule, but it nonetheless "wanted to assert the CFTC's prominence over the SEC" by being "tougher than the SEC was". The Federal Reserve,

[150] Interview US#1, Federal Reserve official, 23 March 2022.

[151] The Federal Reserve official quoted further stated that the FDIC was "on a jihad against all derivatives; it thought derivatives were the devil's work … the Volcker Rule provided an opportunity to put a crimp in [the] derivatives activities of banking organisations". While this was plainly a critical take, this perspective on the FDIC's approach was corroborated by a former FDIC official, who stated that they advocated for the Volcker Rule because without it "the highest risk derivatives would now be inside FDIC insured, taxpayer backed [and] insured deposits [which] were being used for the riskiest of derivatives; the ones that are not cleared" (Interview US#2, FDIC official, 8 March 2022).

finally, had "less … drive" for the Volcker Rule and "was trying very hard to stay as close to the statute as possible and not use it as a vehicle to expand regulation".[152]

Amid these different organisational goals, and with responsibility for the Volcker Rule divided across five different agencies, the "required unanimity" was difficult to achieve: "just getting everybody's points of view, which were often conflicting, to a mutually acceptable place, took a lot of time and negotiation".[153] A proposal for Volcker Rule implementation, published in October 2012 – nearly eighteen months after Dodd-Frank's passage – was nearly 300 pages long and contained more than 350 questions for public comment. The final wording of the regulation was approved a full year later, in December 2013. Even then, considerable disagreement remained among regulators about aspects of implementation.

This evidence accords with a conclusion that the Volcker Rule process has been especially challenging given the highly decentralised bureaucracy responsible for regulatory implementation. On the other hand, it is difficult to sustain the argument that the Volcker Rule has been used as a tool to expand bureaucratic autonomy, such as that of the Federal Reserve (cf. Jacobs and King 2016). Overall, US regulators were cautious rather than supportive of the Volcker Rule, and have faced considerable criticism from politicians frustrated by the cumbersome implementation process. This is the opposite of what one would expect of a bureaucratic autonomy account, which would expect regulation to lead to greater agency and less political interference (Singer 2004).

On the other hand, a wealth of evidence aligns with a more political-institutionalist explanation of the Volcker process. Such accounts explain policy outcomes by reference to electoral and constitutional features of US policymaking, such as majoritarian elections and the high number of veto players (Chwieroth and Walter 2022; Ganderson 2020a; Tsebelis 2002). The Volcker Rule was shaped by this veto-laden process, and especially the need for Democratic leaders to achieve the support of sixty votes in the Senate. In January 2010, the change of White House strategy to active support of structural reform was identified in interviews as making the Volcker Rule's passage even more difficult for Congressional leaders. Even if it may have had the effect of making a proprietary trading ban front page news, the announcement stood out, according to one Senate staffer, as:

> not a positive moment from a bipartisan perspective … Dodd had been trying to sort of quietly socialise the idea of a Volcker rule before then, when the President came out on this … it looked more partisan at a time when Dodd was trying very hard to bring along the Republicans.[154]

Having been at the coalface of the partisan struggles over healthcare, Dodd perceived that "it's really difficult to get legislation of any magnitude through the Senate floor without having

[152] A former FDIC official offered a more critical interpretation of the Federal Reserve position, which was that it "didn't like the Volcker Rule" but that it "had always wanted supervisory authority over these financial organisations". According to this official, the Fed achieved this priority because what "really happened was that you expanded the Fed's power" through giving it the authority to regulate both the bank and non-bank financial system, rather than "separating them off" which would have been "a cleaner and better approach" (Interview US#2, FDIC official, 8 March 2022).

[153] Interview US#1, Federal Reserve official, 23 March 2022.

[154] Interview US#3, Senate Banking Committee staffer, 5 May 2015.

bipartisan support".[155] He "was very conscious of the fact that it can't go too far left or too far right. How do you keep all the Democrats and then pick up some Republicans?" (Kaiser 2014, 308). The Republican leader in the Senate, Mitch McConnell, maintained strong party discipline in an effort to derail Senators Merkley and Levin's efforts in support of what they called "a modest form of Glass-Steagall" (Merkley, quoted in Kaiser 2014, 311). For their part, the Democratic leadership failed to gain the support of Senators Cantwell and Feingold, both of whom voted against their party, citing that reforms did not go far enough.

A political-institutionalist explanation also correctly predicts that reforms will erode during the legislative process if the governing party does not have a supermajority (Lee 2016). On the Volcker issue, pivotal senators sought to extract concessions for the benefit of their own seats, or their party. Senator Scott Brown emerged as a pivotal vote Democratic leaders relied upon. He opposed aspects of the White House and Merkley-Levin versions of the Volcker Rule in the final Senate (18-20 May 2010) and Conference Committee votes (23-24 June). To ensure his vote, Barney Frank agreed to sign a letter asserting that the House version of the bill would "not prohibit depository institutions or their parent holding companies" from helping clients make trades or sponsor "limited" investment funds on clients' behalf (quoted in Kaiser 2014, 320). At Conference Committee, Brown was also successful in obtaining the *de minimus* exception that allowed banks to invest up to 3% of their capital in hedge funds or private equity funds. Of this final version, Volcker complained: "I'm sorry we lost the tighter limitations on hedge funds and private equity … I'm a little pained that it doesn't have the purity I was searching for" (Cassidy 2010). He identified the reason for the more limited outcome as the veto-laden political process: passing a bill "comes down to a squeeze play, and the sixtieth vote, or the person who's perceived as the sixtieth vote, he's got an awful lot of leverage" (Cassidy 2010).

Accounts of US policymaking focusing on the institutional hurdles in the US political system do a good job explaining this late stage wrangling and watering down of stronger versions of reform. In Brown's case, it was also clear that financial services companies in his home state had successfully lobbied him. Where these accounts have less to say, however, is identifying what conditions led this specific policy issue to pass these high institutional hurdles in the first place. With hindsight, the Volcker Rule appears a mainstay feature of the US reform package; but in the period of debate and bill drafting, its passage was far from inevitable. Other reforms promoted by the White House, such as the Financial Crisis Responsibility Fee discussed in Section 5.6.4, failed to ever gain traction in Congress.

In other words, a political-institutionalist account explains a lot about what sinks a reform, but far less about what allows it to pass through these institutions. The democratic drivers experienced by policymakers are crucial to this causal story. It was the increased salience of issues associated with the Volcker Rule during the first half of 2010, just as the Dodd-Frank Bill was being drafted, that drove this policy to the top of the reform agenda.

In this regard, it is illustrative that structural reform was not a flagship White House policy until early January 2010. It had in fact been generally opposed by key members of Obama's economic team, such as Timothy Geithner and Lawrence Summers. Many officials preferred

[155] Interview US#3, Senate Banking Committee staffer, 5 May 2015.

to focus reform efforts on increasing capital and liquidity requirements, which could be achieved through multilateral policymaking. By the end of 2009, however, it became increasingly clear to Democratic leaders that they were facing sustained public backlash against banks and what was perceived their "continuity" reform package (Cassidy 2010). This backlash was observable in several episodes of public antipathy towards industry and discontent about the government agenda. After months of public as well as investor pressure, for example, in December 2009 Goldman Sachs was forced to make an unprecedented climbdown on its bonus awards, agreeing that in 2009 its top 30 executives would not receive cash, but only stock, bonuses (Craig 2009; see also Section 5.6.4). Yet it was the Democrats' shock loss of Ted Kennedy's Senate seat to Scott Brown on 19 January 2010 – a seat they had held since 1946 – that forced the White House to pivot reform strategy. Losing the Senate supermajority brought into doubt much of the administration's legislative agenda, with implications well beyond financial reform.

Expressions of voter discontent at a crucial point of the financial reform agenda led to an overall pivot by the Democratic Administration on banking reform generally and the structural issue especially. From January 2010, a proprietary trading ban became a central spoke of the reform bill. Volcker was brought onside by the White House given his reformist credentials, having been a vocal advocate of reform from the earliest days. According to one official quoted at the time, "We decided there was a way to do it that was O.K. policy and which had a bunch of tactical advantages … It would allow Volcker to align himself more fully with us" (Cassidy 2010). While, reportedly, the President had decided to throw his weight behind Volcker's proposal in December, the tenor of the announcement in January was seen by most to be in reaction to the strong democratic demand for a more robust policy response.

White House announcements became laden with clear anti-business rhetoric. Obama called out the "army of lobbyists from Wall Street descending on Capitol Hill to try and block basic and common-sense rules", stating that "if these folks want a fight, it's a fight I'm ready to have" (Obama 2010). The following morning, *The New York Times* ran the headline "Taking on a Populist Stance, Obama Takes on Banks". This shift came as a surprise to the bank lobby, and was seen as a significant ramping up of anti-bank discourse (Braithwaite and Luce 2010). Congressional leaders were also minimally consulted, and the debate on structural reform quickly became highly partisan. One staffer recalls that once the rule had been announced, Republican Senator Shelby, whom Dodd had been courting for support, took the view that "ok, well now if you get the Volcker Rule, we're going to want something".[156] Having negotiated closely with Dodd for months, by the end of April Shelby formally withdrew from efforts for a comprehensive bipartisan deal. This came after three cloture votes in the Senate, which had blocked the reform bill from being debated. The drawing of battle lines over structural reform again exhibits how financial regulation became subject to the logic of a highly partisan Congress, which had already been displayed during the bruising legislative experience of the Affordable Care Act, passed in March 2010.

In this partisan environment, Volcker Rule passage was far from assured. Yet what ended the Republican filibuster in April 2010 was a sequence of high-profile events which brought the issues the Volcker Rule sought to address to the attention of the American public at large. The

[156] Interview US#3, Senate Banking Committee staffer, 5 May 2015.

Volcker Rule came to be seen as a decisive response to what was suddenly a highly salient issue to the public. Specifically, the SEC announced fraud charges against Goldman Sachs, the investment bank whose reputation had already been dented after its bailout and controversial bonus round. In a case that Goldman later paid a record $550m to settle, the SEC accused the firm of misleading investors by hiding the fact that before the crisis a hedge fund – Paulson & Co. – had provided input on a product that used poor-quality loans for mortgage-backed securities, which it in turn took a short position (bet) on.

Concurrently, the Senate Permanent Investigations Subcommittee (PIS), led by Senator Carl Levin, had initiated hearings about the same security – known as Abacus – to which Goldman Sachs employees, including chairman Lloyd Blankfein, were summoned. In words which became instantly famous and widely quoted in the media, Levin accosted one executive about internal emails in which a Goldman employee referred to the product the firm was marketing as a "shitty deal".[157] Levin implored the executive why "you didn't tell them you thought it was a 'shitty deal' … you knew it was a 'shitty deal' … Should Goldman Sachs be trying to sell a 'shitty deal'?"

The high public attention to this scandal had a decisive effect for the moderate Republicans on whose support the Democrats relied for the Volcker Rule to pass. For example, Senator Collins, who also sat on the PIS, faced stinging criticism on NBC's *Today* show for supporting the Republican filibuster (Kaiser 2014, 282). Interviewees involved in the process saw these hearings as key to changing the stance of moderate Republicans such as Collins. One said: "The Goldman Sachs hearings added a lot of momentum … [Senators] Collins, Snowe and Brown … at some point made it clear to their Republican colleagues that they wouldn't support the filibuster any longer". [158] A second interviewee stated:

> Republicans … like Susan Collins, they couldn't defend that ['shitty deal'] stuff …. And the Republicans were filibustering Dodd-Frank until that hearing. After that hearing the filibuster broke. So it was that level of centrepiece theatre, the centre of the national conversation – that made it so you couldn't hold it up.[159]

Compared with the UK, Switzerland and other countries, a peculiarity of US structural reform is that outcomes were generally supported by the majority party, but mostly opposed by the opposition party. Initially, Republican tactics left the more significant reform items, such as the Volcker Rule, in doubt. Mitch McConnell was leading a Senate Republican Conference which had demonstrated iron discipline in opposing Obamacare. Ultimately, it was the increased salience of corporate governance issues, such as conflicts of interest and speculation by banks, that weakened that resilience and brought pivotal Republican votes onside. As a former FDIC official remarked in interview: "usually ... political pressure is industry friendly … but in [the Volcker Rule], there was such public anger against the banks that the political pressure was for a more robust reaction. It was bipartisan".[160]

[157] Almost every specialist and non-specialist media outlet reported on the raucous scenes in Congress (e.g. Beam 2010; Hudson 2010; Pierce 2021; Politico 2010; Weiner 2010).
[158] Interview US#3, Senate Banking Committee staffer, 5 May 2015.
[159] Staffer involved in bill drafting, quoted in Culpepper and Lee (2022, 643).
[160] Interview US#2, FDIC Official 8 March 2022.

Despite the overall opposition of Republican lawmakers to the Volcker Rule, and the lower support of their voters for policies requiring significant new state intervention, structural reform became possible once the Democrats had a highly salient political event with which to leverage the support of the swing-voting Republican Senators. Democratic pressures were faced by policymakers on both sides of the aisle. The Democratic Party's own support for a proprietary trading ban had been fuelled by a surge in democratic pressure earlier in 2010. Meanwhile, support for more sweeping Glass-Steagall-type separation was always marginal, even among Democrat Congressmen. While Glass-Steagall was widely referenced among pro-reform elites, unlike a proprietary trading ban, the motivating logic behind bank splits lacked the same catalysing event thrusting it to the centre of American public debate. There was no democratic response to demands for Glass-Steagall separation because that demand was far weaker than that directed towards Volcker's initiative. In comparison, the UK and Swiss structural reform debates were animated by the narrative that TBTF banks could very plausibly jeopardise the fiscal strength of the state.

The second crucial dimension of the theory concerns the weak structural position global banks occupy in the US political economy. This is not an aspect of policymaking foregrounded in most existing studies of post-GFC reform. Yet it explains design features of the Volcker Rule which are not found in other countries' structural reform efforts.

