

Regulatory herding versus democratic diversity: history and prospects

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Abstract

Regulatory convergence – within the E.U., across the Atlantic and internationally – is conventionally represented as not only benign but also as essential in crisis prevention. This paper articulates a different frame of reference: one in which regulators “crowd,” “herd” and sometimes merge, so mimicking and exacerbating financial market tendencies toward similarity and contagion, and drawing regulators and markets into the same vortex. The paper looks at some of the historical and contemporary circumstances in the U.K., wider E.U. and the U.S. that have given reign to these tendencies and also at some aspects of regulatory architecture and governance that reduce such tendencies. It mentions pre-crisis tendencies to regulatory subservience to financial markets, with such subservience having a deep history in the U.K. and a shorter one in the U.S.; so-called command regulation, which has the potential to either deepen subservience or transcend it; and the institutional preconditions for permanent regulatory vigilance, such as democratic appointment of heads of agencies. The paper concludes by pondering the prospects for the democratic direction of financial market regulation, in terms of its distributional logics and extraterritoriality.

1. Introduction

A financial trade is said to be crowded when many market participants are trying to transact similarly – for example, to get into the euro, out of bank equity or into bonds. Traders may, in principle, hold to a variety of trading purposes, strategies and intentions; however, if they have come to rely upon the same, linked or similar information sources, analytical approaches, calculative tools and data pools, then they start to make similar decisions (in parallel rather than in consort). Crowding is widely considered to cause difficulties, since not everyone can move in the same direction without causing what eventually becomes recognized as bubbly and sometimes chaotic turning points. Economists, sociologists and ethnographers have various explanations for market crowding – such as information spillovers [Acharya and Yorulmazer (2006)], the performativity of calculative tools [MacKenzie (2003)] and common constraints on investment strategies [Pitluck (2014)]. Most commentators agree that crowding is not essentially a willful copying of others (that is herding, to be discussed below). Indeed, some crowders may hate that they feel obliged to do so, following common information sources and/or logics that seem to restrict their options.

In herding, by contrast, market participants consciously, willingly and strategically emulate the broad trading patterns of those around them. Needless to say that despite the fact that they try to differentiate and spice up their market offerings – through corporate and product branding, complexification of derivatives, combinations of strategies and routing through multiple venues – the underlying aims and tactics remain similar. This deliberate and “sophisticated” herding goes beyond reliance on the information environment; it results from the explicit “me too [but better]” management claims, occupational cultures, product development and sales pitches.

Do crowding and herding also occur in financial market regulation? Yes, they do. Crowding comes to the fore when regulators become reliant on similar mindsets, information sources and regulator rationales and objectives. Such was the case in the long period of complacency prior to the crises of 2007 and onward [Engelen et al. (2011)]. It was not just that the regulatory mind-set models were wrong but rather that they were so similar; hence, allowing the same basic business model to proliferate so widely. More diversity would have been safer. There

was a temporary disruption in the convergence in regulatory thinking, as the response to crisis precipitated some radical rethinking. “Post crisis” rethinking then quite rapidly reconstituted around the new notion of macroprudential regulation, which recognizes that problems arise not only with specific firms and trades but also systemically, in the interstices, connections and similarities. A similar recognition is needed in relation to regulation itself, this paper argues.

How solidified and homogeneous will macroprudential thinking turn out to be internationally? Empirically, the answer to that question is not clear. A range of answers might be suggested, depending on the perspective taken. Some commentators, taking a wide-ranging global perspective, suggest that crises have introduced greater heterogeneity into financial markets regulation, as many rising powers, such as the BRICS, deepen their critique of the failure of western, neoliberal, hitherto dominant approaches [Helleiner and Pagliari (2011)] and encourage construction of pivots for regulatory and interregional regulation [Leahy and Harding (2014)].

Other commentators, more focused on the U.S. and/or the E.U., have noted the rapidity with which regulators picked themselves up from the epistemic floor and have rebuilt and extended their organizations, networking and influence [Blyth (2013)]. Even so, European regulators in particular seem now to be in a more explicitly close relationship with ministers and heads of state than hitherto. That may sometimes push regulators in the same direction (for example, when heads of states are in accord), while at other times allowing for some national regulatory leeway [for example, when countries’ national elites seek to retain influence over regulation of “their” banks, see Spendzharova (2014)].

Jurisdictionally specific work, to be deployed here, suggests a long-term historical continuity: separation of financial market regulation from democratic politics. This separation leaves regulators with each other as their primary reference points, with herding as one consequence. Of course, the market retains some of its influence, even after the continuing scandals over fraud, conflict of interest, benchmark manipulation and trading venues’ favoritism of some market participants over others. Such conduction seems to have been very widespread, possibly more the norm than the exception.

Given recent developments, we seem to be in a historical period in which the international (Western led) regulatory-market nexus is under more pressure than was the case before the events of 2007 onward, opening up some possibilities for non-trivial changes in governance of financial markets. Whether such opportunities can be grasped must depend, in part, on understanding the conditions that encourage regulatory crowding and herding.

2. Private regulation: aristocratic beginnings

In other policy areas, political parties choreograph and sometimes polarize questions of broad strategy, which, in relation to financial market policy, would involve asking questions like: what sort of banking do we want in coming decades in our country or region? Not so in relation to financial market regulation, and for good historical reasons. In exploring the historical issues, our principal scholarly debt must be to economic historians Cain and Hopkins for their account of the development of the City in relation to world trade and politics. Whilst the City's side-stepping of the expanding sphere of democratic politics is not the main focus of Cain and Hopkins' work, the latter helps us to contextualize (what became known as) financial market self-regulation.

