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Banking on States?
The divergent trajectories of European finance after the crisis

By

Elsa Clara Massoc

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requirements for the degree of

Doctor of Philosophy

in

Political Science

in the

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of the

University of California, Berkeley

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Professor Jonah Levy, Co-Chair

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Summer 2018

Abstract

Banking on States? The divergent trajectories of European finance
after the crisis

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Doctor of Philosophy in Political Science

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Many conventional theories in Economics and Political Science stress that the liberalization and globalization of finance have homogenized the behavior of state and market actors. Some even go so far as to assume that states have become irrelevant actors. However, these theories cannot account for empirical observations laid out in my dissertation research: that responses to the financial crisis in Europe have largely been crafted at the national level.

Since the crisis of 2008, there have been different trajectories of finance across Europe. In France, banks have grown bigger, as they have developed their operations in market-based banking as well as in traditional banking, both globally and at home. In Germany, Deutsche Bank maintained, and even developed, its global market activities until 2014-5. On the other side, local banks have reinforced their incumbent position in domestic retail markets. British banks have shrunk quite dramatically. They have largely retreated from the game of global finance, while foreign financial institutions have continued to use the infrastructures provided by the City of London as a base for their global market operations. Now, which actors dominate the national financial system, and how those actors operate the financial intermediation between surpluses and needs of capital, have important distributive and functional consequences for the whole political economy.

I argue that divergent national trajectories of finance result from the differentiated influence of public authorities on banks'

management, through the passing of diverse regulation, through the differentiated enforcement of international regulation, or through direct intervention of public authorities towards banks' management. For this research, I have led a comparison of 12 financial regulation policies and cases of regulation enforcement in France, German and the since 2008. I have questioned each national version of a financial policy according to whether they tend to hinder/permit/enhance the expansion of large banks, globally and at home. I find that everywhere, states have been pro-active in the shaping of the post-crisis domestic financial landscapes; yet they have promoted very different re-organizations of their domestic financial industries.

The divergent priorities of the state towards finance can be explained by different institutionalized modes of coordination between private and public actors across political economies. In France, symbiotic mechanisms of interaction between domestic bankers and government officials have led to the crafting of mutually benefiting compromises in response to the crisis. French state officials have thus to a large extent abided by banks' preferences. Yet, this outcome is to understand in mirror of the reciprocal character of the relationship: in important cases, banks also complied with state's preferences. In Germany, local governments have systematically opposed policies that may have been detrimental to "their" local public banks. On the other side, the urge to promote one German champion in the global financial markets and the deference of state officials towards the expertise of banks' top managers, have led the federal government to abide by the preferences of German largest commercial bank. In the UK, adversarial mechanisms of interaction within and between domestic bankers and state officials have enabled identified public actors to exploit political leverage to the detriment of British domestic banks.

I have based my analysis on data collected during more than 100 interviews with a variety of prominent market actors and public officials as well as private and publicly available documentation released by administrative and business organizations. The analysis proceeds through 12 mini case studies of policy-making processes and two more in-depth case studies of the Banking Structural Reform and the management of the sovereign debt crisis of 2010-2011.

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CHAPTER 1

Banking on states?

Globally systematically important banks – otherwise known as “Too Big To Fail” (TBTF) banks - have become the symbol of both the success and failure of this early 21st century financial capitalism. The 2007 financial crisis has crudely revealed to taxpayers that, contrary to virtually anybody else and in contravention of the basic principles of classical economic theory, some firms just could not be let go bankrupt. The terms of the blackmail were quite simple: public money had to be used to bail the banks out, or else, those banks would wreak havoc on the world's financial systems and economies. Aside a few noticeable exceptions (Zysman 1983; Coleman 1994; Deeg 2005; Grossman 2006), banks were not a central object of study for social science before the crisis. Since then, big banks have been brought under the scrutiny of social scientists. Numerous studies have for example examined the role and effectiveness of TBTF banks in the process of capital allocation (Erturk and Solari 2007; Dymski 2010; Bazot 2014), their capacity to influence policy-making (Culpepper and Reinke 2014; Woll 2014; Pagliari and Young 2013), or their role in rising inequalities (Bell and Reenen 2013; Kus 2012; Godechot 2015, 2016). The willingness of states to promote or prevent the growth of those very special banks is therefore of no small political import.

1.1 Divergent post-crisis trajectories of finance

1.1.1 The post-crisis evolution of large European banks

Large European banks have evolved differently since the crisis. Some banks have had expanding strategies: they got bigger, they maintained or increased their global presence, and developed their market operations, despite circumstantial difficulties. The French BNP-Paribas is a good example of this typical evolution: its balance sheet has increased by 22.57% between 2007 and 2016, the bank has promoted its global market operations¹ and has increased its shadow banking operations². On the other side, some TBTF banks have had shrinking strategies. They got smaller, turned away from complex