A key manifestation of the gulf between US structural reform and the reform pursued in Switzerland and the UK is the extraterritoriality of the Volcker Rule. The "covered funds" regulation has had wide-ranging effects on foreign banking groups active in US markets. This provision prevents banks from participating in proprietary trading indirectly, for example through ownership in investment funds, or by taking on risk in the funds they offer to clients. The policy was pushed by several Democratic Senators who were the most active proponents of a proprietary trading ban, and was intended to reduce the arbitrage mechanism available to global banks operating across borders. A broad interpretation of the type of fund "covered" by the Volcker Rule would mean that banks would not only have to divest of various business ventures such as in private equity, venture capital and hedge funds, but also anything that was not of a US mutual fund structure. A partner of US law firm Sullivan & Cromwell expressed the challenge as such: "Some firms have hundreds of investments that could be covered. In almost every case, there is an economic cost to leaving those ventures. And if you are thinking of getting into one, you are likely sitting on the sidelines until this is resolved" (Chon and Braithwaite 2014).

This was not a problem swiftly addressed by policymakers, but rather created regulatory uncertainty for years after the implementation of the Volcker Rule. The costs of that uncertainty were felt most among big non-US banks active in US markets. The main exemption to the covered funds provision, and therefore an investment activity in which banks could continue to participate, were US mutual funds, in which US banks are the major participants. On the other hand, a broad interpretation of the covered funds provision meant that it was not US banks, but rather foreign banks with a significant presence in US markets, that would be subject to the most significant Volcker Rule constraints. The Volcker Rule thus had highly extraterritorial effects: given the importance of US activity for a bank to sustain its international operations (M. Beck 2021), virtually all global players would be caught in its net. Non-US global banks, in particular European, Canadian and Japanese firms, faced the highest

costs from a broad interpretation of the covered funds provision. US structural reform in this way differs markedly from the policy opted for by the UK, which as demonstrated in Chapter 3 was designed in a way that avoided significant new regulation of foreign banks and instead targeted less structurally empowered UK-headquartered banks.

The extraterritoriality of the Volcker Rule was soon a cause for concern among foreign regulators. Michel Barnier, then the European Commissioner for Internal Market and Services, wrote to US regulators that:

> …the draft rules as presented have an extensive, global scope. This would seem to lead to a number of unintended, non justifiable [*sic*] consequences for non-US banks, markets and institutions. Whilst fully appreciating the wish to avoid any loopholes or circumvention of the rules, I would invite you to reconsider this approach and limit the scope of the rule only to the territory of the United States. Moreover, the current exemption for non-US banks as well as for activities outside of the US would appear very restrictive. As a consequence, it would appear that the rule would be applied well beyond the US activities of non-US banks, without any justification being provided.
>
> (Barnier 2012)

For Europe – then in the midst of a sovereign debt crisis – it was even more concerning that drafts of the Volcker Rule contained exemptions only for trading in US government debt securities, but not those of EU governments, which the US government no longer deemed risk-free. Barnier expressed his "very strong concern" that such an exemption "would have a negative impact on the liquidity of non-US sovereign markets". While the version of the Volcker Rule announced in December 2013 did ultimately make certain exemptions that allowed some such trading, the vocal responses of governments across the advanced economies on its extraterritoriality shows how the US regulation had ramifications well beyond US borders.[161]

The draft wording of the rule similarly alarmed the big non-US banks who were set to experience the highest costs (Braithwaite 2011; Johnson 2011). By 2014, these firms were still awaiting clarity from US regulators on which fund investments they would need to dispose of, because they were unclear which activities would be deemed "covered" by the Volcker Rule (Braithwaite and Barker 2013; Chon 2014; Johnson 2013). It would not be until 2017, as part of a wider review of the Volcker Rule, that regulators announced they would not – for a one-year period only – take action against foreign banks for holding certain types of investment (Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency 2017). During that review, a Federal Reserve Vice Chair noted that the Volcker Rule continued to have "broad extraterritorial impact … in its current form … for foreign banks' operations outside of the United States" (Quarles 2018a). It would not be until late 2019 – more than five years into Volcker Rule implementation – that foreign banks would be granted specific exemptions, allowing them to engage in some US fund activity. Meanwhile, US-headquartered banks had

[161] As Lucia Quaglia (2017) notes, French, British and EU policymakers, as well as European banks, all publicly expressed opposition to the Volcker Rule draft due to its effect on European sovereign bond trading. See also Lavelle (2014).

enjoyed this freedom for years, since US mutual funds had been granted an exclusion from the outset.

A highly plausible alternative explanation for the distributive effects of this protracted policymaking process concerns the cumbersome administration of the byzantine American bureaucracy. Certainly, as has been noted, implementing and amending the Volcker Rule has involved years of coordination among multiple agencies, each with competing agendas. Some have concluded that the repeated delays to implementing Volcker were the result of captured regulators "buying time for lobbyists to continue to chip away at it" (Dayen 2019).

Focusing on the challenging implementation of Volcker, however, fails to answer what conditions allowed such a broad and extraterritorial type of structural reform to pass in the first place. In his testimony to the Senate Banking Committee in 2010, before the legislation passed, Paul Volcker had identified that "surely a strong international consensus on the proposed approach would be appropriate, particularly across those few nations hosting large multi-national banks and active financial markets" but that "the needed consensus remains to be tested" (Volcker 2010b). No such consensus emerged, and so the Volcker Rule became a highly unilateral route to reforming global capital markets.

Unlike in other countries, US politicians never sought to narrow the extraterritorial application of Volcker, for example to head off costs to industry. The restrictive nature of the covered funds provision was the result of work by two Democratic Senators – Durbin and Levin – who, to quote one interviewee, "were very interested in making sure those exceptions were as narrow as possible … to the point where it made investments in covered funds difficult beyond what was necessary to stop evasion of the proprietary trading ban".[162] Since Durbin and Levin were pivotal votes, the federal bureaucracy's concerns about aspects of the Volcker Rule did not gain traction until much later. Bureaucrats also had to adapt after no equivalent structural reform was passed in most other countries. One regulator expressed that "By moving first we've led from a position of strength in setting the international reform agenda and elevating the world's standards to our own", and that the "alternatives, either following the reform standard set by other countries or subjecting our firms to a divergent set of standards across the board would have been unacceptable".[163] As had been the case from the earliest days of the rule's gestation, US regulators were divided as to its merits. Five competing agencies nonetheless proceeded with implementing a regulation of broad scope, which continues to set the terms of global banks' participation in capital markets. They did so following the letter of a law that had been passed without any indication that other global financial centres would follow suit.

The US's road to structural reform of global banks can be convincingly explained by reference to the low structural-economic barriers to US policymaking. While Volcker was being implemented, US banks periodically complained that it would see a movement of proprietary trading to European banks. Instead, the key issue in Europe became the rule's

[162] Interview US#1, Federal Reserve official, 23 March 2022.

[163] Lael Brainard, then Treasury undersecretary for international affairs, quoted in Borak (2012b). Meanwhile, Daniel Tarullo of the Federal Reserve Board likewise commented of US unilateralism that: "In these instances of regulatory reforms being pursued only in the United States, there are not likely to be obvious answers to the resulting international complexities" (Borak 2012).

extraterritoriality. No evidence was presented that bank exit threats were a material constraint on policymakers' choices. Plausibly, Goldman Sachs and Morgan Stanley were the two US banks with stronger exit options, given their investment banking focus and limited retail and commercial activity within US domestic markets. Yet the crisis saw these banks convert to bank holding companies to win a public declaration by the Federal Reserve, and in turn increase market confidence, that they were financially strong. In interview, one Federal Reserve official identified that the shift in business model from a securities broker-dealer towards a traditional bank has been a net gain for these banks: "they've learned … they can collect a lot of [American] consumer deposits through their bank … to lower their cost of funding".[164] Goldman and Morgan Stanley were willing to trade any structural power they may have possessed in remaining a footloose global investment bank for the commercial benefits of becoming significant players in US commercial banking (M. Beck 2021). As Figure 5.1 demonstrates, between 2006-2016, these two firms saw the biggest increases among peer firms in the share of their total revenues deriving from activity in the US domestic market.

Many foreign banks, meanwhile, have decided to comply with the US Volcker Rule even where there may have existed some scope to continue proprietary trading activity in non-US markets. In both official reporting and interviews conducted for this research,[165] it was stated that UK-headquartered banks have decided to comply with the US regulation. In one report, the Bank of England said that "Of those banks which were not bound by the Volcker Rule, most chose to use a Volcker-like definition of classic proprietary trading, and had no activity under this definition"; and further that all firms "reported that risk appetites were smaller as a result of the Volcker Rule" (Prudential Regulation Authority 2020, 27). The Volcker Rule has clear and ongoing extraterritorial effects.

The key alternative explanations – from the bureaucratic, lobbying and political institutionalist accounts of US policymaking respectively – have little to say about these distributional effects, which relate mostly to the US's position in the international political economy. An explanation of *unconstrained democracy*, meanwhile, identifies that the US was able to achieve this outcome because it was not constrained by the same structural-economic factors which shaped the policy process in countries with higher dependencies on global banking. The Volcker Rule is a product of the sustained democratic pressure policymakers faced to reform industry and the limited structural-economic constraints to delivering a response. US policymakers umpire a tournament whose new rules they decided with minimal reference to the preferences of global players: they knew they would turn up to compete even if the odds of them winning were now stacked against them.

The next section further substantiates this application of the theory, analysing a significant structural reform specifically designed to allocate regulatory costs to the non-US global banks most active in US markets.

[164] The official further identified a rule in Dodd-Frank which they quipped was the "Hotel California provision", whereby even if firms such as Goldman Sachs were to decide to divest of their banks and become standalone securities dealers, they would continue to be regulated as bank holding companies and so also continue to be subject to the Volcker Rule. Interview US#1, Federal Reserve official, 23 March 2022.
[165] Interview UK#3, former Bank of England official, 31 March 2021.

5.6.1.2 The US Intermediate Holding Company Regime

A second notable US structural reform of the post-2008 period introduced the requirement for foreign banks to set up Intermediate Holding Companies (IHCs) to conduct their US-based activities. This lesser-known regime is a second crucial component of US bank structural reform. It is a more straightforwardly comparable outcome to the UK and Swiss ringfencing policies. A cross-case comparison is detailed in Table 5.8.

Table 5.8: Bank Structural Reforms Using Ringfences in Three Countries

Country	**Name of Reform** *(Chapter)*	**Type of Ringfencing / Separation**	**Policy Impact**	**Policy Scope**
Switzerland	Ex-ante separation *(Ch. 4)*	Geographic	Largest banks separate out Swiss-based balance sheets	2 Swiss G-SIBs
United Kingdom	Ringfencing of retail balance sheets *(Ch. 3)*	Activity-based	Largest banks separate out retail balance sheets from investment and wholesale banking	6 UK D-SIBs; Santander [Spain]
United States	Intermediate Holding Companies *(Herein)*	Geographic	Largest foreign banks must create separately capitalised US entities	11 non-US G-SIBs; Bank of Montreal [Canada]; BBVA [Spain])

The IHC regime originated from a Congressional debate about the Federal Reserve's extensive use of emergency lending facilities to extend credit to global investment banks during the GFC. During the crisis and post-crisis period, the Fed faced sustained criticism by both the political left and right, albeit for somewhat different reasons. On the right, the criticism among Republicans – especially, as noted in Section 5.5, the growing Tea Party movement – was that the Fed and Obama Administration's crisis-era policies were expanding the size of the state. On the left, the criticism was that large banks were exerting too much influence in politics, and that bailout policies had benefited financial institutions at a high cost to households. For these reasons, the Fed and its Governor, Ben Bernanke, saw their popularity dive among both Republican and Democrat voters during this period.[166] While Dodd-Frank

[166] Irregular polling by Gallup (J. M. Jones 2022) shows a decline in approval of the Federal Reserve: from 53% in 2003, to 30% in 2009. This low rating continued well after the GFC, sitting at 33% in 2013 before improving gradually until the COVID-19 pandemic. Approval of Chairman Bernanke specifically fell dramatically at the onset of the GFC, declining among Democratic voters from 49% in March 2007 to 22% by March 2008. Among Republican voters, Bernanke's popularity fell from 61% to 36% over the same period. Favourability (as opposed

negotiations were underway in early 2010, and with voters from both parties showing similarly low approval and favourability towards Chairman Bernanke, he faced gruelling reappointment hearings in the Senate. He was confirmed by what was, at the time, the narrowest margin of any Federal Reserve Chairman in history (70-30 votes). During Dodd-Frank drafting, Congress even considered legislation which would have stripped the Fed of its role as supervisor of the largest banks.

In a political environment that sought to rein in the Fed, one provision of Dodd-Frank mandated the Governmental Accountability Office (GAO) to audit its crisis-era lending facilities, which had relied on powers granted in Section 13(3) of the Federal Reserve Act. Dodd-Frank also imposed constraints on the Fed's future use of these powers. The report on these lending programmes was published in July 2011, and made various recommendations about how the Fed might improve its use of such facilities in future.

One of the significant findings of the audit was that foreign banks had been among the highest users of these schemes, and especially the Term Auction Facility (TAF) instituted after the breakdown in short-term interbank lending during the crisis. The data presented in Table 5.9 show that 11 of the 20 largest users of these schemes were foreign banks – including, among the top five recipients, Royal Bank of Scotland, Barclays and UBS. After the data on the Fed's emergency lending was published, Senator Bernie Sanders, who would run on an anti-Wall Street ticket in the following two presidential elections, charged: "Has the Federal Reserve of the United States become the central bank of the world?" (Harding, Braithwaite, and Guerrera 2010).

to approval) ratings towards Bernanke have fallen among Republicans over a longer period, seeing a downward trend from 2003 through to the end of his term in 2014. Bernanke's favourability ratings also declined among Democrats from 2003, but plateaued in 2008, before climbing again in 2012 onwards (Flowers and Enten 2015).