With reference to the period from the mid-nineteenth century up until the end of the Second World War, Cain and Hopkins (1987) refer to an "aristo-financial elite" of "gentlemanly capitalists," which preferred to invest internationally rather than to support domestic industry. The success of this footloose strategy made the City more dynamic than international rivals and more politically important domestically than industrial capital.

"The City's overt political influence remained limited. But since City, government, and administration were so closely entwined, it is not surprising that many policy questions were regarded as being beyond the realm of party politics. It was assumed that matters of high finance could safely be left to the small circle of institutions which were thought to have an intuitive understanding of the 'national interest.' There is, of course, no denying that as landed wealth declined in importance, industrial as well as financial and commercial wealth grew rapidly. Nonetheless, the influence of industry on central government and on economic policy continued to be limited by its relative lack of access to the major sources of power and influence. Manufacturers were still largely outside the circle of gentlemanly

culture and did not 'speak the same language' as the aristo-financial elite. And, insofar as they did gain political influence, any residual Cobdenite radicalism was likely to be muted by the need to join gentlemanly interests in defending property against the threats posed by trades unions and the spread of democracy." [Cain and Hopkins (1987, 6)]

Thus, potential opposition to the aristo-financial elite was fragmented. "Militant manufacturers" – as Cain and Hopkins at one point describe British industrialists, who sometimes found themselves disadvantaged by the City's investments in foreign industry – tried to push back politically; however, they were inhibited from taking an overtly oppositional position, because of their concerns over working class pressures, against which manufacturers made common cause with London and the shires. Meanwhile, working class political claims were also somewhat circumscribed by pride over Great Britain's standing in the world and by political identification with the industrial, financial and political arrangements that underpinned this (international trade, sterling, Britain's standing in the world, empire, etc.). An important consequence was that issues concerning the City and its governance were conceptualized as being "above politics" [Cain and Hopkins (2013, 340)] or, as one could also say, beyond politics. The City did not need to influence government, because financiers and political elites were interwoven.

The adoption of Cain and Hopkins' work as a broad framework for understanding the history of financial market regulation might be thought too risky because, although their work has attracted praise for its scope, depth and originality, it also has been criticized. The grounds of criticism include that it is allegedly "excessively monocausal;" finance-centric (paying insufficient attention to other sectors and their strategies); Eurocentric (paying insufficient attention to "autonomous impulses emanating from the periphery"); neglectful of cultural and religious aspects; and in some constructivist critiques, fails to recognize that "the Empire was always an imaginative construct" [see Cannadine (1995, 194)]. It seems to the present writer, however, that a "gentlemanly capitalist" framing of finance usefully captures cultural as well as economic aspects of class alliances and antagonisms – both internationally and within Britain. The international aspects are by no means restricted to the Empire, since much of the City's investment historically went much wider. These authors' placing of the City in terms both of

foreign policy and domestic policy is valuable and some of the potential implications for us today will be taken up later.

In short, Cain and Hopkins' work, alongside that of other economic historians, such as Daunton (1989), and political scholars such as Michael Moran (1988), usefully illuminates the historical, institutional and cultural setting within which financial market regulation arose in club/private form, outside the party political sphere. Indeed it has become common ground amongst social, economic and political historians of the City that, despite the advent of the general franchise in 1918, such private regulation in the City was hardly touched by democracy. As Johal et al. (2012) put it: "The Bank of England, which had hitherto been fairly marginal in the regulation of the City, now emerged as a critical institution. It used its authority to reshape the government of markets. The war had destroyed the kind of open international economy of which the City had been a centrepiece. After 1918 City markets were organised into a series of cartels policed by trade associations. The cartelisation of the markets, coupled with the authority of the Bank of England, was sufficient to sustain what the City called self regulation: accepting the disciplines of self regulation was the price firms paid for being allowed into the privileged cartels. The stability of the self regulatory system in the decades after 1918 allowed the City further to elaborate its regulatory ideology. This pictured the City as a special part of the economy, claiming exemption from one of the main features of 20th century economic government in Britain – the apparently inexorable rise of the state as a regulator of economic life" (ibid., 69).

Turning now to the period from the end of the Second World War up until the 1980s – a period in which Britain struggled in the face of recession, war and competition from the U.S. – Cain and Hopkins point to a development that is in no way prefigured by their analysis of earlier centuries. British finance found itself rehabilitated by the geopolitical response of the U.S. to communism. "In the Great War, Britain had needed American capital to secure victory: after 1939 her very survival depended on American aid. [...] The initial quid pro quo sought by the United States for her extensive aid was the abolition of imperial preference, the destruction of the sterling system, and – ultimately – decolonization. However, with the emergence of Russo-American antagonism after the [Second World] War, all these elements of Britain's world power survived as valued assets

in the Cold War, so much so that sterling was launched on a new international career in the 1950s as a junior partner of the dollar. Gentlemanly capitalists who had once provided the framework for the Pax Britannica now survived to fight another day under the protection of the Pax Americana." [Cain and Hopkins (1987, 17)]

In these circumstances, fortunate for the U.K. and especially for the City, the latter not only survived but thrived, and its economic expansion helped to underpin its political autonomy, at least up until the 1980s. What remains somewhat controversial is to what extent that situation changed as a result of neoliberal reforms in the 1980s.