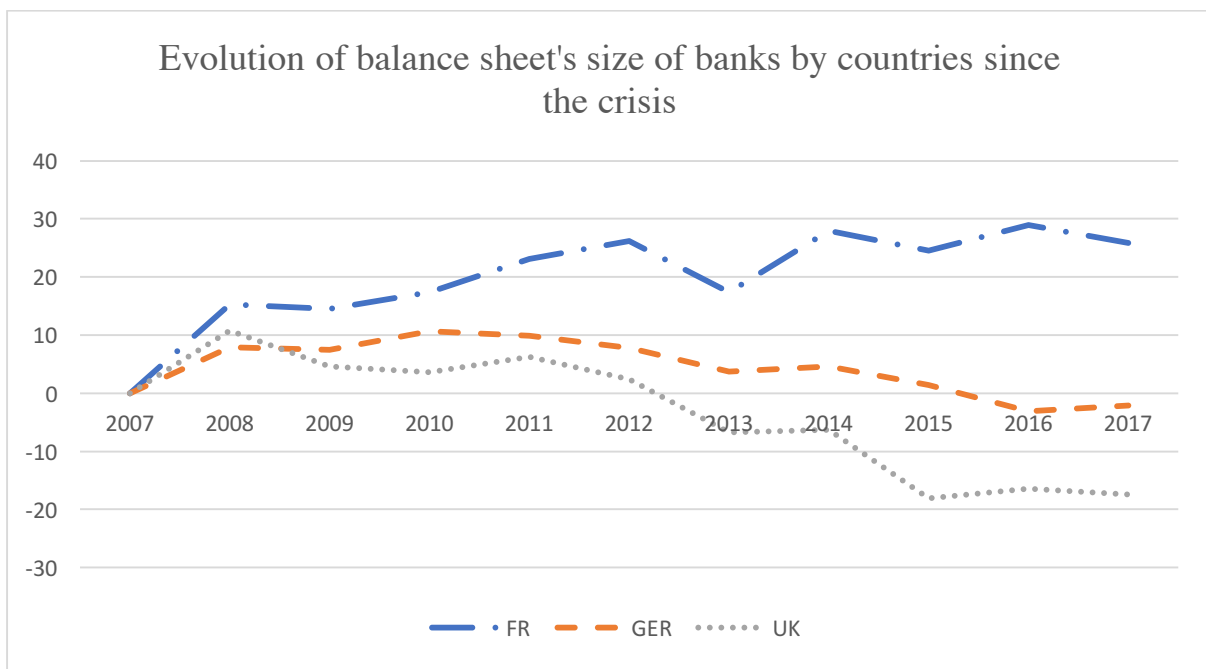
¹ See for example the purchase of a majority of the US Capstar partners LLC or the purchase of the derivatives business of RBS <https://group.bnpparibas/en/press-release/bnp-paribas-buys-60-stake-company-capstar-partners-llc> and FCA(2006)

² See for example the deal Lighthouse trade Finance 1 in 2013 setting up a new Securitization Vehicle (SPV) <http://www.reuters.com/article/commodities-securitisation-idUSL6N0GN2VV20130822>

market operations and retreated from the global scene. The British Lloyds for example followed this path. The bank even dropped off the list of TBTF banks set up by the Financial Stability Board (FSB) in 2013. The size of banks' balance sheet is only but one imperfect indicator of the evolution of banks' business models. Balance sheets' evolution reflects the expansion/downsizing of the bank but is also a snapshot of its health, through the appreciation and depreciation of its assets, which, according to the International Financial Reporting Standards, are mostly valued at their market price³. Nevertheless, a simple comparison of the evolution of European TBTF banks' balance sheet is revealing of the important variations between them⁴.

We observe in Figure 1 that singular patterns emerge when banks are considered according to the jurisdiction to which they belong.

Figure 1: Variation of TBTF's balance sheets' size (%) across countries with reference point 2007*



Sources: Annual financial statements of banks

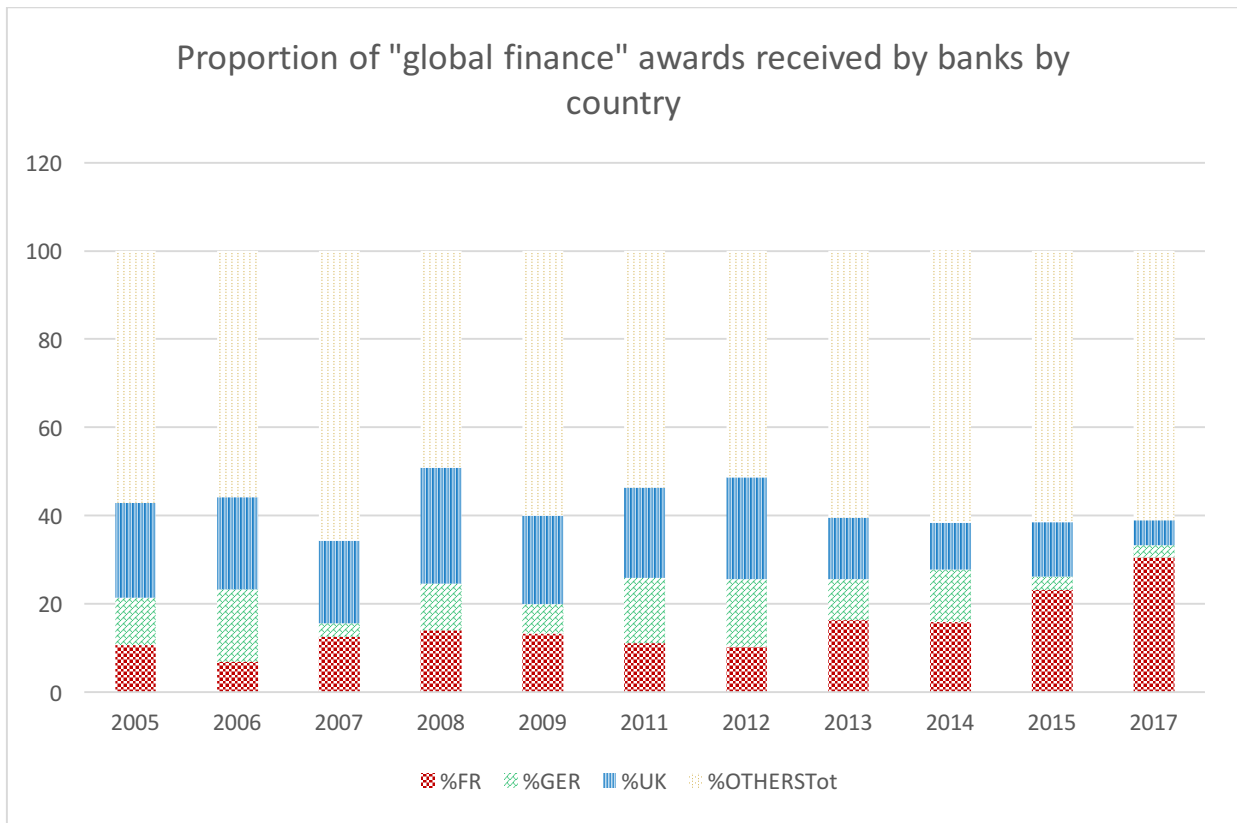
* For LloydsGroup, years 2007-2008, number obtained by adding HBOS and LloydsTBS balance sheets before merger