Table 5.9: Institutions with Largest Total Term-Adjusted Borrowing across Federal Reserve Broad-Based Emergency Programs, 1 December 2007 through 21 July 2010
Source: Government Accountability Office (2011), using Federal Reserve data

Rank	Borrowing Parent Company (& Country of HQ)	Total (%)
1	Bank of America Corporation	6
2	Citigroup Inc.	5
3	Royal Bank of Scotland Group PLC (United Kingdom)	5
4	Barclays Group PLC (United Kingdom)	4
5	UBS AG (Switzerland)	3
6	Deutsche Bank AG (Germany)	3
7	Wells Fargo & Co.	2
8	Dexia SA (Belgium)	2
9	Credit Suisse Group AG (Switzerland)	2
10	Bank of Scotland PLC (United Kingdom)	2
11	Commerzbank AG (Germany)	2
12	Goldman Sachs Group Inc.	2
13	Merrill Lynch & Co.	2
14	BNP Paribas SA (France)	2
15	Societe Generale SA (France)	1
16	Morgan Stanley	4
17	Wachovia Corporation	1
18	JP Morgan Chase & Co.	3
19	AIG	1
20	Norinchukin Bank (Japan)	1

The Fed developed the IHC regime in response to the new constraints Dodd-Frank imposed and the sustained political criticism its leadership had faced. Regulators used the authority granted to them in Section 165 of the Dodd-Frank Act – which dealt with enhanced supervisory and prudential standards – to develop significant new rules for the large foreign banks that had relied so heavily on the Fed's crisis-era emergency funding. Those with non-branch assets of $50bn or more had to establish a US-incorporated IHC for their US activities. As a result, large non-US banks are significantly constrained in how they can move their capital across geographic borders. As Table 5.8 identifies, this is a "geographic" ringfence of global banks. IHCs are subject to the same capital and risk standards as US-headquartered banks and so must also comply with Federal Reserve stress-testing.

A list of the banks required to set-up IHCs is shown in Table 5.10.[167] Many have been forced to fundamentally review their capital and risk allocations, with significant capital now "ringfenced" within the US corporate entity. One effect has been that the IHCs of foreign

[167] Some large users of crisis-era funding, such as RBS, had reduced their US operations to such an extent that they were no longer significant enough players to be subject to the IHC regime.

banks now hold capital at rates well above their US peers, as well as the applicable Basel III rules. This has made it more difficult for these firms to compete with US-headquartered banks in crucial dollar-based markets.[168] This shift in commercial landscape is evidenced in the significant reductions in balance sheet size among the largest non-US banks: the four largest European investment banks alone cut their US-based assets by $280bn in response to the regulation (Noonan 2019).

Table 5.10: Global Banks Subject to New IHC Rules and their Home Countries

Bank Parent of IHC	Home Country
Bank of Montreal	Canada
Barclays	UK
BBVA	Spain
BNP Paribas	France
Credit Suisse	Switzerland
Deutsche Bank	Germany
HSBC	UK
Mitsubishi UFJ	Japan
Royal Bank of Canada	Canada
Santander	Spain
Société Générale	France
Toronto-Dominion	Canada
UBS	Switzerland

At first glance, this case seems a prototypical example of US bureaucrats, and especially the Federal Reserve, flexing regulatory muscle (Drezner 2008). It even corroborates the argument of scholars who claim that the Federal Reserve reliably favours the interests of big American banks (Jacobs and King 2016): the IHC regime can be seen as one enabling condition that has allowed US banks to – as one financial journalist puts it – "take over the financial world" since the GFC (Arnold 2018a). Since the actual content of the IHC rules was not mandated by the Dodd-Frank Act, this could indicate that the Federal Reserve took a broad interpretation of its new powers, expanding its influence over large foreign banks. US regulators are candid that the IHC regime subjecting foreign banks to some of the most onerous capital requirements among major host financial centres (Quarles 2018b). To be sure, literature on bureaucratic power correctly positions the Federal Reserve as a powerful actor in the global regulatory system uniquely capable of enacting this significant regulatory intervention. However, these accounts do not explain what allowed bureaucrats to extend their regulatory reach, especially given that the US political environment is characterised by pervasive scepticism about state intervention in markets. Whether there is authority for such intervention is again contingent on the politics.

After implementation, the former Vice Chair of the Federal Reserve for Supervision, Randal Quarles, noted that the IHC regime was a response to events of the crisis during which "many foreign banks operating in the United States suffered severe stress and survived only with

[168] In this context, it is not surprising that foreign banks' IHCs have performed well in US stress-testing relative to US-headquartered banks. See Humble (2020).

extraordinary support from the United States and their home country governments". In that context, he remarked that "the tolerance for a government-assisted intervention in foreign banks is low" (Quarles 2018b). The post-crisis period was a bruising experience for the Fed, showing that in the future lawmakers were unlikely to give it such a free hand to act as global "firefighter" (Bernanke, Geithner, and Paulson 2019; cf. Awrey 2020). In line with this analysis, in interview the head of the OCC from the period under study stated that US policymakers "felt very stretched and put upon in the financial crisis in dealing with the foreign banks. So the idea that they were going to create a framework for foreign banks that was much more intrusive, I think was on their minds". As a result, "the kind of previous more laissez-faire approach to portions of foreign bank operations in the US does not apply anymore".[169]

As Table 5.8 identifies, the major ringfencing policies initiated by US policymakers on the one hand, and British and Swiss policymakers on the other, differ markedly in both scope and impact. The UK and Swiss regimes primarily target the largest banks headquartered in their country. As Chapter 4 explains, in the UK, ringfencing was an attempt to mitigate the risk of contagion spreading from City of London investment banking into the UK economy. Yet when its expert commission considered a geographic-style ringfence, it rejected this option because it deemed that "authorities in other jurisdictions should be free to act" without imposition by the UK as host regulator (Independent Commission on Banking 2011b, 93). For Switzerland, ringfencing similarly sought to reduce exposure of systemically important parts of the Swiss economy to global financial markets, but ultimately Credit Suisse and UBS were the chief target of reform.

Yet for the United States, the chief target of its geographic ringfence has been cross-border banking groups headquartered outside the US but most active in its markets. The regime was developed after it had experienced significant political critique for its support of foreign banks during the crisis. In response, the Fed put significant new regulatory burdens on international banks in a way that was essentially orthogonal to the UK and Swiss ringfences. The different global bank ringfences created across the three cases demonstrate how the US was able to proceed with a type of balance sheet separation unavailable to more constrained democracies.

The US response has been criticised by both the banks subject to it and regulators at the FSB who set standards for global banking regulation. The FSB has remarked that ringfences of the type used by the US "tend to favour domestic activities and trap resources at local levels", which when "excessive … could lead to global fragmentation" (2019, 33). There is no evidence that this critique is leading to significant adjustment to the IHC regime. Recalling the tennis metaphor used in the introductory chapter, the IHC rules show how the US can singlehandedly change the rules of the global game with limited regard to the stance taken by its own or other countries' champion players. Even if these changes have made it more difficult for non-US banks to compete with US players, they have little choice but to accept the new costs. Access to US markets is what allows firms to stay in the contest of global banking.

[169] Interview US#4, John Walsh, former Acting Comptroller of the Currency, 23 March 2022.

5.6.2 US Bank Capital Reforms

Table 5.11: Overview of Possible Bank Capital Reforms in the United States

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Capital Rules	***Higher capital requirements than applicable Basel rules***	Minimal capital requirements that have equivalency to Basel rules

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

This section describes and explains the advent of a major unilateral US capital rule after the GFC. As in the domain of derivatives regulation, for most countries capital requirements are one of the regulatory issues primarily dealt with via multilateral institutions. Despite the considerable influence of the United States at the BCBS and FSB, it became (aside from Switzerland) the only country that substantially pre-empted the Basel III Accords. US policymakers passed substantively diverging domestic capital requirements into law in July 2010, while the Basel package was signed in November that year.

At first glance, a political institutionalist account seems a highly plausible explanation for the US capital reform outcome analysed, which is known as the Collins Amendment. Like the Volcker Rule, it emerged during Dodd-Frank negotiations. However, as Table 5.1 sets out, neither of the typical explanations of a political institutionalist account – which usually predict erosion of reforms during the law-making process – fits the observed outcome for capital reform. Bureaucratic and lobbying explanations may predict features of this reform outcome, but they are far less useful lenses for understanding the overall process by which this reform was achieved. A more dynamic model which positions democratic demand as the initiating factor of reform helps explains the Collins reform, even if the specific issue of bank capital is one generally unfavourable to broad public debate.

Unlike the bank structure and derivatives issues, higher capital requirements were always a cornerstone of the Obama Administration's plan for financial reform.[170] However, the clear preference of the administration was that these rules be agreed to and coordinated internationally, in particular to avoid arbitrage. As the key statement by the Treasury in September 2009 set out: "Consistent capital rules and consistent application and enforcement of capital rules around the world are essential to prevent geographical

[170] These proposals were articulated by Treasury Secretary Timothy Geithner as part of a "comprehensive" plan for reform. He stated: "Our proposal will tighten constraints by requiring that all financial firms hold higher capital and liquidity buffers. It will establish a higher baseline for all firms, and then go beyond that baseline to impose still higher standards on the largest, most leveraged and most interconnected firms that pose the greatest risk to the system as a whole" (Geithner 2009b).

regulatory arbitrage and an international race to the bottom" (US Department of the Treasury 2009). The US has historically been one of the most influential members of the BCBS, and so there were good prospects that it would be able to shape the international agenda according to its preferences, with lower costs and distortionary effects for its largest firms. Nonetheless, influence does not equate with compliance, and the US had also not fully implemented the Basel II regime, agreed to in 2004. Before the crisis, scholars have argued that the lag in implementing capital standards in the US was due to banking sector lobbying and cumbersome bureaucratic processes (Herring 2007; Lall 2012).

While the US was behind on capital reform before the crisis, in sharp contrast the Dodd-Frank legislation was finalised ahead of the Basel III rulebook; and it included a highly consequential rule that was purposively inflexible to the content of multilateral rules howsoever they might develop. The Collins Amendment requires that federal agencies establish minimum leverage capital and risk-based capital requirements for insured depository institutions, bank and thrift holding companies, as well as systemically important nonbank financial companies. It subjects these firms to *two* floors for leverage and risk-based capital, one based on what would in future be agreed to at the BCBS, and the other based on the rules "in effect for insured depository institutions as of the date of enactment of this Act".[171] Dodd-Frank directs that firms must hold capital at the higher of these two floors. The first floor would effectively hold firms to the same standards as non-US G-SIBs. The second meant that big US banks had to comply with the same rules applicable to smaller community banks (i.e., the "insured depository institutions") as they stood in 2010, if the calculation of that capital requirement was quantitatively higher.[172] The Amendment was purposively brief, not least compared to the 338,000 words and highly technical language of Basel III, but it has had significant ramifications for industry. It sought to prevent big banks exploiting Internal Risk-Based (IRB) models that are allowed by Basel rules for global banks, thus ensuring they are held to the same standards as smaller community banks.[173]

This rule has had material costs for the big US banks. By June 2018, the IRB capital calculations of Bank of America, Citi, JP Morgan, Morgan Stanley, State Street and Wells Fargo (but not Goldman Sachs and BNY Mellon) were all lower than the "Collins floor". As a result, these firms are held to the capital standards applicable to small community banks, exactly as Collins had intended. It has resulted in many of the US's biggest banks being held to higher standards

[171] Section 171 of the Dodd-Frank Act reads that the risk and leverage capital "shall not be less than the generally applicable leverage [and risk-based] capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable leverage [and risk-based] capital requirements that were in effect for insured depository institutions as of the date of enactment of this Act". For further detail of the technicalities of the rule, including the treatment of different types of capital, see Tahyar (2010).

[172] Sheila Bair, whose agency drafted the wording of the Collins Amendment, describes the rationale for maintaining common standards between large cross-border firms and smaller community banks in her biographical account of the crisis (2013, 236–39)

[173] In the famous "The Dog and the Frisbee" speech by the Bank of England's then Chief Economist, Andrew Haldane speaks approvingly of the Collins Amendment as an example of a regulation which seeks to overcome the "opacity and complexity" of IRB models favoured in the Basel III regulations. However, Haldane concedes that the Collins Amendment only added to the complexity of the Basel regime, given that firms would continue to calculate both Standardised Approach and IRB models (Haldane 2012).

than are required by multilateral rules (Brookes, Everitt, and Vo 2022).[174] In 2012, Jamie Dimon cited the Collins Amendment as an example of a regulation which harms US banks' ability to compete globally (Dimon 2012). Five years later he would complain that the capital rulebook as a whole meant that "permanently idle capital [can] never be utilised to support our economy" and – in a broader critique of US national regulation – that "no rational person could think that everything done was good, fair, sensible and effective, or coherent and consistent, in creating a safer and stronger system" (Serwer 2017).

A lobbying account clearly fails again at an early hurdle. Large banks were able to extract concessions only on specific technical requirements associated with the Collins Amendment, which hardly constitutes a victory for what is one of the best-funded lobbying operations in America.[175] The more nuanced argument from James and Howarth (2023) – that divisions among the bank lobby ("competitive" financial power) mean that industry's agenda does not cut through to policymakers – is more plausible. However, these authors argue that the US achieves "contested" reform when financial regulation is chiefly decided by politicians. In fact, this is quite at odds with this capital reform outcome: the Collins Amendment has now been in place for a number of years and there have as yet been no strong indications of Republican lawmakers seeking its repeal. This appears to be a durable reform.

As for the arguments in the bureaucratic literature, there are some grounds to see the Collins Amendment as the outcome of a tussle among competing US agencies (Carpenter 2010a). Its wording was drafted by FDIC staff under the direction of its then Chair, Sheila Bair. According to Bair the Treasury and the Fed unsuccessfully joined banks in "working to oppose or water down the Collins Amendment" (Bair 2013, 239–40). Overall, the outcome is aligned with the preferences of the FDIC, which has always taken a more conservative stance on bank capital requirements given its role as bank resolution authority and provider of deposit insurance. Meanwhile, both in interviews and media coverage, the regulation was criticised by officials from other agencies. In interview, a former Federal Reserve official referred to it as "badly drafted" due to its inflexible wording and scope.[176] Similarly, a former OCC chief simply stated: "I never thought the Collins amendment made any sense."[177] The Collins Amendment represents a tactical success for the FDIC, and reveals institutional divides among US agencies. Yet a bureaucratic explanation has little to say about what conditions brought the FDIC such a win. Indeed, that one of the smaller financial regulatory agencies gained its preferred outcome is opposite to what much bureaucratic literature would predict (Carpenter 2010b; Jacobs and King 2016).

[174] Since these capital standards are more stringent than those of Basel III, the US approach remains compliant to the multilateral rules: countries can be compliant with Basel III if their capital rules are considered more stringent than Basel rules.

[175] Arguing that the Collins Amendment would harm community banks, moderate Democrats in the House attempted to change the grandfathering provisions at conference stage, which would have aligned more closely with the preferences of big banks. House Democrats wanted less stringent rules around what amount of trust-preferred securities (a type of hybrid capital) could count towards Tier 1 capital. Ultimately, the final version tracked Collins' preferences more closely, such that large banks did not benefit from grandfathering (Reuters 2010; Tahyar 2010).