2. Mother of regulators: history of pseudo-public regulation in the U.K.

An important question is whether the U.K. policy reforms of the 1980s can be understood in terms of political disruption of the preceding historical arrangements of private or club regulation. The orthodox position – which dominated the academic literature as well as policy thinking before the financial crisis – concedes the history of club regulation, whilst claiming that modernizing reforms under both Conservative and Labour administrations displaced historical arrangements. According to the orthodox narrative, the opening up of the City by "Big Bang," the creation first of a Securities Investment Board (SIB) and then of an "independent" regulator, the Financial Services Authority (FSA), swept away the old order. So says the conventional history; but on what grounds?

This question can be taken in stages, starting with the SIB, the forerunner to the FSA.

Writing in the 1980s about the SIB, Moran refers to the City having "lost the battle to keep the politicians and the civil servants at bay." On the other hand, the SIB "is conventionally described as self regulation within a statutory framework" [Moran (1988, 22)]. And: "It [the SIB] is, in essence, a franchising operation: semi-private and private bodies (the SIB and the various self-regulatory organizations) will be awarded a franchise to exercise legally backed powers of regulation" (ibid., 24).

If the transition arrangements represented by the SIB did not really signal a decisive break with club/private regulation – but rather institutionalized those arrangements within public policy –

then the next question is, to what extent did the advent of the FSA as such change things? Or, to put the question slightly differently, did the FSA outgrow and overcome the historical, club/private regulation heritage?

With benefit of hindsight – in the circumstances observable from 2007 onward – revisionist work (including my own) suggests that the FSA represented continuation of private/club regulation within a façade of public regulation [Dorn (2014)]. In a focused study of the FSA, McPhilemy (2013) suggests that the FSA deployed a massively technical rulebook alongside continuation of cosy “club” regulation. The older tradition was hidden within the newer one: so says the revisionist story. Gilligan’s (1997) deployment of the notion of the “relative autonomy” of financial market regulation drives in a broadly similar direction.

In the angry atmosphere following political recognition of the risks taken by the financial markets, the U.K. Parliamentary Commission on Banking Standards castigated senior management within banks for evading and gaming regulation by thus setting up compliance regimes as “Potemkin villages to give the appearance of effective control and oversight, without the reality” [Parliamentary Commission on Banking Standards (2013a, 43)]. However, the parliamentarians stopped short of applying such language to regulation itself. That distinction may be merited on empirical ground (and not simply as a matter of politesse). Potemkin villages are deliberately constructed from the start in order to mislead, a process that may be fairly discerned in financial market participants’ overt and frank gaming of regulation. Can we really say the same of the historical evolution of regulation? Until we find clear evidence of conspiracy, it might be safer to think of regulation in terms of a series of sins of omission.

Bellringer and Michie (2014) have put forward the view that the opening up of the City was “an accident,” in the sense that it occurred in response to a contingent series of events. Bellringer and Michie’s work focuses on the liberalization of the London Stock Exchange, although they extend their conclusions to banking. There is, they say: “[A]n absence of evidence to connect the sequence of events that led to Big Bang, and even less to its consequences, with any conscious decision by the Conservative government whether through the actions of its politicians or officials. Nor was Big Bang the product of City influence

with the deliberate intention of making London into a global financial centre. [...] There is no evidence that the Conservative government under Mrs Thatcher intended to transform British banks into the dynamic sector of the British economy they had become prior to the Global Financial Crisis of 2007/6. Neither the Conservative government that won the election of 1979 nor, in all probability, the Labour government that emerged from the landslide victory in 1997 had a detailed plan of how to transform the UK financial system into a globally competitive sector that would replace manufacturing as the engine of the British economy.” [Bellringer and Michie (2014, 22)]

Some refinement of that account is in order. No doubt it is true that neither Labour, in creating the SIB, nor Conservatives, in replacing the SIB with the FSA, had “a detailed plan of how to transform the U.K. financial system.” Incoming governments quite often lack detailed plans. However, both governments held a broadly “modernizing” agenda, rather putting into doubt Bellringer and Michie’s description of the reforms as accidental. Rather, the broad direction of change was foreseen, within which negotiations and step-by-step decision making filled in the detail. As the authors observe, the Conservatives came into office in 1979 on the basis of a radical commitment to competition and the break-up of all forms of cartels. It would have been politically difficult to retreat from that position, especially since a Restrictive Trading Practices Act (RTPA) had been enacted under the receding Labour government, after which the Office for Fair Trading had referred the rule-book of the Stock Exchange to the Court of the RTPA (*ibid.*, 12). As for market context, Bellringer and Michie astutely observe that interests in the financial markets were diverse and shifting, there being both support for the old City ways and for innovation – as represented by upstart and unclubable banks, notably S.G. Warburg, which had introduced the Eurobond market and championed hostile takeovers in the industry.

On the evidence presented by Bellringer and Michie and by many other commentators – and unsurprisingly – there were schisms that ran across politics and the markets, rather than any hegemonic bloc. For example, these authors refer to widespread City hostility to a new and upstart bank, SG Warburg. On the basis of having worked at SG Warburg, the then Secretary of State for Trade, John Nott, denounced its culture as “vigorous, unsentimental [and] meritocratic” [Nott (2002)] – a description

that would have been found apt by many at the time, be they detractors or supporters of such a manner of doing business.