³ Evolution of the balance sheets must be considered as an illustration of the broader evolution of banks rather than a proof of it.

⁴ See Appendix X for the individual banks' evolution of balance sheets

The evolution of banks' business models will be developed in chapter 2. But for now, another revealing indicator of the presence of banks on the global scene are the awards they receive from financial magazines. The following figure shows the evolution in the number of awards granted by Global Capital, Global Finance and The Banker to European banks in the categories "Best Global Banks" and "Best Derivatives Providers". The presence of British banks among the awarded banks diminished considerably between 2005 and 2016. German banks (Deutsche Bank in the vast majority of cases) increased their presence until 2014, but have stepped back from the podium since then. French banks have dramatically and continuously improved their performance.

Figure 2: Evolution of 'global finance' awards received by banks by country (2005-2017)*



Source: The Banker, GlobalFinance, GlobalCapital
 •Data missing for the years 2010 and 2016

The evolution of large European banks has impacted the landscape of the global banking market. But global banks are also

locally rooted. Their evolution is to be understood in connection with their position in their domestic retail markets. Different trajectories of finance can be defined by how (global) market finance and (domestic) retail finance interconnect. Different trajectories of finance have important distributive and functional consequences for the whole political economy.

1.1.2 The French universalist trajectory of finance

French banks have grown considerably since the crisis. They have expanded their global market activities and reinforced their presence internationally. To consolidate their position as global players, French banks have benefited from the reinforcement of a quasi-hegemonic position in their domestic retail markets, which has given them stable sources of capital and revenues' flows. French banks have also extended their presence in non-bank activities such as asset management and insurance. Market and traditional finance feed each other in the heart of the French universal banks. Because the developments of French banks' position in the global and in the domestic markets go hands in hands, the trajectory of French finance is universalist.

The French trajectory of finance may appear, at first sight, to unite the best of the two worlds. French banks are competitive in the global markets. On the other side, at home, proximity banking remains the rule and French banks have preserved their expertise in SME relationship lending. Yet, the French universalist trajectory of finance has darker sides. First, the hegemonic position of French banks allows them to use retail domestic markets as a never-ending source of revenues flows: French banks push their products on quasi captive consumers and they increase fees for retail banking services more than their European counterparts. Second, French banks are, today more than ever, too big to fail. They are Democles swords hanging over the head of an already highly indebted French state. They will remain a threat on the public budget as long as there is no credible single European resolution fund up and running as an alternative.

1.1.3 The German bifurcated trajectory of finance

Large German commercial banks, especially Deutsche Bank maintained and even expanded its global market activities until 2014-5. Yet, contrary to their French counterparts, German commercial banks have lacked the capital and revenues support of their domestic markets. Indeed, local banks, both cooperative and public, have

reinforced their incumbent position in domestic retail markets, including because they have remained protected from competition by law. Because global market finance and domestic retail banking are operated by two different sets of actors, the trajectory of German finance has been bifurcated.

There are doubts on the future viability of market-based banking in Germany, as Deutsche Bank may not be able to continue to play its role as a global financial champion. Yet, the fragility of the Bank will continue to pose a threat to the German budget and economy in the foreseeable future. On the other side, although local public and cooperative banks need to address chronically low levels of profitability, German traditional relationship bank-based finance seems back on track – to the satisfaction of domestic SMEs and customers.

1.1.4 The British offshore trajectory of finance

British banks have shrunk quite dramatically. They have largely disappeared from the game of global finance and refocused on their domestic retail markets⁵. In parallel, foreign financial institutions have continued to use the infrastructures provided by the City of London as a base for their global market operations. The British trajectory of finance has been offshored.