[176] Interview US#1, Federal Reserve official, 23 March 2022.

[177] Interview US#4, John Walsh, former Acting Comptroller of the Currency, 23 March 2022.

As with the bank structure and derivatives cases, much more can be predicted about the capital reforms through a political institutionalist framework. Specifically, Susan Collins was not just a regulatory specialist but a pivotal vote – what one interviewee referred to as the "thin sliver from the North-East" that Senator Dodd relied on to overcome filibusters.[178] Neither when it was brought to the Senate floor in May 2010 and swiftly approved, nor at the time of Dodd-Frank passage, did the Collins Amendment attract any significant criticism among Democratic ranks. Its leaders were keenly aware of their need for Collins' vote. It also attracted scant opposition from Republicans. While it was widely expected that the amendment would be withdrawn at conference stage (McGrane and Paletta 2010), it proved too controversial to do so because of Collins' importance to Democrats. Even if regulatory officials were far from unanimous in support of the regulation, increased capital requirements were one of the few issues that did not create a partisan fault-line in Congress. This is surely in part to do with Collins' status as a "pivotal vote" (Krehbiel 1998).

It is more difficult to test the democratic dimension of US reform as "unconstrained democracy" to this case. Unlike the structural reform and derivatives issues, no clear evidence was found that capital reform was an issue that attracted much attention among voters after the GFC. It is certainly different from the Volcker case, where it can be said with a high degree of confidence that the high issue salience of a scandal about proprietary trading led to strong pressures on policymakers. Capital requirements, meanwhile, remained mainly the purview of regulators and policy entrepreneurs like Collins, who saw this type of regulatory reform as most likely to reduce risks in the banking system. The most that can be concluded is that, in the reformist political atmosphere of 2010, the policy was seen to be tough on the banks, and in that environment policymakers were willing to ignore the banks and some regulators who preferred that it be removed from the reform bill. As a result, like the Lincoln Amendment discussed in Section 5.6.3, it was difficult for Collins to be rejected once it had gained a certain amount of political traction in Congress. This upended pre-crisis orthodoxy by holding big banks to the same standards as small banks, which had previously been seen as the more risk-prone firms.

Policymakers leading on this reform acted with limited regard to any competitiveness costs that might cause for big US banks. The Collins Amendment was decided in advance of the Basel reforms and it holds these firms to higher standards than the rules applicable in other countries home to G-SIBs. In particular, its primary aim was to reduce the risks created by big banks, for example their ability to exploit IRB models. The difference in the approach to capital reforms taken by US policymakers relative to their UK counterparts is illustrative. In Chapter 3, it was shown how the UK's expert commission recommended that capital requirements should not be imposed on the non-retail operations of large banks because it would create inconsistencies with the Basel regime and create arbitrage effects. This was an argument also made by the US Treasury, but this did not deter lawmakers. A former policymaker at the OCC – the agency responsible for regulating large banks – stated of the US outcome: "the whole Basel process … it wasn't completely thrown out the window, but it was ignored … the notion of uniformity and consistency just seems … to have been a victim of the crisis".[179] For most large US banks, the Collins floor has become the key capital rule, not Basel.

[178] The quotation is from Interview US#3, Senate Banking Committee staffer, 5 May 2015.
[179] Interview US#4, John Walsh, former Acting Comptroller of the Currency, 23 March 2022.

Absent the dependency constraints faced by the UK, US politicians pursued a policy which created a significant regulatory burden on large banks, and which continues to diverge from multilateral standards. Even if the Collins Amendment is a regulation that few voters would be able to cite, it was nonetheless passed by Congress at a moment where the drive to respond to democratic demands for reform was far stronger than any representation made by the bank lobby. Contrary to expectations of a regulatory "sine curve" after issue salience falls in the years after a crisis (Coffee 2011), the rule still remains in place today.

5.6.3 US Reform of Markets in Financial Instruments

Table 5.12: Overview of Possible Markets in Financial Instruments Reforms in the United States

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Central clearing mandate	*Maximal central clearing mandate*	More flexible central clearing mandate
Push-out of derivatives from banks	Banks forced to push-out all derivatives activity	*No derivatives push-out*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Table 2.8 identified that the US passed substantive derivatives reforms ahead of any other country and before the multilateral regime took shape at the FSB. In fact, the key reform spearheaded by the Obama Administration – the central clearing mandate for derivatives – came to be one of the central spokes of the global reform package. Meanwhile, a second reform known as the Lincoln Amendment or "swaps push-out" was specific to the US, and eventually repealed. This section examines the process that produced these different outcomes.

Chapter 3.6.3 already detailed some of the events which led to the G20 initiative to reform derivatives markets. To recall, before the crisis, derivatives had mostly been traded bilaterally or "over-the-counter". After 2008, world leaders laid blame at the role of "increasingly complex and opaque financial products, and consequent excessive leverage" as root causes of the GFC. The G20 governments agreed a number of actions for immediate implementation, including "required disclosure of complex financial instruments by firms to market participants" and "efforts to reduce systemic risks of CDS [Credit Default Swaps] and over-the-counter (OTC) derivatives transactions" (G20 Leaders 2008). CDSs represented about 10%

of total derivatives outstanding at the end of 2008, so this was a significant but ultimately partial reform of global derivatives markets.

Yet the scope of the G20's proposed derivatives reforms swiftly expanded. Within a year, national leaders had pledged more concrete and sweeping goals. They agreed that "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms … and cleared through central counterparties" by the end of 2012; and further that "All non-standardized contracts that were not centrally cleared were to be subject to higher capital requirements" (G20 Leaders 2009). This represented a huge expansion of the central clearing policy.

This widening ambit of reform had little to do with the state of multilateral cooperation on the issue, as a more functionalist account of global regulatory change might predict (e.g. Kapstein 1994). Rather, when the progress of these multilateral reforms is assessed alongside the US domestic policy process, it becomes clear that the thrust of this multilateral agenda originated in US domestic politics (Murphy 2022, 151–76). The failure in derivatives markets was certainly not a US-only problem (Tooze 2018). However, the issue attracted pronounced public attention in the US compared to in Europe. A notable instance of how that attention shaped policy was identified in Section 5.6.1.1, concerning the Abacus derivatives product Goldman Sachs sold to its clients. Derivatives – a US-led financial innovation that Warren Buffet famously called "financial weapons of mass destruction" – were seen as responsible for the collapse of both the US Government-Sponsored Enterprises Fannie Mae and Freddie Mac and insurance giant AIG.[180] Their inadequate regulation was also identified, both in the US and abroad, as a particular regulatory failure of the US bureaucracy, with former Federal Reserve and Treasury officials both experiencing political censure.

Section 5.6.1.1 showed how the Volcker Rule was taken up by the White House after it faced a popular backlash for what was perceived as a status quo package. Derivatives regulation presents another case of how political demands for more decisive change broadened the scope of the reform package. Specifically, the derivatives clearing mandate grew out of bruising experiences for the Obama Administration in its first months. The appointment process of the CFTC Chair Gary Gensler reveals how this otherwise technical area of policymaking became a lightning rod issue against which the reformist credentials of the new White House were assessed. Within days of President Obama announcing Gensler as nominee, key Congressmen began expressing their reservations. Gensler was a former Goldman Sachs executive, who had served in the US Treasury during the Clinton Administration when substantial derivatives deregulation had occurred. The chairs of both the House and Senate Agricultural committees expressed reservations, with the latter stating publicly that he "remained concerned about the deregulatory orientation of the nominee's past" (Carnevale 2009). During the Clinton Administration, as a senior adviser to both Robert Rubin and Larry Summers, Gensler had opposed then CFTC Chair Brooksley Born, who had sought to undertake more stringent and pre-emptive regulation of OTC derivatives. Born's stance had proven to be prescient. Just as Gensler was being nominated, Born received the

[180] There is debate on the exact role that derivatives played in the crisis. A more conservative assessment of derivatives as a cause of the GFC is offered by legal scholar David Murphy, who argues that "even though OTC derivatives did not cause a cascade of failures … The opacity of the OTC derivatives market amplified the loss of confidence which hit the markets in 2008, potentially contributing to contagion" (Murphy 2022, 21–22).

John F. Kennedy Library Foundation's "Profile in Courage" award for standing up to "adversaries" and showing "political courage … in sounding early warnings about conditions that contributed to the current global financial crisis" (John F. Kennedy Presidential Library and Museum 2009; Schmitt 2009). Gensler was branded as one such opponent, a "Rubin Democrat" at a time when this had become a synonym for someone who had supported the "light-touch" market-friendly regulation prior to the GFC.[181]

In response to the popular appetite for a reformist agenda, and sensing a battle ahead for Gensler's and other bureaucratic nominations, the Obama team agreed that Gensler would develop more sweeping derivatives reform proposals. In consultation with Tim Geithner, Gensler developed plans for the clearing mandate. In Senate committee, Gensler conceded that "it is clear to me that all of us that were involved at the time – and certainly myself – should have done more to protect the American public through aggressive regulation, comprehensive regulation". Gensler also stated his preference that "we bring the whole over-the-counter derivatives marketplace on the market, into exchanges … And to also bring [the] over-the-counter derivatives marketplace onto centralised clearing" (Nomination Hearing to Consider Gary Gensler to be Chairman of the CFTC 2009). Even after passing a committee vote, Gensler then faced further hostility from the left of the Democratic Party: Senators Sanders and Cantwell put a procedural hold on Gensler's confirmation, which was only lifted after Geithner further committed to a more interventionist regulatory agenda (Geithner 2009a). This proved a strong enough broadening of derivatives reform for Gensler to pass confirmation hearings. However, the opposition of five Democrats including Senators Cantwell, Merkley and Dorgan (as well as Bernie Sanders), whose votes the administration would soon be highly reliant on, showed how derivatives reform had become a topic of mainstream political debate.

These events show that the significant expansion of the US derivatives reform agenda occurred prior to and mostly independent of negotiation in multilateral institutions. The stance of the bank lobby played no part in this story. Indeed, it appears that banks had no say in either the US domestic reforms or the multilateral agenda which US regulators successfully exported.[182] While it was bureaucrats such as Gensler who had the expertise to develop and advance the technical content of the derivatives reform, the demand for reform originated in Congress, where lawmakers were responding to strong democratic demands for reform after the bank bailouts. No evidence was presented that politicians were at this stage wary of the costs of this sweeping set of reform proposals which promised to transform global derivatives markets.

When it came to the drafting of Dodd-Frank a year later, the central clearing mandate was supplemented by a policy related to swaps products traded by banks. This represented yet another broadening of the derivatives reform agenda. It again originated in the US; and the prospects for exporting this agenda to the FSB were far more limited. Known as the Lincoln Amendment or swaps push-out, what became Section 716 sought to prohibit banks from

[181] For further commentary on the Senate confirmation process, using insight from first-hand interviews with Gary Gensler, see Murphy (2022, 157–58).

[182] One leading actor responsible for advancing the central clearing mandate in multilateral fora stated: "I have no recollection of the banks having any views on it at all, which meant whatever their views were, they didn't matter". Interview UK#14, former senior Bank of England official, 18 February 2022.

engaging in most derivatives activity of any type. A legal adviser involved from the period summarised that early drafts of the Lincoln Amendment intended that "no Federal assistance may be provided to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity" (Madigan 2015). This proposal would effectively force the largest US banks to spinoff, or at least subsidiarise, their derivatives operations, which had grown to become one of the most lucrative segments of investment banking. Like the Volcker Rule, the Lincoln Amendment sought to restrict banks to traditional commercial banking activity. This proposal was informed by the widespread perception in the US that banks had, since the repeal of Glass-Steagall, become speculative traders rather than customer-oriented lenders.

As with the clearing mandate, the swaps push-out did not originate from negotiation among policy elites as a technical solution to a commonly defined problem, as a functionalist account would predict. Rather, it was the result of political competition over what was by early 2010 one of the most salient regulatory issues of the day. Preliminary quantitative media analysis shows that, while derivatives reform did not become as high salience as an issue like banker bonuses, attention grew substantially during the period in which Lincoln's Amendment was gestated.[183]

Early in the reform process, as Chair of the Senate Agriculture Committee (which helps oversee the CFTC), Democratic Senator Blanche Lincoln had sought to achieve a compromise reform package with her Republican counterpart Saxby Chambliss. As bipartisan hopes for Dodd-Frank faded, however, she pivoted strategy. Facing a tough primary challenge from the left in her home state, Lincoln chose to capitalise on the broad public salience that derivatives trading had achieved. In a dramatic statement, she warned that "The dark days of deals are over" and that "Financial institutions will have to decide if they want to be banks or if they want to engage in risky trading that caused the collapse of [financial] firms" (Kaiser 2014, 293). If successful, Lincoln's new proposal would see banks forced to spinoff or subsidiarise their derivatives operations. It would have been a big shift away from the model of universal banking that had developed in the US since the 1990s.

Lincoln's proposals emerged from electoral pressures she personally experienced. They were very unpopular among many bureaucrats. Banks, having been mostly passive bystanders on the clearing mandate issue, took a determined stand against this policy proposal, given the seismic changes that would be required to their business model if it passed. The reform was also not favoured by many policymakers, including senior Democrats such as Senator Dodd.

Despite this considerable opposition, once Lincoln had thrown down the gauntlet, it proved very difficult for any of these critics to sink the proposal. While, to be sure, this can partly be explained by the fact that Lincoln was a "pivotal vote" on whom Democratic leaders relied (Krehbiel 1998), there was also broad public demand for derivatives reform. The position of

[183] Media analysis by Culpepper and Lee (2022) compares coverage of different "faces" of the financial crisis through Boolean search terms, for example "Blankfein AND Goldman", "Fuld AND Lehman", etc. A rough proxy of the salience of the derivatives issue is the combined search term of "Lewis AND Big Short". Michael Lewis' *The Big Short*, published while Dodd-Frank was being written, achieved runaway success and spent more than 6 months in *The New York Times*' top-10 bestseller list for non-fiction articles. The Boolean search on media coverage on this topic grew from nil to become the second most covered "face" of the GFC by April 2010. This was the crucial period in which the Lincoln Amendment was being debated.