Given the mingling of and antagonisms between old, clubby, aristocratic financial networks and newer, "unsentimental" meritocrats, it is unsurprising that the outcomes, in terms of regulation, were not unitary. Taking the SIB and the FSA in turn and applying to them the historical analysis mentioned above, we might characterize the SIB in terms of a technocratic but somewhat flimsy superstructure (the board itself) erected over – almost floating over – the foundations of club regulation (diverse self-regulatory bodies). As Moran (1988, 27) has it, with the establishment of the SIB and its self-regulatory bodies, "semi-private and private bodies [were] awarded a franchise to exercise legally backed powers of regulation." Of course, each self-regulatory body more or less corresponded to an existing pocket of private regulation, already holding a franchise, so perhaps it was rather more a case of the SIB acknowledging than awarding franchises. At that stage of regulatory reform, the private nature of regulation was retained, being overtly acknowledged, although being somewhat bureaucratized: the proliferation of rulebooks began.

The FSA presented a further development of these private-public arrangements, installing club regulation within a unitary public institution. The FSA was a victory for modernity in terms of its appearance – diverse bodies were replaced by one – and in terms of its formal routines at the operational level. However, it retained clubby relations and functioning at management and policy levels (as McPhilemy and other revisionist authors cited above suggest). The FSA was not a Potemkin village – the construction of such a conspiracy would have required a level of unity and organization that was beyond the capacities available at the time – but neither was it an accident. It was more of a regroupment of historical forces, re-settling private mentality within a public façade.

3. Global subservience, national command, local activism: three regulatory playbooks

Widening our focus to Europe and the U.S., we find three regulatory playbooks: (i) regulators' subservience to markets, which in the pre-crisis period had to some extent spilled over from the U.K. to other jurisdictions; (ii) so-called "command regulation," in which regulators are strongly supported by or directed by federal politicians, meaning that they may be directed

to apply either a heavy hand or a lighter and "recalibrating" one, depending on the political mood (a heavier hand emerging with recognition of the seriousness of the crisis, then receding); and (iii) regulators and prosecutors (acting as conduct supervisors) are sometimes locally appointed or elected, making them structurally independent of federal governments and also of regulates (and a thorn in the side for both). Here we briefly discuss these three, before going on to assess future prospects within the contemporary European scene.

3.1 Pre-crisis regulatory subservience, as revealed by the crisis

Once the depth of the crisis had been recognized, public regulation of financial markets became seen as something of an imposter. In the U.S., federal agencies became seen as being rather too close to the industry [Miller and Dinan (2009) and, for a pre-crisis review of evidence, see Bó (2006)]. Keynesian economist James Crotty put things as follows: "The design and implementation of the changes needed in financial markets is a political as much as an economic challenge. Unfortunately, most elected officials responsible for overseeing US financial markets have been strongly influenced by efficient market ideology and corrupted by campaign contributions and other emoluments lavished on them by financial corporations. [...] Moreover, powerful appointed officials in the Treasury Department, the SEC, the Federal Reserve System and other agencies responsible for financial market oversight are often former employees of large financial institutions who return to their firms or lobby for them after their time in office ends. Their material interests are best served by letting financial corporations do as they please in a lightly regulated environment. We have, in the main, appointed foxes to guard our financial chickens" [Crotty (2009, 577)].

On reflection, perhaps that last line should have been written as appointing "fox cubs to guard foxes?" Leaving that aside, acerbic commentary – which would have been dismissed as oddball or (in the U.S. context) un-American before the emergence of financial market crisis – became mainstream in the years following 2008 [see for example Parliamentary Commission on Banking Standards (2013a)].

It is however fair to mention that the above judgment about ideology, emoluments, revolving doors and institutional corruption in regulatory agencies may be rather too sweeping.

Not all those who cross over from markets to regulatory agencies, or vice versa, take all of their intellectual baggage, buddy obligations or emotional attachments with them.

Indeed, some research suggests that the workings of regulatory agencies at national and at international levels are more nuanced than that. Looking at some case studies involving the U.S. Securities and Exchange Commission, Tai and Carpenter (2014) summarize that “the evidence for capture is variable [and] the precise role of the revolving door is not yet clear. These authors suggest that, rather than motivating regulators to act favorably toward industry or causing them to adopt industry arguments uncritically, the revolving door seems to act as one type of a general influence that past experience has on regulators’ perspectives” [Tai and Carpenter (2014, 227)] [regarding international regulatory committees, see Young (2012)]. In one sense, a person who goes through a revolving door may be better placed (and sometimes may even be motivated) to take action: whether they do so or not depends on circumstances (see following paragraphs). On the other hand, a person who has never worked in the industry, and who comes with a different occupational history, may struggle to make sense of aspects of the industry [especially since some of its famous complexity has been designed to “game” regulation, see McBarnet (2010) and Gerding (2013)]. So, it is not so easy to say that separating regulatory careers from industry careers would automatically improve the quality of regulation. We have to say: it would depend.

3.2 Command regulation: not necessarily restrictive

Political leadership matters: it can exacerbate collusionary dynamics within the regulator-industry nexus – as U.K. regulator Lord Turner plausibly alleged in relation to U.K. Chancellor of the Exchequer Gordon Brown in the run-up to the crisis [Waugh (2009)] – or it can work against the grain of regulator cooption. In this paper, we refer to both these possibilities as command regulation, although the second sense is the more familiar use of the term. Indeed history offers us examples of regulators who gain the support of political leaders to carry through sustained regulatory reform – such as James Landis, who gained the support of several U.S. Presidents for firm regulation from the 1930s onward [O’Brien (2014), Scott/National Public Radio (2004)].