British banks have arguably become smaller, simpler and safer, although the largest of them still count as globally systematically important banks. But British banks have had difficulties to develop traditional bank-based finance, such as simple SMEs lending, because they lack expertise in this area. They have kept investing in niche markets such as credit cards and consumer lending. British small business thus remains confronted to a chronic lack of finance. The government has tried to promote challenger banks with a more traditional locally-rooted business model, but these challenger banks are confronted to structural characteristics of the British economy that are not favorable to banks-based finance, such as low levels of customers' deposits and savings. The UK economy thus remains to this over-reliant on the City as an offshore financial center. Brexit raises a lot of uncertainty concerning the sustainability of the British trajectory of finance.

⁵ HSBC, a partial exception to the general trend in British banking, has also refocused on the Asian markets, its traditional domain of expertise.

1.2. States' proactive stance towards finance

I argue that divergent national trajectories of finance result not exclusively from market factors, but also from the differentiated influence of public authorities on banks' management, through the passing of diverse regulation, through the differentiated enforcement of international regulation, or through more direct intervention. The dissertation is thus part of the long-tradition of scholarship stressing the role of states and public authorities in creating, sustaining and transforming markets (Polanyi 1944; Gerschenkron 1962; Shonfield 1965; Zysman 1983; O'Sullivan 2007; Bohle and Greskovits 2007; Vogel 2006, 2018). 'Regulation and governance through rule making and rule enforcement' (Levi-Faur, 2005, p17) is only one way for state agency to shape markets. In particular, another set of literature stresses that state agency is often market-based – state actors appear not just as regulators of but also as participants in - and crafters of- financial markets (Gabor and Ban 2016; Fernandez and Wigger 2017; Braun 2015; Braun et. al. 2018; Mertens and Thiemann 2018; Endrejat and Thiemann forthcoming). In this research, I focus mainly on cases of financial regulation and policy enforcement because they do matter and they also have the advantage to be observable and comparable across jurisdictions⁶.

For this dissertation, I have led a comparison of 12 financial regulation policies and cases of regulation enforcement in France, Germany and the UK since 2008. I have questioned each national version of a financial policy according to whether they tend to hinder/permit/enhance the expansion of large banks, globally and at home. There has been a good amount of comparative work on post-crisis financial regulations (See among others Goodhart 2008; Thiemann 2011; Woll 2013; Hardie and Macartney 2016; Young 2014). While those studies undeniably focus on substantially very important policies, this research offers a more exhaustive view of the general landscape of financial reforms in the three countries of study.

Everywhere, states have been pro-active in shaping the post-crisis domestic financial landscapes; yet they have promoted very different re-organizations of their domestic financial industries. French

⁶ Chapter 6 examines a case of direct intervention of state actors to influence the decisions of banks' top managers during the Euro sovereign debt crisis in 2011.

banks have been protected, even promoted, globally and at home. For example, the refusal to implement a strict separation between retail and trading activities and the refusal to promote competition in the banking sector are revealing of the will of the state to let the banks expand globally and at home. In Germany, global activities of banks have been to a large extent protected, with for example the refusal to implement a strict separation of retail and trading activities. On the other side, the traditional turf of local public and cooperative banks– which dominate the domestic retail markets– has been fiercely protected, with for example a clear refusal to promote competition in those markets. British policies reveal an attempt to hinder large banks’ expansion, regarding activities operated both globally and at home. For example, British banks have been submitted to a tougher version of the separation between retail and market activities and to relatively ambitious projects promoting competition in domestic retail banking.

Table 1 sums up the signals sent by the policies analyzed: does a given policy allow (+) or hinder (-) the expansion of large commercial banks at home and globally?

Table 1: Summary of states’ priorities as observed through post-crisis banking policies

	Expansion of large commercial banks on the global markets (for example the Banking Structural Reform)	Expansion of large commercial banks at home (for example competition policies)
France	+	+
Germany	+	-
UK	-	-

Strikingly, the substance of the policies is quite consistent across all of the 12 cases, revealing national patterns in the influence of the state towards finance. Chapter 3 will develop the nuances within cases and present the mini case studies of the 12 policies.

Boxed text 1: policies analyzed by category

The policies are categorized in terms of what they aimed at regulating in banking: systemic risk, competition, governance and market activities.

Regulating Systemic risk

Regulating systemic risk is the most important task undertaken to reform TBTF banks after the crisis. Systemic risks regulations' purpose is to tackle major problems in banking such as excessive risk taking and leveraging, moral hazard and implicit public subsidies. This type of regulation may affect the structure of banks' balance sheet (on the sides of assets and liabilities), and has the potential capacity to affect banks' business models considerably.

More stringent policies addressing systemic risk may limit the expansion of large banks, especially regarding their riskier global trading activities.

The analysis of the regulation of systemic risk consists of two pieces of regulation: 1) the banking structural reform and the 2) enforcement of banks' capital ratio requirements.

Competition in banking

Competition policies signal the willingness of states to challenge large banks' position as incumbents. More competition may reduce structural importance of large banks. This category of policy is significant, because it may potentially shape the competitive landscape of banking and thus the opportunities / challenges for banks to expand.