Rahm Emanuel, White House Chief of Staff, was said to be: "I like the derivatives issue. We're on better ground on that than talking about bailouts. If they [the Republicans] talk bailouts, we talk derivatives" (Scheiber 2010). In the late stages of drafting, President Obama himself stated that he would veto legislation sent from Congress that did not bring the derivatives market "under control" (Rampton 2010). The drawing of party lines on derivatives reform is a clear effect of the partisan climate of 2010, but derivatives was chosen and then subsequently defended by its supporters because it was a broadly salient issue among the public who saw financial institutions as being responsible for the speculative activity that had preceded the crisis. While the detail of the Lincoln Amendment may have been too complex for most to fully grasp, it was a policy opposed by industry. For policymakers to take strong positions against policies harmful to big banks was to risk being accused of kowtowing to the bank lobby. According to the staff director of the Senate Agriculture Committee, the proposal "transformed itself from a sacred cow, to more of a zombie that would not die. It became this mythical provision that could exact a perceived amount of pain on Wall Street that certain advocates wanted to inflict" (Madigan 2015).

Ultimately, the need to keep Lincoln and a few Democrat Senators on the left of the party onside led to the swaps push-out remaining in the Dodd-Frank bill. Not even letters critiquing the draft rule from two of the most reform-minded policy entrepreneurs of financial reform – FDIC Chair Sheila Bair and Paul Volcker – could sink what many saw to be a flawed proposal.[184] Aside from the final appropriations provisions, the Lincoln Amendment was a final sticking point at Conference Committee. There, a revised version was presented that would allow banks to trade derivatives based on traditional bank assets, but not on "generally the more risky items" such as commodities, energy, stocks and bonds (Kaiser 2014, 349). Lincoln finally relented, and while she insisted that she had successfully retained "the 716", it had in fact been dialled back substantially. Later, the Lincoln Amendment was repealed as part of a "must-pass" $1.1tn spending bill in December 2014, a move initiated by Republicans which was met with stinging criticism from some in the Democratic Party.

Plainly, these events depict the peculiarities of passing legislation in a highly partisan Congress, in which the Democrats were reliant on support from an at times unruly coalition. In this case, the crucial votes in the Senate came to be Democrats on the left of the party, a single Republican (Snowe), and of course Lincoln. Yet derivatives reform was also an issue that emerged as a highly salient feature of the overall reform package; and it is these conditions which explain why the reforms gained such traction in Congress. Later, during the bureaucratic implementation period until 2014, some accused the Federal Reserve of putting up stiff resistance to the Lincoln Amendment (Davidson 2015). Certainly, it was far from popular among senior officials in many of the key agencies. Yet bureaucrats were not an important part of this reform's genesis, or its ultimate demise. The effort to roll back parts of Dodd-Frank required the concerted effort of Republicans.

The scrapping of the Lincoln Amendment undoubtedly landed in big banks' favour, and came after a sustained lobbying effort. Assessing the passage of the Lincoln Amendment alongside

[184] Volcker's letter, sent 6 May 2010 to Chris Dodd, Secretary Geithner, and Senators Shelby, Merkley, Levin and Lincoln, stated that he had "concerns" about "the extensive reach of Senator Lincoln's proposed amendment". Volcker thought that many derivatives undertakings by commercial banks were necessary to fulfil customer needs "in the usual course of the banking relationship" (Volcker 2010a).

the central clearing policy, however, what stands out above all is that the bank lobby had very little influence as these reforms were crafted and took shape. Even though the Lincoln Amendment was substantially watered-down during Conference Committee, a later government audit showed that it was ultimately the largest four swaps dealers (which are all G-SIBs) that came to be the most affected by the push-out rule. In total, the rule forced them to push-out $265bn of swaps (in notional value) (Government Accountability Office 2017). This outcome still amounts to a significant lobbying defeat.

As with its structural reforms, US derivatives reform took shape in domestic – rather than multilateral – policymaking institutions. If these regulations were merely the result of a functional need – as the outcome of a technical problem that demanded a global solution – then the US reform process is difficult to understand. US policymaking on this issue makes more sense using a model of reform whose foundations are built on the demands made by voters. Indeed, subsequent events show that the clearing mandate was a policy that quickly found widespread support among other major regulatory powers.[185] Yet the two derivatives reforms saw the US acting as first-mover not because that would enable it to influence global regulation, but because policymakers sought to respond to what had become a highly salient issue for voters. Specifically, the failure of regulators to properly regulate derivatives before the crisis, and the fear that banks would return to "business-as-usual" by engaging in speculative activities, emerged as crucial issues of broad public concern. No evidence, on the other hand, was presented during the research process that US policymakers were materially constrained by competitiveness costs to, or exit threats made by, US banks. At the point of enactment, this was an unconstrained democratic response. Even with the Lincoln repeal, compared to the pre-crisis status quo, these have been notable unilateral reforms that have substantially changed the commercial landscape of global banking.

[185] According to one former Bank of England official interviewed for this research, central clearing was "sold to the British as part of the G8/G20 process" and senior UK officials "bought this pup that was invented by Geithner". Interview with former senior Bank of England official, 31 March 2021.

5.6.4 Tax and Pay Reforms in the US Banking Industry

Table 5.13: Overview of Possible Bank Tax and Pay Reforms in the United States

Reform Agenda	**Field of Possible Outcomes**	
	(A) Maximal Policy Considered	(B) Industry Preference
Banker bonus cap	Bonus cap in force	*No bonus cap*
Bank levy	Bank levy in force	*No bank levy*
Financial transaction/activity tax	FTT/FAT in force	*No FTT/FAT*

Key: Policy outcome in *bolded cell* is closer to Actual Outcome reached

Note: Policies considered in the Reform Agenda are simplified for guidance. Possible Outcomes (A) and (B) are simplified to binary for guidance; this overview shows whether each Actual Outcome was closer to (A) or (B).

Unlike the three other policy areas discussed in this chapter, no notable tax and pay policy targeted at banks was passed in the United States after the GFC. Given the high salience of executive pay and other policies with a more distributive bent after the crisis, the lack of policy response to this issue at first glance appears as a challenge to a theory that predicts US policymaking under high democratic pressure will yield an unconstrained democratic response.

Among these various tax and pay policies, the issue which attracted the most significant public debate was executive pay, and specifically caps or extraordinary taxation of bankers' bonuses. That debate erupted with a scandal associated with bonuses soon after the bank bailouts. In March 2009, the bailed-out insurance giant AIG paid 73 employees in its beleaguered Financial Products division bonuses of between $1m-6.4m. The firm made total bonus payments of $165m. The Financial Products division had been responsible for the firm's insurance of mortgage-backed derivatives products, which had led to the huge losses precipitating the government bailout. The bonus payments caused significant public furore. Using data on news media coverage, Culpepper and Lee show that AIG attracted, by a considerable margin, the highest number of articles compared to five other crucial issues across a slate of US newspapers. As these authors summarise, "there were two media faces of the crisis: AIG and Goldman Sachs" (2022, 644). The focus of the AIG scandal was bonuses paid to executives at the bailed-out firm, but policymakers considered reforms that would tax executives across the entire banking sector.

During the period under study, the American public was overall quite supportive of government intervention on executive pay. In June 2009, just months after the AIG scandal,

a Gallup survey found that 59% of endorsed government action to limit executive pay (35% oppose; 5% no opinion). More Democrats (77% favour, 17% oppose) supported such intervention than Republicans (56% favour, 39% oppose).[186] However, this partisan effect was far weaker than on attitudes towards government intervention in markets generally, which as the polling data set out in Table 5.6 indicate saw a far stronger divide.

The visceral public reaction to the bonus issue drew a swift response from policymakers. At the House Financial Services Committee, Republicans and Democrats were united in their condemnation of AIG. Gary Ackerman (D-RI) delivered an opening statement in which he remarked:

> There's a tidal wave of rage throughout America right now, and it's building up, and it's expressing itself at this latest outrage which is really just the tip of the iceberg. And that rage is because the taxpayer knows that they are the ultimate sucker on the list who pays for all of the greed that has been going on in the marketplace for years and years.
>
> (Kaiser 2014, 47)

Republicans similarly condemned AIG's compensation practices. In a move that was later retracted, Barney Frank, as Chair of the Committee, asked the interim CEO of AIG for a list of names of bonus recipients, threatening to issue a subpoena if they were not given voluntarily. On 19 March 2009, the House passed a bill that mandated a surtax of 90% on bonuses to employees of firms that had received over $5bn in bailouts, where their total household income was over $250k. Achieving 328-93 support, there appeared strong bipartisan support for such a policy among lawmakers.

Given the scale of public anger, and the clear democratic pressures that policymakers faced to respond, it is somewhat surprising how quickly this legislative momentum faded. President Obama spoke cautiously about the legality of the proposals, while Senate Majority Leader Harry Reid stated that he would delay introducing bonus-related legislation in the Senate for a month or longer. Aside from legalities, the political shift can be attributed to the strategic response by AIG. Executives began to return their bonuses voluntarily, eventually totalling about $50m, which led the House Majority Leader to conclude that the bill he had helped draft "may not be necessary" (Hitt 2009). There was particular caution about causing an exodus of talent from firms still in receipt of government bailout monies. As an alternative measure, Obama appointed a Special Master for Compensation (or "pay czar"), whose task was to assess the pay packages of executives at bailed out firms only, most of which in any case soon returned to private ownership (Solomon 2009).

The AIG scandal was the high watermark of policy attention to executive pay reform. Other issues soon captured the public's attention. This shift can be traced through news coverage. By October 2009, the proprietary trading scandal involving Goldman had eclipsed the bonus

[186] Survey conducted 13-14 June; N=998 US-based adults (J. M. Jones 2009). In a follow-up survey in 2018 (26-31 March; N=1,513 US-based adults), the difference between Democrat and Republican stances had become even more pronounced: 42% of Republicans favoured and 56% opposed the government limiting executive pay, while 77% of Democrats favoured and just 17% opposed such a policy (Newport 2018). It seems the partisan cleavage among American voters in regards to redistribution has become more pronounced in the years after the GFC.

issue at AIG as the dominant issue of the crisis covered in the media (Culpepper and Lee 2022). While further less scandalous pay-related events occurred, firms were generally successful in diffusing public censure by engaging in strategic constraint on their pay awards. In 2009, for example, when Goldman Sachs faced a backlash about its record bonus pool, its leadership responded by cancelling cash bonuses for top executives and introducing a shareholder "say-on-pay" policy (Craig 2009). As salience receded, and in line with the theory's prediction, no significant policy proposal involving hard caps or extraordinary taxation arose.

While no extraordinary cap or tax on banker bonuses came to pass, there were however points at which some such version of reform appeared a perfectly plausible outcome. No doubt firms actively lobbied to prevent executive pay reform, but at the point of highest salience, it was not lobbying briefs politicians were primarily responsive to, but rather the mood of the public. On this issue, banks were probably helped by the fact that, unlike in proprietary trading and derivatives, a major pay scandal did not occur during the crucial law-making period between January-June 2010. In the US, there is indeed a lower appetite for redistributive policy and higher institutional barriers to reform than in most other countries. These factors generally preclude significant reform. If reform were to occur on the executive pay issue in future, it seems reasonable to conclude that this would be catalysed by a democratic response to a highly salient event. Unlike other countries, the US does not make policy in an environment of high structural business power, which works to constrain the delivery of democratic responses elsewhere.

While executive pay reform was seriously considered, bank levies and financial transactions taxes never came close to passing. Serious proposals were periodically made. For example, in January 2010, in the context of a rising tide of popular resentment directed at large banks (see Section 5.6.1.1), President Obama proposed a Financial Crisis Responsibility Fee. He stated that he was committed to "recover every dime the American people are owed" and that "my determination is only heightened when I see reports of massive profits and obscene bonuses at the very firms who owe their continued existence to the American people – who have not been made whole, and who continue to face real hardship in this recession" (White House Office of the Press Secretary 2010). The Responsibility Fee was a levy on bank leverage, and it was estimated that 60% of the revenues would be paid by the largest 10 financial institutions, i.e. firms that had received the majority of bailout monies (White House Office of the Press Secretary 2010a). It was projected to return a sizeable $117bn over 12 years, but it was ultimately never picked up by Congress. In 2015, as part of a wider Democratic effort to forestall the rollback of Dodd-Frank, President Obama again proposed a new bank tax, billed to raise $110bn over a decade (Westbrook 2015).

Unlike bonus caps and even the failed Responsibility Fee, a tax on financial activities or transactions was never seriously considered by US policymakers. British Prime Minister Gordon Brown, who after the GFC became an advocate of a multilateral FTT (see Chapter 3.6.4.3), lobbied the US government to support such a proposal. Upon the request of the G20, the IMF produced a report in June 2010 on possible bank taxes, offering qualified support for a Financial Activities Tax (Claessens, Keen, and Pazarbasioglu 2010). However, despite reports that President Obama was again personally favourable to such a tax (Suskind 2011, 365), it was immediately and publicly discounted by Tim Geithner (Somerville 2009).

Possessing the largest financial markets, the lack of US support essentially meant that the IMF's proposals had no chance of being achieved via multilateral institutions.

Unlike executive pay controls, there is not public opinion data from the period to evaluate the level of public support for financial transactions taxes or bank levies. A more recent poll, conducted in March 2021 for the US Chamber of Commerce, showed that a significant majority of voters oppose the introduction of an FTT (63% oppose, 23% support), including a slim majority of Democrats (U.S. Chamber of Commerce 2021). Of course, this snapshot poll captures public opinion in a very different political environment, and high salience events are often required to produce significant shifts in associated policy preferences among voters (Culpepper, Jung, and Lee 2023). No major scandal or crisis occurred during 2010 that could act as a launch pad for either a bank levy or an FTT to become a focal issue of public debate. As the AIG bonus scandal demonstrates, the highest public anger on tax and pay issues occurred when a firm still in public hands decided to continue paying big bonuses. Americans meanwhile generally showed far less favour towards taxing banks once they had returned to private hands. By June 2009, all but two of the big American banks were cleared to begin paying back their bailout monies. As this chapter has demonstrated, it is difficult enough for a policy to pass through US policy institutions on a highly salient issue. It proved impossible on these taxation issues to capture public attention and shift public opinion when there was not a significant crisis or scandal at the crucial moment of policymaking reform.