Something similar happened (albeit briefly) in the U.S. from 2008 onward, with a return to forms of command regulation that had not been seen since the New Deal. And of course the U.K. – long considered within Europe to be a bastion of neoliberalism – became equally, if not more, interventionist, with parliamentarians feeling badly let down by financial market elites, particularly banking elites [Parliamentary Commission on Banking Standards (2013b), Kerr and Robinson (2011)]. For some years, the U.K. found itself broadly in accord with other European Union member states on the need for action across the board in the years immediately following 2008, resulting in a massive re-regulatory effort, causing dizziness for regulators [Tsingou (2010)] as well as for market participants and their compliance departments.

Nevertheless, there are already reminders that command regulation is the historical exception to the rule, both in the U.S. and in Europe. In the U.S., the foxes are returning [Gandel (2015)] and there has been a sustained push back against the Dodd-Frank Act [United States (2010)], with sections of the industry putting sand in the wheels of the laborious process of moving from primary legislation to the regulatory rulebook [Coffee (2011)]. Moreover, at the end of 2014, Congress cut back aspects of the legislation [Przybyla and Wasson (2014), Johnson (2015)]. And in Europe, the longer drawn-out and deeper crisis and depression is currently being interpreted in terms of a need to encourage capital markets in particular, through the creation of a Capital Markets Union (CMU): thus command regulation may turn out to be a quite brief historical moment, which is now moderating in favor of regulatory “recalibration” [Van Steenis (2014)]. CMU seeks to overcome “barriers to a well-functioning securitization markets in the E.U.” [Bank of England and European Central Bank (2014, 15-18)]. These barriers include “too big to fail” banks, aspects of Basel capital rules and rating agencies’ caution toward derivatives in the shadow of the crisis.

Interestingly, CMU and the recalibration opportunity that it offers may be seen more as an opportunity than a threat within the banking sector, if recalibration involves some loosening of bank regulation [Milne (2014, 16)]. European Commission President Jean-Claude Juncker’s 2014 appointment letter to Lord Hill, the then Commissioner-designate for Financial Stability, Financial Services and Capital Markets Union, tasked him with finding “appropriate ways to revive sustainable and

high quality securitization markets, to reduce the cost of raising capital in the Union and to develop alternatives to our companies' dependence on bank funding" [Juncker (2014, 4)]. Considering what this might mean in terms of regulation, Hill's statement to the European Parliament included the following: "Now [after the banking crisis] we are entering a new phase. Although we must continue to be alert to the emergence of new risks in our system and stand ready to take appropriate action, we are unlikely, over the next 5 years, to need to pass the same amount of new legislation again. The work done by the last Commission therefore provides a clear framework for the next Commission: regulation needs to be stable as well as rigorous. The priority will thus be implementation, enforcement, and evaluation. If, during this process, evidence appears that we have not got it quite right, we should not be afraid to make quick and effective adjustments" [Hill (2014, 4)].

All of the above historical and contemporary points show that regulatory command over financial markets is possible when policy makers lend their support to it – the other side of that coin being that "policy fatigue" and/or a change in political atmosphere allows regulatory recalibration and roll-back.

3.3 Exceptionally: local and democratic mandates

Our third and last illustration of the contingent nature of the relation between markets and regulators concerns local pivots of power within federalized systems. Within the U.S., state Attorney Generals have long led the charge against market misconduct, and for good reason. In most U.S. states, Attorney Generals are elected and, as such, are subject to a governance structure and a set of motivations different from those of federal regulatory agencies. State Attorney Generals can be socially distant from federal ministries and closer to popular sentiment. Moreover, in the important case of New York, the Martin Act gives extra leverage to prosecutors [O'Brien (2005)].

The combination of these factors – electoral selection, specific powers and distance from ministerial restraint – gives market (mis)conduct regulation more "bite" in New York than elsewhere in the U.S., and also much more than in European countries. Before the emergence of the financial crisis, New York State Attorney General Elliot Spitzer castigated investment banks as being "at the vortex" of wrongdoing and he opined that "the solution is not more regulation but more innovative application

of existing enforcement strategies" [Eliot Spitzer, New York Attorney General, speaking in 2004, cited in O'Brien (2005)]. Understandably, Mr Spitzer was unpopular in the industry – though not in his electorate – and in time the sort of investigative powers he had deployed against financial market misconduct in New York were turned against his person, personally disgracing him and causing his resignation [Gross (2010)]. Whether or not that was a honey-trap operation has never been ascertained. However, New York State Attorneys – and the New York Department of Financial Services (DFS) – continue to weigh in, frequently embarrassing federal agencies [Schneiderman (2014), O'Brien (2004)]. All of this suggests that, even when federal agencies lack high political backing for robust action, local circumstances can provide a basis for it.

We can now summarize the above three points about regulation and its varied capacities for capture and for activism. (i) An industry-regulation revolving door certainly exists but what goes through it may be a set of occupational experiences and mentalities, rather than sure-fire corruption. (ii) The revolving door can be locked shut by political power – for example, if one key senior policy maker gives his or her support to a regulator committed to command regulation; this tends to happen for a while after periods of crisis, during which time light touch regulation becomes less politically untenable than in boom times. (iii) Local circumstances, electoral politics and legal powers can make a difference, distancing agencies and individuals within them from federal government influences as well as from the industry. Which of these comes to the fore? We have to say, "it depends."