More competition in banking may limit the expansion of large banks, especially at home.

The policy areas that allow us to evaluate competition policy are: 3) the direct promotion of challenger banks, 4) the promotion of competition in payment system services, 5) consumers and SMEs credit data sharing and 6) the regulation of alternative finance.

Governance in banking

Governance reform aims to tackle the toxic culture of banking, conceived as systematic mismanagement of risk, individual short-term profit-seeking to the detriment of the long-terms interests of the clients. It has the potential to discourage certain practices by making them punishable, or less profitable.

More stringent rules on banking governance may limit the expansion of large banks.

The policies under study are: 7) the establishment of bank levies, 8) caps in top executives and traders' salaries and bonuses, and 9) the reform of the penal accountability of banks' executives.

Market activities

This category of reform endeavors to shape the type of finance that is allowed/promoted in society: market finance or more traditional banking.

Enhancing market activities can be to the benefit of large banks or not. In France, market activities have been promoted, to the benefit of large domestic banks. In the UK, market activities have also been promoted, but mostly to the benefit of non-UK banks. Germany took a more cautious stance regarding market activities.

I look at different policies aimed at regulating market activities: 10) the regulation of hedge funds, 11) the regulation of High Frequency trading, and 12) the regulation of derivatives trading.

Table 2 summarizes the policies (organized by category) adopted in the three countries and the signal these policies send in terms of the state's priorities towards the expansion of large banks. Policies most favorable to large banks' expansion are noted +. Those most adverse to banks' expansion are noted -.

Table 2: Summary of banking policies and states' priorities towards large banks

	France	Germany	UK
Systemic risk	Regulation a minima +	Regulation a minima +	Relatively constraining regulation -

Competition	Cosmetic measures unchallenging of incumbents (large banks) +	Protection of local cooperative and public-sector banks -	Active promotion of competition in banking -
Governance	No significant reform +	Relatively ambitious legal accountability reform, beyond that no significant reform +	Loose enforcement of moderately ambitious reform +/-
Market activities	No measures aimed at hindering market activities	Cautiously restrictive regulation of some market activities	No measures aimed at hindering market activities
Synthesis of states' priorities as signaled by policies	Promoting large domestic banks globally and at home	Promoting large domestic banks globally and preserving local banks' locally	Hindering the expansion of large domestic banks globally and at home.

States have all been proactive in shaping the post-crisis evolution of their domestic large banks, but their action reveals different state priorities. What explains the observed different stance of states towards finance, in particular large domestic banks, across political economies?

1.3. The institutionally mediated power of banks

1.3.1 Bringing structural power back

Larger banks are powerful firms, both in structural and

instrumental terms. The very definition of “Too big to fail” means that the health of the whole economy depends on the health of these banks. They are key in the capital allocation to the real economy. They can threaten to reduce resources granted to firms and individual consumers. The largest and most globalized of them can threaten to move investment and headquarters out of their home country (Hirschman 1978). They are big firms and as such, they provide many jobs and are economically significant. Finally, scholars have recently underscored the infrastructural power of banks: they exert control over the transmission channels of central banks’ monetary policy (Braun, 2018). It is arguably very difficult to find accurate measurements of structural power of specific firms or groups of firms, but by definition, all TBTF banks are structurally powerful. Large banks are also instrumentally powerful: they have money, access to politicians and expertise. The preferences of banks did not vary after the crisis. All of them favored regulation that would not penalize their expansion, globally or at home. Why have the blatant structural power of European banks led to different states’ attitudes towards finance across jurisdictions?

Social scientists have brought back the study of structural power to the forestage of their disciplines. Because they take structural power seriously, they have grappled with important gaps in the traditional scholarship on structural power (Lindblom 1977). First, they realized that they had to explain why powerful business sometimes lose. They have questioned the deterministic aspect of structural power that in traditional accounts seems to be “generated independently and automatically” (Hacker and Pierson 2002). According to more recent scholarship, the claim that structural power is at work implies neither a deterministic outcome nor that the exercise of structural power must happen automatically and apolitically (Culpepper and Reinke 2014).

Recent studies have shown how institutions may give lenses for state actors to confront, interpret and react to pressures of powerful businesses. Institutions permitting venue shifting in decision-making processes will tend to hamper the expression of business power. By altering venues, new actors may mobilize around an issue, who are outsiders of the narrow range of participants that normally occupy a policy subsystem (Baumgartner et. al. 2006, p968). The involvement of outsiders favors the emergence of new ideas in general, and new interpretation of the reality of business structural power in particular (Bell and Hindmoor 2015, Hay 2004, 2006). For example, Bell and Hindmoor (2015) argue that British members of Parliament were key in the establishment of banks’ ring-fencing in the UK, because,

contrary to Treasury officials, they did not believe bankers when they threatened to leave the country. As developed in chapter 5, the research done for this dissertation supports this claim.

Institutions allowing the emergence and sustainability of political salience around specific issues will also tend to hamper the expression of business power. Under low salience, business power is likely to be disproportionately greater as policy making is less visible and ‘outsider’ interests are unlikely to be mobilized, so government is more likely to defer to the expertise of industry. As an issue becomes increasingly salient, the power of business is undermined as interaction with government becomes more conflictual. In this situation, non-business groups, political parties and legislatures will increasingly mobilize and challenge business’ privileged position (Culpepper 2011; Massoc 2017a).