5.7 Conclusion: US Policy Reform as Unconstrained Democracy

This chapter has described and analysed four policy issues that were subject to post-crisis reform in the United States: banks' structure, participation in derivatives trading, capital requirements, and tax and pay practices. In the first three of these, policymakers passed reforms which saw the US meaningfully diverge from international regulatory norms; while on the fourth, policymakers did not pass significant reform. Through close analytical attention to this within-case variation and comparative insight from across cases, gaps in existing explanations of US policymaking were revealed. It is shown how an application of the theory can fill those gaps. Specifically, the within-case analysis demonstrates that policymakers will respond to high democratic pressures experienced when a regulatory issue becomes highly salient to the American public. Unlike policymakers in states that experience high dependency on global banking, US policymakers operate in strategic independence from big banks. This means that structural interdependencies with global banking do not significantly shape policies. When there exist high, broad, and persistent democratic pressures for reform, policymakers deliver an unconstrained democratic response.

The chapter offers some important findings for the study of American politics and political economy. Certain features of policymaking are shown to persist across these four reform areas, which overall weaken the explanatory power of some mainstay existing explanations in the literature. The first of these is the argument that the American bureaucracy has developed a remarkable capability to shape business regulation, and that therefore decisions made in legislatures are correspondingly less important (Carpenter 2010a; Carpenter et al. n.d.). It was instead demonstrated that on the slate of issues analysed in this chapter, what took place in law-making bodies in the first half of 2010 was determinative of how bureaucrats were empowered (or not) to regulate the banking sector thereafter. The

rulebook that they police today is the outcome of how lawmakers created democratically responsive policies in the US's highly partisan legislative institutions. This constitutes evidence contrary to bureaucratic power theories, which generally downplay the democratic underpinnings of financial regulation.

More strident critics have nonetheless referred to US-led post-crisis reform as reinforcing a "policy status quo" (Helleiner 2014; Young and Yagci 2019), indicating that despite democratic institutions engaging in reform, negligible regulatory change occurred. The findings in this chapter offer a significant qualification to this claim of stasis, demonstrating that reforms have often created meaningful regulatory costs for big banks that still exist today. These policies were delivered despite the veto-laden American political system, and despite US banks' huge lobbying operations. In fact, contrary to accounts of public interest reform being rendered impotent by lobbying, the position industry took on specific policies during the legislative process tended to matter only at the marginal level. Overall, the position taken by the bank lobby on different reforms is shown to be a weak predictor of the observed pattern of variation. These reforms were instead passed after the issues they sought to address became highly salient among voters. The policies made as a result constitute democratic responses to the high democratic pressures exerted on US politicians.

On the other hand, significant reforms to banker tax and pay have not been forthcoming. Periodically, the executive pay issue did indeed become highly salient, and for some voters elicited strong reactions, for example about fairness and inequality. That reforms in this area mostly did not pass does not mean that US politicians were straightforwardly "captured" by the bank lobby on this one issue. Rather, the chapter presented public opinion data showing that the major government intervention these policies would have required was far from universally popular, especially among Republican voters.

A temporal dimension was also shown at work on the executive pay issue: the highest salience event did not occur during the crucial period of law-making in 2010, when the popular drive for banking reform reached a crescendo. Coupled with the strategic action taken by banks to diffuse periodic executive pay scandals, it seems that there was not sufficiently strong nor sustained democratic pressure for Republican Congressmen, or indeed many moderate Democrats, to support major executive pay reform. The challenges to policymaking where public opinion is less than resolute are surely amplified in the US case: there is a stark partisan divide among the American public, and veto points can often frustrate even popular reform proposals. Yet the main reason that bank tax and pay reforms were not forthcoming, but other policies were, has to do with variation in democratic pressure in these cases, not blockages in the US political system. Due to the lower democratic pressure on tax and pay issues, special interests were correspondingly better able to hold out against reform, as the application of the theory presented in Table 5.3 identifies.

It has also been shown how particularly high costs could be imposed on global banks when policymakers responded to salient voter issues due to the US's place in the global economy. Policymakers were able to impose reforms because big banks were not structurally empowered to oppose them. Even if at the margins some activity could relocate, the US government is not significantly dependent on cross-border banking as a source of tax revenue or high-wage employment. As a result, unlike the US and Switzerland competitiveness costs

were an insignificant part of the calculus of US policymaking during post-2008 reform. Policymakers knew that global banks would have to accept the new rules of the game: it was a contest in which they had no choice but to compete. Policymakers could deliver an unconstrained democratic response when they experienced strong pressures from voters for reform.

The effect of a strong force of democratic pressure after an episode of high issue salience periodically swept aside established industry interests and delivered significant regulatory reform. Voters on the left might feel that the resulting package of reform does not regulate banks enough; while those on the right might feel that regulation went too far. Such disagreement is elemental to any democracy, but is surely experienced more acutely in a country with such stark partisan divides. Still others might look to some post-crisis reforms and lament that their poor design means they failed to achieve what they set out to. Nonetheless, the case of US post-crisis reform yields evidence that decisive policy change is still possible where there exists a strong will for reform despite deep-set cleavages about the governance of contemporary politics and society. For those looking to study or indeed influence the regulation of global business in future, the findings of this chapter suggest that the US Congress remains the crucial locale in which to concentrate those endeavours.

6. Conclusion: Financial Reform as Democratic Response

For a tournament to be successful, to be world class, it needs to attract the top players. But if the stars of the circuit are judged reprehensible by a large number of spectators, then the umpire comes under pressure to penalise them. For the tournament organisers, the paradox is that people turn up to watch the established stars and feel cheated if they are not there. In a similar way, global financial centres must attract the big players to succeed, but can be under considerable pressure to regulate them in ways that might make them decide to leave. This thesis has investigated the way that different countries dealt with this paradox, and the implications that those decisions have had.

Challenging existing accounts which have mostly dismissed the role that democratic publics can have in shaping business regulation, the theory of *democracy under constraint* sets out the conditions under which the demands voters make of their elected representatives become integral to a dynamic process of regulatory change. The empirical chapters have demonstrated that three countries which existing models of regulatory governance would deem "least likely" candidates for reform in fact passed some of the most significant and unilateral regulations observed among the ACDs. It has been proposed that the pressures faced by policymakers to respond to democratic demands were responsible for this surprising outcome. If this theory stands up to scrutiny, it offers a significant contribution to knowledge about the governance of global capitalism, including how such reform processes might occur in other democracies and in various regulatory domains.

The focal events that captured voters' attention and galvanised calls for change were the bailouts of some of the largest financial institutions in the world. Some may remain sceptical that demands made by voters in themselves shape complex regulatory policy. Notably, the alternative explanations considered throughout this study operate with the prior that complex policy areas such as financial regulation remain the preserve of elite debate. Even if evidence has been presented that democratic demands do drive reform, one key difficulty in ascertaining whether the actual content of these demands shapes outcomes remains the absence of a counterfactual. Since bailouts occurred in each of the three main case studies, it cannot be proven beyond doubt that absent that public anger, reforms would not have occurred. Literature on policy learning, for example, assesses that policymakers learn from past policy failures and seek to correct them in new episodes of policymaking (Dunlop and Radaelli 2013). Earlier studies on the political economy of regulatory and global governance cited in this dissertation took a similarly functionalist stance to the process of regulatory change, arguing that policymakers proactively coordinate on new regulations as new systemic problems emerge in the global economy (Kapstein 1994; Keohane 1984).

A theory of regulation as *democracy under constraint* argues instead that democratic pressures exerted on policymakers are both necessary for significant new regulations that go against the interests of dominant firms, and in turn actually shape the content of the resulting reform. One way of further testing the merits of these claims is to study what happened in a country where voter demands were far fewer, but where there were still arguments being advanced about the need for reform. One such case is Australia.

6.1 Australia as Counterfactual: Regulatory Reform Absent A Salience Shock

Australia is widely acclaimed as one of the few ACDs that weathered the financial crisis remarkably well (Bell and Hindmoor 2015). Table 2.16 presented data showing that on a variety of metrics, the deflection of potential economic output relative to the main cases was far lower. As well as the lesser downturn, the Australian case contrasts with the US and much of Europe because there were no bank bailouts during the GFC (see Table 2.15). The catalyst event which made financial regulation a salient public issue elsewhere did not occur in Australia.

Lower issue salience in Australia can be traced through media coverage. Figure 2.1 presented media trends analysis which shows that coverage of financial regulation in Australia was substantially different than five other countries which experienced bailouts. In particular, articles categorised within the "Crisis/Bailouts" and "Regulation" categories attracted far less press coverage, while "Business-as-Usual" articles remained more prevalent throughout the GFC period. Coverage of financial crisis, bailouts and regulatory issues was certainly not nil in Australia, but the peak coverage was lower, later and shorter than in the five countries where bailouts did occur. Overall, in the absence of surveys conducted in Australia during this period, it can be concluded on the basis of this evidence that financial reform after the GFC was not as salient an issue to the Australian public as it was in countries that experienced more significant crises and bailouts. The prediction of the theory put forward in this dissertation is that the democratic drivers pushing for reform will be resultingly fewer. If evidence were found, however, that policy entrepreneurs were able to drive through strong reforms even in the absence of strong democratic pressure, this would constitute evidence contrary to the theory.

The Australian debate over bank structural reform is a strong candidate for assessing these competing hypotheses. Structural reform was a focal topic of analysis in the three empirical chapters, and in each case policymakers undertook to pass significant regulations that went decisively against big bank interests. These reforms sought to reduce taxpayers' exposures to global markets that had been revealed during the GFC. There was effectively nil route for multilateral reform in this area, so this issue mostly saw national policymakers taking decisions independent of incentives to align with global regulatory frameworks. Australia thus presents a useful counterfactual case for how decisions unfolded on structural reform without bailouts as a precursor event. It is certainly not the case, however, that Australia was uniquely immune to the GFC: its policymakers recognised that without extraordinary intervention such as government guarantees of bank debt issuance, Australian banks were highly exposed to many of the same risks as European and American banks (Debelle 2009; Kennedy 2009).[187] Yet absent bailouts, which are the clearest showcase of taxpayers footing the bill of banking sector failure, the issue salience of financial reform remained overall low.

[187] Some may object that Australian banks are not "global" in the way that Swiss, US and British banks are, and that this is therefore not a fair comparison to use in a study that is mostly about the regulation of global and systemically important firms. Notably, no Australian bank has ever been on the FSB's list of G-SIBs, and as the data in Table 2.10 showed, the Australian financial sector is not highly internationalised, scoring about the same as the US on this measure. The "Big Four" banks are, however, extraordinarily important to the Australian economy, collectively possess a very high market concentration, and act as the key avenue through which global capital is channelled into the country.

Systemic risk in the Australian banking sector remained an issue mostly of concern to a small circle of policy elites.

As Table 2.5 set out, the prediction is that a scenario of weak democratic pressure should produce policy that reflects a low democratic response. Instead of policymakers pushing for outcomes that reflect salient voter concerns, in Australia – which has low financial sector internationalisation and banks that have effectively zero exit option – a debate on bank structure should produce an outcome characteristic of interest group politics. In Australia, this yields the prediction that its "Big Four" banks, which have long enjoyed privileged access to Australian policymaking institutions (A. Black 2020), should attain their preferred outcome.

A debate on the merits of structural reform took place in Australia, but considerably later than in Europe and the United States. As in Switzerland and the UK, an expert commission was charged in December 2013 with assessing Australia's regulatory system and to make recommendations in light of some of the challenges observed during the GFC. This was known as the Financial System or "Murray" Inquiry (FSI) after its chair, the former head of the Commonwealth Bank of Australia. It considered an array of options for regulatory reform. On the structural reform issue, it reached a similar conclusion to the Swiss expert commission, but one considerably different from the UK's ICB. Australia's FSI concluded: "structural reforms such as ring-fencing … can have high costs" and as a result "Neither APRA [the Australian Prudential Regulation Authority] nor the RBA [Reserve Bank of Australia] nor the banking industry saw a strong case for these reforms" (Murray et al. 2014, 81). Structural reform was rejected on these grounds.

While the FSI's conclusion was similar to the Swiss expert commission, the ultimate policy outcomes in each country could not be more different. The publication of the Murray Inquiry's final report represents the bookend of the debate on this issue, while as Chapter 4 showed, the political debate in Switzerland was protracted, and eventually banks were forced to structurally reform despite its expert commission rejecting such measures. This divergence presents another serious challenge to scholars who have argued that a venue-shift to an expert commission itself significantly changes regulatory outcomes (Howarth and James 2023). Rather, interviews conducted with Australian policymakers involved in the process show that, as in Switzerland, politics was not suspended just because experts had been given nominal authority to recommend reforms.

Interviews with Australian policymakers instead reveal that the main differentiating factor with the Swiss and British structural reform process is that in Australia there was no backing among lawmakers for such a policy. This affected the tenor of the debate both prior to and during Australia's FSI. The key academic expert on the inquiry panel, Professor Kevin Davis, had after the GFC sought to start a wider debate on such issues, but found that:

> I don't think there was anything much of a push in Australia for that stuff. So I mean, I wrote a number of op-ed type pieces, I guess, prior to … the FSI … talking about Dodd-Frank and also the ring-fencing, the stuff in the UK and Europe … I didn't find anybody else interested in talking about those things. So I think it's fair to say there was no momentum for structural changes of that sort.