4. Europe and the single market: mixed prospects for politicization

Following the Second World War, the London approach to financial market regulation was projected upwards and outwards, to the European and also up to international levels. This was important for the development of the European Community (EC), its single market and the modes of governance thereof. Elsewhere I have summarized the forces at work in the following terms: "[The Bank of England] was strategically pro-EC, acting in accord with the City's historical international orientation. For example, to the considerable annoyance of Prime Minister Margaret Thatcher, Governor of the Bank Leigh Pemberton later went so far as to sign the 1989 report of

Jacques Delors on monetary union [...] Understanding and shaping the emerging EC agenda on financial service regulation facilitated the bank's domestic agenda-shaping, underlining that Parliament was the agenda-taker" [Dorn (2014, 16)].

Why the Bank of England favored the development of the EC, Britain's eventual entry into it, and the construction of the euro, is no mystery. The Community and its single market represented an opportunity for the City. Some commentators go further, seeing British entry into the EC as a part of the politics of opening up the British economy, including financial services, to the rigors of a global economy: "membership of the EC was trumpeted as a liberal measure opening up British markets to competitive pressures that would force [UK] business to rationalise" [Gifford (2007, 467-468)]. Some see British entry as transforming Europe: through entry, Britain became "a vehicle and protagonist for the globalisation of Europe" (ibid., 465). Indeed, that had been a fear of President De Gaulle, in opposing British entry. In the event, eventual entry in 1973 not only helped to open up the EC (as it then was) to international trade, it also provided a meta-reform at home: financial market regulation, once tied into the single market process, was further distanced from the domestic political process. Since then, there has been much water under the bridge, with the creation of the multi-level Lamfalussy architecture [Posner (2010)], which was then replaced by three European Supervisory Authorities and, for the Eurozone, the European Central Bank – the influence of which has become much enhanced in the context of the Eurozone crisis [Moloney (2012)].

What has not changed is the extent to which parliaments at either the regional or national levels have struggled to exert influence. The European Parliament has been rather in the position of dotting the i's and crossing the t's of proposals brought forward by the European Commission: a task of considerable interest to regulatees – who lobby the Parliament passionately – but not clearly connected to debates between MEPs and their publics. National parliaments have rather acted more as semi-expert arenas for governments to test out and fine-tune proposals, and as arenas to let off political steam as displays of "banker bashing" indicate, rather than stirring strong inter-party debates amongst European citizens. These are honorable roles but they also represent the historically-bequeathed, rather restricted notion of what parliaments are for, when it comes to financial market regulation.

What then might be the prospects for a broader and more adversarial public politics of finance? According to political scientists Swen Hutter and Edgar Grande, politicization means issues becoming salient not just for elites, but also for wider sections of society and for political parties, who then take a variety of positions on those issues, amounting to polarization within the political arena [Hutter and Grande (2014)]. Polarization, expressed in the form of institutional conflict in open fora, is taken as evidence of politicization, with salience being the necessary precondition. Politicization may sometimes be triggered by so-called "fringe" parties (which were quite successful in European elections in 2014). Yet, it could also result from the mobilization of "mainstream" parties.

For present purposes, the question is to how much salience, mobilizing power and polarizing potential currently attach to issues around financial markets, politicizing their governance. Such politicization would demote econocrats down to the level of operationalization of policies, rather than formulation thereof. Empirically, the answer seems to be that politicization of such issues has not strongly occurred yet, in the sense that, whilst there has been much political pressure on regulators, this pressure has come more from elite political circles to "do something," than from political parties' mobilization of citizens. Admittedly, in the European elections in 2014, an anti-neoliberal party in Greece, Syriza (Coalition of the Radical Left) did very well against incumbent political parties – suggesting that under conditions, such as a combination of bank bailouts plus austerity under outside direction, domestic political opinion can become polarized. Yet, in other countries, such as Spain (admittedly not so badly hit as Greece), consensus politics has held up. Indeed, most mainstream political parties across the E.U. did not strongly articulate issues around financial markets per se – they focused more on the euro, postulating a need to save it. Nor was financial market reform a central rallying cry for the various Eurosceptic parties that have come to prominence in countries such as France and the U.K. (the latter's UKIP is headed by an ex-commodity trader, who however talks about other issues).

So, scanning and summarizing across the EU, it seems that while fiscal issues may have been contested in some member states, financial market issues have not been strongly politicized. Why so? The context is a series of interlinked crises around banks and bailouts, the euro and austerity measures. The "highly unequal

distributional effects” of all this cause a “dramatic decline of citizens” trust in the European polity in recent years [which] is a consequence of the higher political salience and lower factual plausibility of arguments adduced to legitimate the exercise of governing powers at the European level” [Scharpf (2014)]. However, the potential political mobilizing consequences have to some extent been contained by European elites’ top level power bargaining (more between themselves and with banking interests than with their citizens), and by heads of states’ common strategy of building new arrangements of economic governance on an intergovernmental basis, outside the E.U. and escaping many of its legal and political constraints [Schimmelfennig (2014)]. Associated with this, “mainstream” political parties have sought not to rock the political boat, so do not publicly contest with each other the fundamental questions about financial markets. Elite bargaining, at a distance from party politics, is one reason that such questions have not been more politicized.

A second and rather ironic reason that financial markets have been spared politicization is the euro crisis. The euro and the various positions taken vis-à-vis it – save it, stay in it, make sacrifices for it, induce other people to make sacrifices for it, leave it, etc. – have definitely occupied much of the public debating space in the euro area since 2009. Lacking such a political preoccupation, banking per se might otherwise have become a bit more politicized in Europe. Such a “currency distraction” does not occur in the U.S., which does not suffer from structural conditions and contradictions that produced the euro crisis (currency union without political union).