Students of structural power have also questioned the conception of the state as a sheer hostage of powerful capitalist firms. Rather than as a one-directional relation from powerful capitalists imposing their priorities to a statist empty shell, they have started to conceptualize structural power as a set of mutual dependencies between holders of capital and the administratively superordinate authority – often the state (Culpepper 2015). This new trend of literature evaluates the resources and effects of state strength associated with power resources in the financial industry (Young 2014, 2015; Farrell and Newman 2015). As Culpepper states: "Accounts of structural power can be especially penetrating when they highlight the way in which features of the reciprocal relationship influence the action of both states and businesses" (Culpepper, 2015, p8). By doing so, those authors suggest that key factors to explain economic outcomes are not on the side of the state nor on the side of market, but in institutionalized patterns of interaction between the two of them (Vogel 1999; Fourcade and Babb 2002). Students of structural power have stressed that states structurally depend on banks. Structurally, banks also depend on “their” state, today more than ever. Indeed, banks’ competitiveness in international markets largely depends on 1) the capacity of their state to bail them out, if need be and 2) the assets acquired through deposit taking, which is still mainly operated at a national scale. Between states and banks, there is rather a relation of structural *inter*-dependency that frames all the following policy-making processes.

The argument developed in this dissertation takes seriously the claims of the students of structural power. Because they are key actors in the sustainability of economic growth and in the process of capital

allocation, banks find themselves in a ‘privileged position’ when it comes to weight in political processes (Lindblom, 1977). As Admati and Hellwig have experienced when they tried to convince policymakers to adopt more ambitious financial reform: “Politicians, regulators and others prefer to avoid challenging the banking industry” (Admati and Hellwig 2013, pxiv). Yet, structural power is less unidirectional than what Lindblom suggested, and its effect are institutionally mediated.

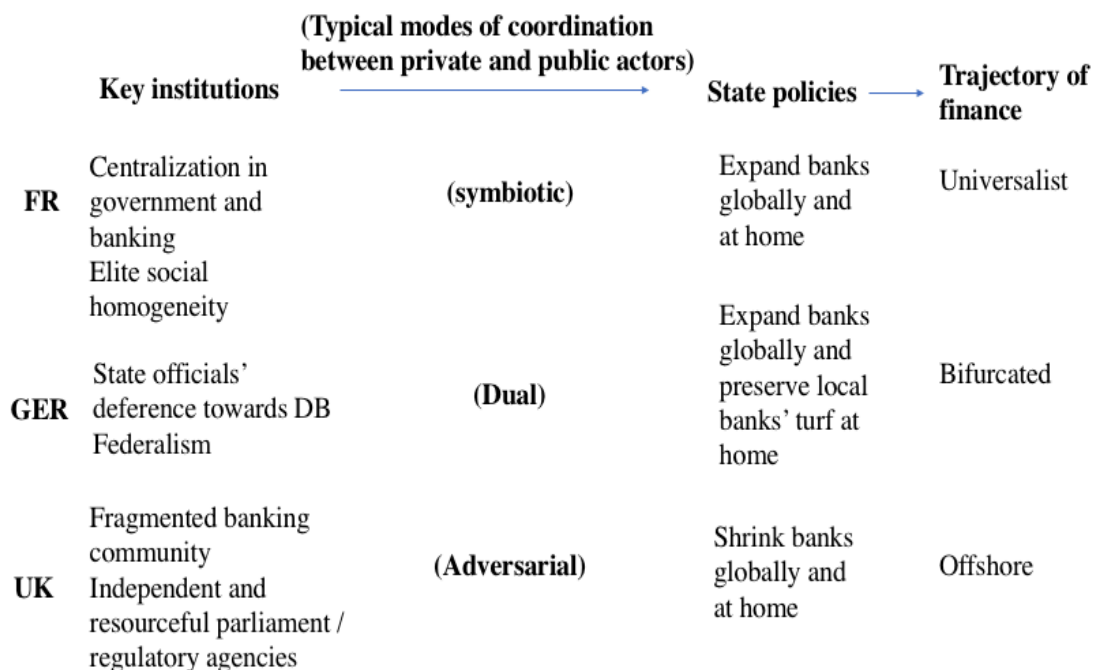
1.3.2 Institutionalized mode of coordination between private and public actors

In his seminal book, *Governments, Markets and Growth*, Zysman (1983) analyzed the different institutional arrangements characteristic of European financial systems. His main contribution was perhaps to show that the structures of the financial system constrained (and shaped the opportunities of) the relationship between government and industry, and thus the capacity of government to influence industrial growth strategy and domestic firms’ position in the international competition. Different institutional arrangements structuring the interaction between market actors and the state thus influenced both which interests found political expression in decision-making processes and the forms of conflict that ensued. Thus, in the post-war France, Germany and Great Britain, different actors mattered, because different actors occupied key position in the decision-making process of controlling who gets what.