On the effect of this lack of momentum on the FSI, Davis put it plainly: "There's no point in making recommendations if they're just going to say 'bugger off' … And I think the Liberal Government would have just rejected it had we done so. There's no point in pushing shit up hill, as they say".[188] Instead, the committee made various other recommendations, notably around the need to bolster capital requirements for Australia's biggest banks (Murray et al. 2014, 41–59). According to Davis, these recommendations meant that "we thought we could avoid heavy-handed structural changes".[189] Another involved stated that overall, the commission "had the view that … the system while imperfect is probably not broken".[190]

This evidence points to a conclusion that the Australian debate on structural reform, such as it was, was essentially closed before the Murray Inquiry's committee had even been appointed. Even if those who sought a substantive debate about structural reform, such as Davis, were given a formal institutionalised role in the policymaking process, neither politicians nor regulators were interested in considering such policy proposals. One involved in the FSI stated that regulators went into the FSI process with the clear sense that the existing regime had been "almost vindicated by the financial crisis".[191] A financial regulation specialist from the Australian Treasury, the department that commissioned the FSI, meanwhile identified the absence of any political pressure to spark a debate about reform as key. The Australian Treasurer – i.e. Treasury minister – Joe Hockey appointed the commission a full five years after the crisis, and "the reality is they didn't face that political pressure to do something they didn't need to [do]".[192] A similarly unenthusiastic approach was on display within government, independent of the FSI process. According to the same Treasury official, "A lot of academics came to us and wanted to talk to us about it and explore the idea", but there was not any sense that the Treasurer ever seriously entertained structural reform. The government saw bank structural reform to be a costly and unnecessary venture.[193]

Some interviewees suggested that the government's unequivocal rejection of structural reform had to do the market-friendly leanings of a centre-right government. Such an account is not part of the model advanced in this study, which posits that the chief holdback to reform is lack of democratic pressure, not partisan preferences for less state regulation of markets. Kevin Davis of the FSI committee, for example, emphasised that it was a Liberal Government to which they were reporting. As the party generally more supportive of big business, Davis suggested that this meant the government would be less likely to accept strong structural reform recommendations. Another involved stated that it was initially seen by some to be "a bit cringeworthy"[194] that the Treasurer had appointed a former CEO of one of the big banks to chair the FSI – an individual whom Davis described as a "free market-type person" unlikely to support major new state regulation.[195]

[188] Interview AU#1, Professor Kevin Davis, FSI Panel member, 23 September 2021.
[189] Interview AU#1, Kevin Davis, FSI Panel member, 23 September 2021.
[190] Interview AU#2, FSI secretariat member, 26 October 2021.
[191] Interview AU#2, FSI secretariat member, 26 October 2021.
[192] Interview AU#3, former Australian Commonwealth Treasury Official, 29 October 2021.
[193] Interview AU#3, former Australian Commonwealth Treasury Official, 29 October 2021.
[194] Interview AU#3, former Australian Commonwealth Treasury Official, 29 October 2021.
[195] Interview AU#1, Professor Kevin Davis, FSI Panel member, 23 September 2021.

Comparative insight casts doubt on the causal weight of this partisan explanation, however. In the chapters on British and Swiss reform, for example, structural reform was a policy supported – and in some cases championed – by parties of the right. Some years later in Australia, in 2017, it was a centre-right Liberal-National Coalition that introduced a bank levy strongly opposed by big banks. These were not parties intrinsically opposed to policymaking against industry interests. Instead, as an Australian Treasury official interviewed identified explicitly, it was the lack of democratic pressure for reform after the GFC that led to an end to the debate over structural reform: "there wasn't the same community sense that this is completely busted and we need to not just do something, but be seen to palpably do something radical."[196] Absent public demands, neither left nor right politicians faced strong incentives to push for policies that would be strongly opposed by the banking sector. The government eventually appointed a committee chaired by a former bank CEO, which was itself supported by an advisory panel whose members remained in active employment by global financial companies. These appointments are in themselves evidence of the low salience of the FSI process. Even if FSI personnel had much the same expertise, in the equivalent UK expert commission, it would have been politically untenable to appoint a chair who had a close association with the financial industry.

It remains perfectly plausible that the institutional design of the expert committee led by a centre-right government may have acted as the final nail in the coffin for Australian structural reform. Yet the most convincing explanation for how different policymaking institutions were empowered by political actors relates to the underlying democratic environment. There was no strong democratic pressure experienced by politicians for strong reform. FSI commissioners may have themselves achieved their preferred outcomes, but ultimately the group never had teeth to achieve major reform in the first place. No structural reform was the policy favoured by Australia's big four banks; and without strong democratic pressure incentivising politicians to root for a different outcome, no institution or actor was empowered to deliver viable alternatives. The lack of democratic pressure made a status quo outcome all but inevitable.

Australia thus exhibits how a reform environment characterised by low issue salience produced a very different policymaker assessment of the merits of imposing structural reform on big banks. A type of reform seen by politicians as core to delivering a democratic response to the GFC in the three main cases was regarded as an unnecessary and costly policy intervention in Australia. Australia in this sense serves as the proverbial exception that proves the rule: reforms which run against big business interests occur when politicians face strong democratic pressures to deliver reforms aligned with voter concerns; they do not occur when these democratic pressures are absent. The counterfactual case of Australia, which did not experience bank bailouts, thus adds to the armoury of evidence about what conditions are most likely to produce strong regulatory reform. Financial reforms against business interests are most likely when policymakers seek to deliver a democratic response.

6.2 The Political Aftershocks of Financial Crisis and Possible Futures of Democratically Responsive Public Policy

[196] Interview AU#3, former Australian Commonwealth Treasury Official, 29 October 2021.

The three countries whose reforms were analysed in this study each saw significant policy responses after major economic events which had produced strong democratic demands for new regulation of big banks. Evidence was presented that policymakers often struggled to develop reforms responsive to those pressures. Indeed, *democracy under constraint* does not mean that the holdbacks to policymaking that often characterise low salience environments, such as tight networks of policy elites, are substituted by a blank policy canvas. In Switzerland and the UK, asymmetric dependency on cross-border banks meant that policymakers could deliver only a constrained response to strong democratic demands. In the US meanwhile, the political economy's strategic independence to a great extent negated the dependency effect, but it was often difficult for common democratic demands to build among voters in a way that cemented a strong policy response.

Understanding reform processes as *democracy under constraint* is nonetheless a counterpoint to diagnoses of the modern regulatory state which typically showcase policy elites as operating in a democratic vacuum. It suggests that financial regulation is often a more dynamic process, in which voter demands periodically come to the fore and precipitate significant change. The scope for democratically responsive policy is resultingly broader than that predicted by more static models of reform predicated on decisions made among a tight network of policy elites.

If this theory of reform stands up to scrutiny, some predictions can be made about the scope for possible future reform. Such predictions have important implications for both participants and scholars of global business regulation. In particular, it points to how future reform processes might be optimised in a way that can produce both democratic and economic wins.

Overall, by positioning issue salience as the fulcrum of regulatory reform, the governance of global firms may be more up for grabs than is typically assumed, even in countries such as those included in this study in which the financial sector is constituted by particularly big and global firms. Regulatory contests such as occurred after 2008 are also not one-off events. The period since the GFC shows that financial regulation rears its head as a salient political issue more often than might be expected given its highly technical content. Events including the Libor scandal, Brexit, the Covid-19 pandemic, the collapse of the cryptocurrency exchange FTX, and of Silicon Valley Bank and Credit Suisse, as well as a succession of leaks about the offshore tax affairs of the super-rich, have periodically made financial regulation specifically and corporate governance generally highly salient political issues. As yet, none of these events has been quite the same catalyst for regulatory change as the GFC, but each show technical and even esoteric issues periodically being brought into mainstream political debate. This suggests that it is quite possible that the regulation of big business will become a topic of broad public debate once again, and for major reform to be considered by policymakers.

This study has shown that in such high salience circumstances, significant challenges to business interests are most likely to occur when lawmakers experience strong political pressures to pass reform. That prognosis positions the legislature as the chief locus of policy contestation. This is a shift in the terrain of regulatory contest compared to that proposed in many existing studies of financial policymaking. Notably, those scholars who have assessed that regulatory reform is mostly decided in bureaucratic agencies generally see today's legislatures as impotent to address many of the governance challenges of the contemporary

era. A proposed remedy that has been suggested in light of this is to make agency decision-making more transparent and accountable to democratic institutions (Tucker 2018). While this would surely be a positive step, the implications of this study suggest this approach is unlikely to have a decisive effect on a policy process where the main regulatory contests play out in legislatures.

Instead, if law-making bodies remain the locus of the most significant regulatory decisions, this changes the constellation of actors and interests that are expected to shape key episodes of reform. Of course, the significant body of scholarship on business lobbying referred to throughout this dissertation already positions the legislature as the focal site of policy contest. In that reading, the main holdback to reform tends to be big business, which remains overwhelmingly successful in capturing the policy process through a well-resourced lobbying operation and – at least in the United States – significant campaign contributions. However, this study has shown that in key cases of post-GFC reform, the bank lobby had limited success in achieving its lobbying goals. On the highest salience issues, politicians cast aside the views of the business lobby as they sought to respond to strong democratic pressures. As a result, the content of bank lobbying only sometimes serves as a good prediction of the outcomes that will occur (cf. Grossman and Woll 2014). Indeed, if *democracy under constraint* is a good fit for how financial reform is shaped after major crises, then the main driver of consequent reform will be the strong democratic pressures arising from that crisis. The main holdback, meanwhile, is expected to be the high structural dependencies that many contemporary states experience with big banks. Decisions about how these competing forces should be balanced play out in the legislature on the basis of the information available to lawmakers.

What can be learned from this study by students of public policy depends, to some extent, on where one sits in this constellation of actors and interests. For more reform-minded individuals, 2008 was a "status quo crisis" which failed to deliver on more radical calls for reform, such as became palpable during Occupy Wall Street in 2011 and similar movements. Advocates of reform will be interested in how future episodes of regulatory adjustment might better deliver on the interests of voters at large. On the other hand, for many bank executives but also some regulators and politicians, some reforms have benefited neither firms nor the taxpayers in whose interests they were nominally achieved. During the interview process for this research, the UK's ringfencing measures and the US's Volcker Rule were the most often cited as being understandable responses to popular pressures, but ones with ultimately deleterious effects for economic growth and stability. In both cases, these reforms continue to have strong supporters, and as of writing neither are likely candidates to be repealed. Since neither reform advocates nor critics appear content with the outcomes of post-GFC reform, however, each is likely to take from this study their own lessons for future possible episodes of reform. Reformists might seek to further the reach of democracy by building reform movements that light up public interest. Industry players deeply sceptical of such initiatives may work to strengthen their position of structural power in the political economy.

Such zero-sum games are hardly likely to move the dial on the outcomes that should be expected of each political economy. The key economic holdback to reform – banking sector-state dependency – will remain a significant constraint in countries such as the UK and Switzerland. In contemporary US politics, the sharp popular divide in attitudes towards government is likewise unlikely to change soon. Even if the US is in theory capable of

delivering far stronger reform than most European economies, it takes the unlikely coalescing of democratic pressure on both the political left and right for a critical threshold of lawmakers to back significant reform. Both types of holdback produce distinct distributional effects. In the UK and Switzerland, the value created in major financial centres is accrued mainly among highly paid workers and shareholders that typically co-locate in affluent urban economies (Iversen and Soskice 2019; Venables 2018). If policymakers continually pass reforms that allow value to continue being extracted from industry, this is likely to reproduce the same winners and losers in successive regulatory contests. In the US, if reforms are continuously framed as either losses for big business from excessive government interference, or untrammelled industry overpowering voter interests, this is similarly likely to reproduce the same distributive conflicts that have characterised the country's post-GFC politics.

For voters on the receiving end of these regulatory contests, *democracy under constraint* may produce long-standing perceptions about the capacity of the democratic process to respond to new challenges. Big banks and their executives, policy elites, as well as urban-dwellers who reap "rents from agglomeration" (Collier 2019), may come to be seen as the chief progenitors of democratic constraint. Indeed, few would deny that the period since 2008 has seen a surge in popular discontent about how ACDs are governed. On this topic, a great deal of attention in the political science literature has been given to recent political earthquakes, especially the election of Donald Trump and the Brexit vote. Scholars and analysts alike have seen these political events as a backlash against the long-term economic inequalities experienced in these countries (e.g. Colantone and Stanig 2018).

Investigating voter attitudes about financial governance can similarly reveal some of the longer-term repercussions of reform emerging from *democracy under constraint*. Survey research conducted by the Banklash Project offers insights about how highly salient issues of the GFC period continue to shape public opinion (Culpepper, Jung, and Lee 2023). For example, survey respondents in the UK are consistently found to have higher regulatory preferences than those in Australia, France, Germany, and the United States; while Swiss respondents are consistently among the lowest regulatory preferences. In comparison, US respondents' appetite for high regulation is overall lower than in the UK, but surveys have repeatedly shown there to be a strong partisan effect: Democrats overall support stronger regulation, while Republicans support weaker regulation (see also Young and Yagci 2019).

In the British case, the fact that today voters want still more regulation indicates that the changes introduced in the wake of the GFC have not satisfied their demand for reform. This is in spite of a number of specific outcomes, such as ringfencing, which have targeted banks with costly reforms in a way that has measurable real-world effects. Looking at the overall shape of the British financial sector today, however, it is not difficult to see why a strong perception remains that global banking has been insufficiently reformed. Despite clear public demands, financial services have had an increasing role in the UK economy since the GFC, and London is seen as having become even wealthier; strikingly so relative to the rest of the country (see Chapter 3.2). If the process of UK post-GFC reform was as constrained as the theory and empirical chapters of this dissertation propose, it is less surprising that the British public continues to harbour strong anti-finance attitudes. Despite a significant package of reforms compared to those in many other countries, the UK still exists in asymmetric dependence on an industry that nearly collapsed its economy and which epitomises the

country's inequalities. The Brexit negotiations, in which the City of London became a key bargaining chip, have in this respect been painful reminders of that dependency (Fraccaroli, Regan, and Blyth 2023; Kalaitzake 2017; Thompson 2017).

On the other hand, for the US, if we similarly reflect on regulatory outcomes as the product of a democratic response, it begins to make sense that the cleavage among voters today remains a highly partisan one. As Chapter 5 showed, the entire US regulatory process was refracted through political institutions that were and have remained starkly divided along party lines. US reform efforts are an output of the country's deep-set political divides. Their divided attitudes about regulation today are as such quite understandable.

As for Switzerland, lower preferences for regulation among its voters may on first glance seem puzzling given that the country, like the United Kingdom, exists in a similar state of asymmetric dependence on its banking sector. However, as was demonstrated in Chapter 4, its economy is today far less exposed to global finance than it was in 2008. This is likely to do at least in some part with regulation, given that Swiss policymakers enacted policies that have seen the size of the two biggest firms go down significantly. Swiss voters were also twice given a direct say on executive pay policies. At least in some instances, people were given the opportunity to significantly adjust this aspect of financial sector governance. It is not just the institutionalised referendum mechanism which may make Switzerland a somewhat unique case: the Alpine nation is also a small and wealthy country with far less pronounced regional inequalities than those which afflict the UK and the US, and indeed also France and Germany. The Swiss people may as a result collectively perceive greater buy-in to its finance-led economic model, even if after 2008 its policymakers were ultimately able to deliver only a constrained democratic response that reflected similar dependencies as the UK. That regulatory settlement, however, was ultimately not sufficient to prevent the collapse of Credit Suisse, nor the safe failure of the firm. With the latest state intervention, the "Swiss Finish" is probably not one that other countries either can or would want to replicate.