A third reason that public debate on financial markets and their governance has remained somewhat shallow, and not politicized in the sense under discussion here, is that the financial markets have become a focus for moral outrage, as elites, media and populations react to recurrent scandals [frauds, mis-selling, market manipulation of Libor and many other benchmarks, “front running” by high frequency traders in dark pools, etc. see Schneiderman (2014)]. Under differing political circumstances, moral/ethical considerations might have acted as a stimulus to the asking of fundamental questions about what financial markets are for, and to political parties’ contestations on such questions. In the event, however, given the “issue competition” provided by the euro crisis and austerity measures, and the reluctance of mainstream political parties in most E.U. member

states to open up fundamental questions about financial markets, such questions have tended to decompose into debates about punishment of individuals and the reform of “banking culture.” In parliaments, the press and scholarly work, the latter issues still tend to be posed in terms of professional ethics rather than democratic direction [see, for example, *Law and Financial Markets Review*, 8(2), whole issue].

For all these reasons – mainstream political parties’ reluctance to engage with big issues around financial markets, issue competition from the euro crisis and the seduction of responding to financial market participants’ bad behavior – politicization of the governance of financial markets has been limited to date. The technocratic terms of debate seem as firmly seated as ever [Blyth (2013)]. Experts argue amongst themselves in a language that is as assertive as it is impenetrable to citizens. Outside the regulatory gates, there has been public anger, yet this has taken the forms of cynicism over elites, with some displacement of anger unto foreigners and marginal groups. Banking and other financial services have indeed moved into the center of political debate, yet the discourse still escapes party political polarization (with the exception of a minority of hard-hit Eurozone countries). This is both a normative problem and a functional one.

5. Articulating public policy preferences

Normatively, it must be unacceptable that such a core aspect of governance should continue to be convened outside the arena of common politics. Tacitly, political parties have adopted emergency powers, crisis resolution mentality, giving carte blanche to leaders and technocrats. Thus, whilst financial market regulation was previously implicitly off the party political agenda, it is now explicitly off. Centrist political parties of both Left and Right hold much responsibility here, for their failure to take up fundamental questions about banking and other aspects of financial markets and to stimulate debate and deliberation. Shamefully, it has been left to so-called “fringe” parties to engage with these issues, starting from the political orientations of their constituencies, then from there articulating visions of the broad purposes that should be served by financial markets.

What might such debates look like? We start with some functional questions, which on the face of things might appear to some citizens to be only lightly politicized, then move on to some

politically frank but functionally vague positions. Functionally, what kinds of financial markets citizens might want and for what purposes. For example, just personal banking or also some or all of the following. If “all,” then in what priority? Housing purchase (much more strongly emphasized in the UK than in some other countries); retirement savings (collective or individual?); domestic industrial investment (where the U.K. tradition has been to direct investment externally); and/or infrastructural development (by public or private actors?).

Cutting across preferences regarding the end-purposes of financial markets are some geopolitical questions. Political parties might articulate value positions and preferences concerning the local, regional and international foci of financial markets and their relation to the real economy. Should financial markets be open to the international winds, in a universal model that allows any firm structure in any country and local context – this being more or less the current arrangement for the U.S. and the E.U. Alternatively, should particular types of financial markets be encouraged by particular countries, and other types by other countries, on the basis of complementarity with countries’ economic and social policies? Such differentiation is currently discernable on the wider global level – taking account of China, Russia and other countries [Tett and Farchy (2015)] – and is possibly being consolidated as the post-crisis norm [Helleiner and Pagliari (2011)]. And/or, should financial markets, or aspects of such markets, be subordinated to regional and local policies and economies, on the model of old-style local and regional banks [Knafo (2006, 183), and for prospective comments see Leaver and Williams (2014, 221)]?

Also cutting across questions about the purposes of financial markets is the question of who pays for them when they blow up. Are citizens still prepared to bail out banks and other vehicles at national level? That is the model perfected in the U.S. [Dorn (2012)] but made notorious in Ireland and many other countries from 2008 onward. Do citizens – and the political parties that compete to gain their votes – prefer to mutualize such risks at regional level? That is not an approach that currently gains much support in the E.U., although some actions of the European Central Bank allegedly arrive at such a result [which may survive legal challenge, see Cruz Villalón (2015)]. If citizens and political parties do not advocate any public support, then they need other means through

which difficulties could be dealt with. National and European legislation has put in place resolution policies, according to which public bailout of failing banks is only one option, and not the first one. However, the long timeframe envisaged for the building up of banks’ own resolution funds makes clear that, for the next decade at least and possibly for the foreseeable future, public funds remain vulnerable. These distributional questions are inherently political.

Let us briefly mention three broad political profiles. Unreconstructed free marketeers, such as neoliberal Republicans and Tea Party people in the U.S., disfavor state “interference.” They favor leaving the industry – and its customers – to their own devices. That would mean allowing failing banks, for example, to do just that: to fail. That policy option has so far been held at arm’s length, due to concerns about possible knock-on effects, especially through bank bond-holdings. By contrast, and with relevance in some parts of Europe, some political constituencies articulate the issues in terms of economic justice, the direction of financial recourse to the real economy, and possibly public ownership of financial entities and infrastructures (on a continuing basis, not just as an emergency intervention). For green parties, the purposes of the financial industry, as with other industries, include transformations aiming to safeguard the planet and its ecosystems. That could mean special attention to modes of financing (and hence governance) of commodity producers and traders, and control of financial instruments referencing foodstuffs, for example.