At the very time Zysman was publishing his book, the institutional arrangements that he described began to crumble. The formal institutions of *dirigisme*, such as the National Credit Council, disappeared in France. Banks’ cross-shareholding faded in Germany. In the UK, the growth of both domestic and foreign market-based banks altered the post-war British market-based model. The encompassing institutions that characterized post-war traditional models of capitalism have to a large extent been disrupted, but other, arguably more limited and softer institutions, have remained. In agreement with Zysman’s insight and with the tradition of historical institutionalism more generally (Pierson 2004), I argue that different institutionalized routine modes of coordination between public and private actors systematically determine which actors have their way in policymaking processes in financial areas. It is not always banks. Although they are structurally and instrumentally powerful, their preferences have not always prevailed. Their power is institutionally mediated.

Institutions display considerable inertia, or what Paul Pierson calls “*the status quo bias of political institutions*” (Pierson 2000, p200). Yet, this research rather underlines the practices that agents deploy to sustain or disrupt the very institutions that constrain their actions (in agreement with Jabko and Sheingate, 2018). The detailed analysis of policymaking processes allows us to identify which (public and/or private) actors systematically occupy key position in the decision-making process, which preference finds political expression and the forms of conflicts that ensue.

Figure 3: Summary of the argument



In France, symbiotic mechanisms of interaction between domestic bankers and government officials have led to the crafting of mutually benefiting compromises in response to the crisis. French state officials have thus to a large extent abided by banks' preferences. French universal banks were able to expand both globally and at home. Yet, this outcome is to understand in mirror of the reciprocal character of the relationship: in important cases, banks also complied with state's preferences. In Germany, local governments have systematically opposed policies that may have been detrimental to "their" local public banks. On the other side, the urge to promote one German champion in the global financial markets and the deference of state officials towards

the expertise of banks' top managers have led the federal government to abide by the preferences of the German largest commercial bank, namely Deutsche Bank. This tension has led to a bifurcated trajectory of finance, where Deutsche Bank was able to expand globally, but not at home - a situation that has aggravated the structural difficulties of the bank. In the UK, adversarial mechanisms of interaction within and between domestic bankers and state officials have enabled identified public actors to exploit political leverage to the detriment of British largest banks. British banks have shrunk quite dramatically, leaving room for foreign and non-bank financial actors to expand both in the global markets operated from London and in the British domestic retail markets.

1.4. The empirics of policymaking processes (synthesized)

Chapter 4 provides an extensive account of the typical modes of coordination between private and public actors during policymaking processes in France, Germany and the UK as well as a detailed description of the key institutions on which they build. Below is a short overview of those.

1.4.1 The French symbiotic mode of coordination

“The French state played its role well vis-à-vis the banks. We have absolutely no interest to trap the state by refusing to get a solution to get the debt out of the state’s debt. We will find a solution” (French bank’s top manager, Interview 12122009)

France used to be the archetypical *dirigiste*, or state-led, political economy. But the formal institutions that ruled the interactions between banks and states under the *dirigiste* model have now to a large extent disappeared. Scholars have stressed how dramatic of a rupture French capitalism had undergone in a relatively small amount of time (Hall et. al. 2008; Levy 1999, 2006)⁷. Among other reforms, the lifting of capital controls, interest rate deregulation, as well as the privatization of major

⁷ For example, Levy states: “The reforms after 1983 left no *dirigiste* stone unturned. Looking across the wealthy democracies, one would be hard-pressed to find any country that shifted so far away from its post-war economic strategy as the France of François Mitterrand and Jacques Chirac” (Levy 2006, p112).

commercial banks were key in the dismantling of the policies and institutions of dirigisme. The death of the National Credit Council in 1986 and the de facto euthanasia of the Planning Commission at the beginning of the 1990's were the highlights of the end of *dirigiste* capitalism. Yet, important aspects of the French institutional heritage have remained within less encompassing institutions. In particular, France still sticks out by the concentrated and centralized character of the organization of both its state - organized around the Treasury and the Executive (Clift 2003; Tiberghien 2007), and its banks – organized in the very close French Banking Federation (which functioning still consistent with the depiction made by Coleman in 1994). Also, the persistence of elites' proximity in this country has repeatedly been underlined by French scholars, often to explore how banks have “captured” government's policies (Bourdieu 1989, 1996; Dudouet and Gremont 2010; Véron 2007; Philippon 2007; Chavagneux and Philipponnat 2014). On the other side, the potential ‘capture’ of banks by the state has rarely been explored, yet it is plausible that some mechanisms of social capture may also work the other way around (Jabko and Massoc 2012).

More than capture, I argue that characteristic French institutions foster a symbiotic mode of coordination between state and bank elites through mechanisms of group identification and trust, as underlined in the literature on the sociology of elites (Olstrom 2000; Kwak 2013; Neely 2018)⁸. Trust is a willingness to be vulnerable in the face of risk or uncertainty (Luhmann, 1990; Rousseau *et al.*, 1998). Trust derives from a sense of similarity or shared interest (Luhmann, 1990) and involves a perception of reciprocity (Schoorman *et al.*, 2007). Group identity matters because, in helping member of what they see as their own group, actors help themselves as a member of that group. Identification with a group has several effects that go beyond material self-interest. People seem to gain utility from behaving in conformity with their group identities. Bank top managers and French state officials conceive of each other's preferences as legitimate to take into account and find comfort and utility in agreeing with each other. They will prefer to find common ground when collectively shaping their

⁸ Kwak writes: “You are more favorably disposed toward someone you have shared cookies with, or at least it is harder to for you to take some action that harm their interest. Relationships matter because we care about what other people think of us, in particular those people whom we come into contact regularly”. Olstrom (2000) also stresses that face-to-face communication considerably increases the likelihood of cooperation. This is made easier thanks to the small number of actors involved.

preferences. When antagonism remains, they will prioritize the crafting of compromises, not the confrontational use of their power resources.