This may seem like a critical assessment of these projects of post-crisis reform, which in fact demonstrate some of the further-reaching changes to financial sector governance among the ACDs. Indeed, there are few instances in this dissertation in which policymakers achieved outcomes that chalk up as both democratic and economic successes. Yet these episodes of reform give ample grounds to be optimistic that future episodes of reform could yield improvements on both measures. If the key forum in which such future reforms will be decided remains the legislature, and the most likely outcome will involve firms experiencing at least some regulatory costs, this suggests one failsafe gain would be to improve the process by which such decisions are made by lawmakers.

There can hardly be a one-size-fits-all approach to improving legislative decision-making. One mechanism that nonetheless appears a common solution would be to improve the quality of information about reform options that is made available to lawmakers, and in turn the transparency about how such information is used in decision-making. This would remedy the tendency of policymakers in many countries to delegate to expert committees, and in so doing to often mask the distributional effects of what remain at core political decisions. In the case of the United States where such delegation is less common, improving the information available to Congress, including rigorous impact analyses of different regulatory options and

ensuring that this information is made available in a public and accessible format, could ameliorate the highly partisan deployment of evidence that often occurs today.

This proposal shares with legal scholar Roberta Romano's work a focus on the power that is resident in the legislature to drive through reforms. Romano, who proposes the sunsetting of regulation after a period of time unless it is re-enacted, however invokes a profound cynicism that law-making bodies can ever deliver efficacious regulation in the heat of a major crisis (Romano 2014; Romano and Levin 2021). In contrast, the recommendation set out herein has as its starting point that policymaking reform is not only a likely outcome after a major crisis, but is also in these moments uniquely capable of delivering regulations that take the content of democratic demands seriously. A regulatory system that lacks such input, as occurred during the period of deregulation up until 2008, was ultimately shown to have disastrous effects for many capitalist democracies. This is not to say that the regulation which came after 2008 has been an unequivocal success. Yet a route to significant reform remaining open after such events is surely to put trust in the democratic process; while conversely assuming that the output from democratic contestation will always be inefficacious appears a damning indictment. In any case, if hard-won democratic contests fade into the ether after a set period, this seems likely to only erode democratically responsive policymaking at just the moment when the public at large is likely to be paying less attention. This is surely a recipe that would lead to the enhancement of special interest influence.

Voter perceptions about the quality of a regulatory process will naturally differ from policy elites and subject matter experts. For example, when in 2015 Mark Carney as Chair of the Financial Stability Board declared that the "final tools" necessary to end Too-Big-To-Fail banking were in place, everyday voters taking notice may have baulked at such an assessment. Given that many of the firms deemed TBTF when they were bailed out in 2008 were by 2015 only bigger and more globally systemic, scepticism would be understandable. Indeed, many voters continue to perceive a gap between their own interests and the reforms that policymakers enacted after the GFC. One of the implications of this study is that this perception is not only an important yardstick to measure attitudes about capitalism and democracy, but also to a great extent reflects real dynamics of the reform process after 2008. British voters continue to be dissatisfied with the financial sector because, despite political promises to resolve the "British dilemma", the UK remains as dependent on its global financial centre as ever. Whether American voters are satisfied with post-2008 outcomes is highly correlated with whether the party they vote for spearheaded, or sought to forestall and rollback, reform. All in all, after 2008 voter interests were only periodically incorporated into financial regulation; and these indicators suggest that voters have some intuition of the gaps that exist between what they demanded and what was achieved.

While latent public attitudes about financial regulation may be of limited concern to policymakers in a low salience equilibrium, this domain of policymaking is sometimes brought to the very centre of democratic debate. The digitally supercharged, news-saturated environment we today live in is conducive to making scandals in big business more accessible and relevant to the general public. This has been a study of a major instance when debate about financial regulation animated national politics across the globe. In such instances, beliefs about whether democracy can deliver a public interest response to such events become far more important. The democratic aftershocks of financial crisis and reform may

ricochet far beyond the bookends of a regulatory reform agenda set by policymakers. This does not mean that for reform to be effective policymaking institutions should be made aseismic to democracy. Rather, narrowing the cleavage between the reforms demanded by voters and the policies that are delivered is an elemental challenge from which the future of advanced capitalist democracy will be built.

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Appendices

Appendix 1: Methodological Note to Newspaper Article Category Classification

The Banklash Project media database was created by Dr Tom Nicholls, Lecturer in Data Science, University of Liverpool. The database is a compendium of articles about banks and banking which has been generated through use of LexisNexis and other newspaper search databases. It represents a comprehensive record of articles from some major national newspapers in six countries in three languages between 2007-2019.

Once this database was generated, Dr Nicholls and Prof. Pepper Culpepper then categorised articles in order to classify this text computationally via supervised analysis. The five categories chosen were derived inductively by looking at unsupervised categorisations of front-page stories of articles about banks and banking and aggregating the stories into politically meaningful categories. Articles were excluded from this inductive process if they were general discussions of the direction of the economy or of the stock market, in which banks were mainly included as examples. Once blind double-coding could be conducted with high inter-rater reliability, a text classification exercise using a transformer-based model (Terechshenko, Padmakumar, and Brown 2020) was then conducted. The transformer-based model classifies articles to one of these six categories, or to no category at all. Figure 2.1 reflects the number of articles in each category in the six case countries (with one graph for each of Swiss-German (CHD) and Swiss-French (CHF) newspapers).

The final codebook for these six categories created by Prof. Culpepper and Dr Nicholls is as follows:

1. Scandal

All the articles about scandals that are clearly in this category feature one or more named banks that were involved in, or allegedly involved in, *misconduct* that involved settlement/charge/fine/claim etc. The lowest of these is a customer complaint, which I have put in the scandal category only when they come in large bulk when they are reported (write-in advice columns where customers note an individual complaint and ask if their bank is allowed to charge them for product x or fee y are not included). Fixing of exchange rates, such as Libor and Euribor, are clearly in. Hidden fees (ATM or credit card or mortgage exit fees), if not found to be illegal, are not a 'scandal'; if a regulator forces fees to be reimbursed by the banks, that *does* count as scandal/misconduct. If a bank is completely exonerated of charges of some sort in an article, this is also not a scandal.

2. Regulation

These are articles about the making of rules for banks or the regulatory or political oversight of banks. Articles about financial reform, rules about financial stability, liquidity requirements such as Basel III or CRDIV, European banking union, stress tests, or prudential regulators (whether micro-prudential or macro-prudential) fit this category. Articles about taxes specific to banks also fit this category. Articles about backlash against potential or actual regulation fit this category, as do congressional or parliamentary hearings about banks. Articles about banks organizing for political action – to shape regulation – also fit this category.

3. Business as usual (strategy and products, executives, and profit/loss)

These are articles that deal with the business of banking as a normal economic activity, including earnings, profits and loss, and share price of the bank. Articles about business strategy, entering or leaving particular markets, the development of new products (savings accounts, credit cards), and discussions of senior leaders in banks (including obituaries of senior bankers), as well as their boards, all fit this category. Articles about fees, which are not about alleged misconduct, fall into this category as products. Articles about fintechs (financial services through technology) firms, where they discuss these firms competing with banks in certain markets, fall in this category (articles about fintechs without reference to banks fall in none of these categories).

4. Financial crisis and bailouts

These are articles that deal with the events of the financial crisis of 2008 and the bailouts that resulted from them. Articles about particular institutions involved – such as Northern Rock or Lehmann Brothers – are in this category, as are articles that discuss the details of taxpayer bailouts, specific bailout policies such as TARP, toxic assets or the sources of the crisis – too-big-to-fail banks, high risk financial products such as CDOs based on the sub-prime market, or bank borrowing standards that are low because banks don't hold the risks of mortgages – all of these are in.

5. Executive pay

These are articles about the level of executive pay and bonuses, including shareholder votes on (or revolts about) remuneration of senior executives.

Appendix 2: Statistics on Banking Sector Internationalisation

Data on bank internationalisation are from the Bank for International Settlements' Locational Banking Statistics (LBS). The time period chosen for each country and each metric is 2006 Q4, before the effects of the Global Financial Crisis had impacted banking activity in these areas. The corresponding BIS metric for each variable is in the supporting table below.

GDP data used in Table *2.10* is taken from OECD Gross Domestic Product (accessed 6 February 2023).

Table A.1: BIS Metrics used for Banking Sector Internationalisation Variables

Variable	Underlying BIS Metric
International Market Activity of Home Banks	Positions reported by banking offices located in LBS-reporting countries and controlled by parents of the specified nationality (total outstanding claims)
Cross-Border Positions in Overall National Banking Sector	Positions reported by banking offices located in the specified country regardless of the nationality of the controlling parent (outstanding cross-border positions)
Foreign Banks in National Market	Banks' cross-border positions on residents of specified country (claims in all sectors and all instruments)

Appendix 3: Dynamics of Internationalisation in the City of London

Most securities firms were acquired by non-UK international banks after the "Big Bang" in the 1980s, as shown in Table A.2. As securities markets increasingly internationalised up to the GFC, a substantial share of cross-border activity conducted in the City of London was not performed by UK-headquartered firms. Two measures of the balance of this commercial activity are shown in Tables A.3 and A.4.

Table A.2: Major Acquisitions of UK Securities Firms

Acquiring Institution	Nationality of Acquirer	Target Institution	Date
ABN AMRO		Hoare Govett	1992
Bankers Trust/Deutsche Bank		NatWest Markets (part)	1997
Barclays		De Zoete Bevan	1985
		Wedd Durclacher Mordaunt	1985
Chase Manhattan		Flemings	2000
Citigroup		Schroders (part)	2000
Credit Lyonnais		Laing and Cruikshank	1985
Credit Suisse / CS First Boston		Buckmaster & Moore	1985
		BZW (Barclays) (part)	1997
Deutsche Bank		Morgan Grenfell	1989
Dresdner Bank		Kleinwort Benson	1995
HSBC		James Capel	1992
ING		Barings	1995
Merrill Lynch		Mercury Asset Management	1997
		Smith New Court	1995
Midland		Samuel Montagu	1974

ING		Barings	1995
NatWest		Fielding Newson Smith	1985
		Bisgood Bishop	1985
		Wood Mackenzie	1987
Société Générale/Investec		Hambros	1997
Swiss Bank Corporation		S.G. Warburg	1995
UBS		Phillips and Drew	1986

Table A.3: Assets of foreign banks in the UK banking sector
Source: Bank of England (cited in Bowen, Hoggarth, and Pain 1999)

	USA	Japan	Europe	Other	Total
Year	**Assets (£bns)**				
1980	60	41	28	46	175
1985	100	178	95	106	479
1990	110	255	233	126	724
1996	155	181	495	229	1,060
	Market Share (%)				
1980	34.4	23.4	16.0	26.2	100.0
1985	20.8	37.2	19.8	22.1	100.0
1990	15.2	35.1	32.2	17.5	100.0
1996	14.6	17.1	46.7	21.6	100.0

Table A.4: M&A Transactions League Tables by Firm and Firm Headquarters (Data is aggregate for 2010-2014 Transactions)
Source: S&P Global Intelligence

Rank	Firm	Firm HQ	No. Deals	Deal Value ($M)
1	J.P. Morgan Securities LLC		14	14,571.88
2	Credit Suisse (USA), Inc.		12	8,736.41
3	UBS Investment Bank		10	8,594.21
4	Lazard Freres & Co. LLC		9	7,383.26
5	Citigroup Global Markets Inc.		8	5,863.88
6	BofA Securities, Inc.		11	5,589.61
7	Barclays Capital Inc.		8	4,383.83
8	HSBC Securities (USA) Inc.		4	4,162.52
9	Centerview Partners LLC		3	4,146.00
10	Goldman Sachs & Co. LLC		8	3,781.70
11	Morgan Stanley		14	3,308.83
12	Rothschild & Co SCA	/	8	3,153.36

Appendix 4: List of Interviews Cited

Table A.5: Interviews Cited

Reference	Name/Role	Date
Australia		
#AU1	Prof. Kevin Davis, FSI panel member	23 September 2021
#AU2	FSI secretariat member	26 October 2021
#AU3	Former Australian Commonwealth Treasury Official	29 October 2021
Switzerland		
#CH1	Senior Policymaker at Swiss Department of Economic Affairs Official	15 January 2021
#CH2	UBS official	12 February 2021
#CH3	Two Finma officials	02 March 2021
#CH4	Credit Suisse official	15 March 2021
#CH5	Finma official	29 January 2021
#CH6	Representative of 2014 Swiss Group of Experts	Confidential
#CH7	Representative of 2010 Swiss Commission of Experts	05 February 2021
United Kingdom		
#UK1	ICB official	16 April 2021
#UK2	Conservative Government adviser / Former Treasury adviser	24 September 2021
#UK3	Former senior Bank of England official	31 March 2021
#UK4	Former senior Bank of England official	18 February 2022
#UK5	Martin Wolf, ICB Member	12 November 2021
#UK6	Prof. Sir John Vickers, ICB Chair	08 November 2021
#UK7	Prof. Gregory Thwaites, ICB secretariat member	28 February 2021
#UK8	Former senior Bank of England official	31 March 2021
#UK9	Liberal Democrat politician	09 July 2021
#UK10	ICB secretariat member	05 February 2021
#UK11	Dr Greg Clark, former Financial Secretary to the Treasury and City Minister	21 April 2021
#UK12	Former senior Bank of England official	09 April 2021
#UK13	Senior banking executive	19 May 2021
#UK14	Former senior Bank of England official	18 February 2022
#UK15	Bank of England official	16 December 2021
#UK16	UK regulatory official	24 June 2021
#UK17	Baroness Kay Swinburne, former Member of the European Parliament for Wales	21 September 2021
#UK18	Lord Stewart Wood, former adviser to Gordon Brown	10 September 2021
#UK19	Former Morgan Stanley International executive	01 April 2022
#UK20	UK bank trade association representative	03 March 2021
#UK21	Giles Wilkes, former adviser to Sir Vince Cable	29 September 2021

#UK22	Senior HSBC official	19 July 2021
United States		
#US1	Federal Reserve official	23 March 2022
#US2	FDIC official	08 March 2022
#US3	Senate Banking Committee staffer	05 May 2015
#US4	John Walsh, former Acting Comptroller to the Currency	23 March 2022