And so on, the general approach being to start not with bankers’ or regulators’ agendas, but rather with political parties’ convictions, seeking to shape finance accordingly: *chacun à son gout*.

The principle may be extended from domestic to international policy preferences. Consider, for example, the dissatisfaction that arose in French political circles in 2014 over the large level of fines, business curtailments and reputational damage that BNP Paribas suffered at the hand of the U.S. authorities in 2014, arising from the bank’s sustained breaches of U.S. sanctions law in respect of Iran and Sudan [the latter’s President having been indicted by the International Criminal Court, see Protess and Silver-Greenberg (2014)]. As an article in the Economist noted: “The case has left people on both sides of the Atlantic unhappy. One reason is that the individuals responsible seem to be getting

off lightly. Some have been disciplined by BNP with demotions and cuts in pay, and some top brass are being pushed out the door, including Mr Chodron de Courcel. None, however, has faced even the mildest legal sanction so far; instead, the bank's shareholders and customers look likely to bear the brunt of BNP's misdeeds" [Economist (2014)]. As the same source went on to observe: "A second source of discontent – in Europe, at any rate – is that the case appears to be an example of America throwing its financial weight around, using the threat of withholding access to its market and currency to force compliance with its own priorities. The French central bank sent a clear message that, whatever the rights and wrongs of BNP's behavior, crippling so large a European bank could harm the world's financial system, as well as a region struggling for growth. BNP's behavior in doing business with the likes of Sudan may have been morally reprehensible but it did not break European or French laws (though falsifying documents would be a crime anywhere). By eagerly exploiting their authority over dollar-denominated transactions, American regulators are increasing the incentives for international banks to set up a payments system based on another currency" [Economist (2014)].

In some regions and countries, national political elites' historical concern over U.S. economic dominance coalesces with dislike of the extraterritorial reach of U.S. justice [Financial Times (2014)]. Such jurisdiction remains applicable as long as banks clear in dollars, which at some stage have to pass back to the U.S., triggering the latter's jurisdictional claim. Could the euro or the yuan provide an alternative vehicle for clearing? Potentially, however for the present the dollar remains the principal currency of international trade and it would take some time and effort to put another currency into a comparable position. Maybe in time the BRICS will develop a new channel. If so, bank regulation might not only diverge from U.S. norms in respect of international sanctions, it might also diverge on a regulatory wider front.

Summarizing, we can say that as for the future, there is potential for financial market regulation to be shaped – and differentiated – by the diverse foreign policies of countries and blocs, as well as by their domestic policy preferences. Against that, regulatory elites to some extent transcend domestic and regional differences, so reinforcing preferences within transglobal financial service firms for similarity in regulatory regimes. Reading this, most readers will know which side they are on.

6. Conclusion

Regulators crowd when they form a common culture, which, although it is partially detached from their diverse origins as individuals, does allow them to understand each other and to negotiate the meaning of events and what should be done about them. Going a step further, regulators herd when they intentionally and strategically set out, negotiate and agree global principles and rules (which nevertheless may be fine-tuned operationally and reputationally with an eye to jurisdictional competitiveness). Arguably, regulators were crowding before the crisis and, since then, have been engaged in various (sometimes fraught) arguments over the extent to which they should herd, at the European level and across the Atlantic [Akhtar and Jones (2013)].

Both crowding and herding are distinct from the final stage in convergence, which is merger. In the market, mergers occur through takeovers or through agreed mergers of equals, producing "financial institutions" that may then be regarded as too big to fail. Such was the situation that became recognized from 2008 onward, which is not solved today, as many regulators have pointed out [Haldane (2013)]. It is difficult and arguably impossible to discipline such entities.

By analogy, what are we to think about global and regional regulators when they are in various stages of merger, such as in the E.U. (and particularly in the Eurozone)? Do they then become too big to fail, in the sense that they become politically untouchable? That question will come more into focus as European arrangements bed down: the Eurozone has a degree of centralized and technocratic rule that will be much studied and debated over the coming years. Whilst it is welcome that the European Parliament and national parliaments scrutinize financial market legislation proposals that have been proposed by other actors, such scrutiny remains agenda-taking.

Meanwhile, the wider international regulatory networks, which before the crisis were dominated by U.S. and European ideas and personnel, have lost prestige and leadership capacity. As one transatlantic network has lamented: "the future of coherent global financial regulation is unclear [...] the United States and European Union must act expeditiously and collaboratively if they are to continue as leaders of financial reform on the global stage" [Bowles et al. (2013)]. Those authors – the first named

of whom stood down as a British Liberal Democrat MEP at the May 2014 elections, having up until then chaired the European Parliament's Economic and Monetary Committee – advocate the global regulatory herding that has been critically dissected in this paper. Our concern is not about whether or not regulation should (continue to) be under U.S. and E.U. leadership. Rather, we draw attention to the adverse consequences inherent in any international regulatory herding.

As regulators internationally converge in their thinking – as regulatory crowding (thinking and acting similarly because sharing the same social and epistemic space) evolves into regulatory herding (thinking and acting similarly because we are strategically emulating each other) – so the questions of “too similar” and “too big” become as relevant for financial market regulations as for markets. We are only at the start of recognizing these phenomena and their consequences.

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