In France, the key position in a decision-making process has thus been held by a narrow nexus of state-bank elites, which makes it very difficult for other actors to step in. French state officials have to a large extent abided by banks' preferences. The action of the French public authorities in banking after the crisis has consisted of not hindering the expansion of large domestic banks globally and at home, leading to a French universalist trajectory of finance. Yet, as illustrated by the quote of a French banker in the context of the 2008 banking crisis management at the beginning of this section, this outcome is to understand in mirror of the reciprocal character of the relationship: in important cases, banks also complied with state's preferences. Chapter 6 shows that French banks, contrary to their German counterparts, accepted to comply with the requirement of their state not to sell Greek bonds until a political agreement was found in 2011.

1.4.2 The German dual mode of coordination

“Deutsche Bank is a state within the State” (EU lobbyist, Interview 05052015)

Germany is the poster child of the Coordinated Market Economy (CME). Since the 1980s, it has been much discussed whether or not Germany retains its institutional distinction in terms of organization of the different areas of its political economy. In the domains of labor and training, Germany has undergone significant changes (Streeck 2001a, 2001b; Hacketal et al 2005). In finance, the tax reform led by the Social-Democrat Chancellor Gerhard Schroeder in 2000 put an end to one key institution of traditional German capitalism: the banks' interlocking directorates⁹. Very quickly commercial banks and the biggest Landesbanken started to dismantle the extensive interlocking directorates in which they had been stuck with for a long time. They also adopted a global and market-based banking strategy, metamorphosing their traditional business models (Hardie and Howarth 2009; Hardie et al. 2013a, 2013b).

Although it is not clear whether the different areas of German capitalism remain coordinated, some typically German institutions remain unchanged, fostering a German dual mode of coordination between private and public actors.

⁹ The centerpiece for Schroeder's tax reform was indeed the abolition of all taxes on the sale of assets, which was previously set at the dissuasive level of 53%.

Federal governments, whatever majority in charge, have always considered since the 1980s that it was crucial for an economic power like Germany to have its “own” national champion. Deutsche Bank in particular is still considered as a jewel of the crown by German state officials. Deutsche Bank’s top executives enjoy a privileged access to Treasury officials and the minister of finance. For the most part trained as lawyers, treasury officials attitude is characterized by their deference toward the expertise of large banks’ managers. When it can, the federal government thus tends to abide by its national champion’s preferences. German banking policies have to a large extent consisted of letting Deutsche Bank expand globally. Observers have dubbed Deutsche Bank “the state within the state”. Note that in the case of Germany, there is no social homogeneity between banking and political elites that may promote institutions of group identity and trust. The reciprocity necessary to foster a symbiotic mode of state-bank coordination *à la française* is thus lacking. Deutsche Bank does not listen to the request made by the German government favorably (See chapter 6).

On another hand, the federal government must also cope with strong coalitions composed of local governments and local public banks, to a large extent supported by the well-organized network of medium enterprises, the famously known *Mittelstand*. Local governments are public banks’ shareholders and local politicians sit in local state banks’ (Landesbanken’s) directorates. The preservation of the local public banks’ turf thus ranks high in the priorities of local governments. Germany is a decentralized state in which the federal government is strictly accountable to local governments (Gunlicks 2003; Scharpf 1988), which may use formal and informal, parliamentary and party channels, to veto or promote specific policies. When the preferences of TBTF banks conflict with their own priorities of protecting local banks, local governments will almost systematically overrule them. By contrast, when decisions don’t affect local banks, the policy outcome tends to conform with Deutsche Banks’ preference. This dual mode of coordination explains why post-crisis financial reform in Germany has sought to promote the expansion of large commercial banks globally while protecting local banks (including against commercial banks) in the domestic retail markets.

1.4.3 The British adversarial mode of coordination

The debate was due on Monday. (...) I called [Chancellor] Osborne, and told him: on Monday, either I say: “you support the banks against the poor”, or I say

“you support the Poor against the banks”. He changed his mind on Sunday. So we agreed that there will be regulation!” (Member of the Parliamentary Commission on Banking Standards, Interview 07122016).

Close social, political and cultural ties between the City, the Treasury and the Bank of England were characteristic of post-war UK. The top executives of the handful of old and prestigious high street banks composed a distinguished “gentlemen club”, prone to playing bridge together while sealing agreements (Gilligan, 1997). The sweeping and radical reforms of finance undertaken at the very beginning of the 1980s, known as the “Big Bang”, and which led to the increasing presence of foreign firms in London and to the integration of British banks into global markets, dramatically transformed the social character of the City (Clemons and Weber 1990; Plender 1986). British bankers lost their social homogeneity and their special relationship to the gentlemen of the government. Today, the British Banking Association represents the banks operating in the UK. The association struggles to shape common positions and doesn’t have much influence in decision-making processes. On the other side, the state is more fragmented than in France, despite the centralized nature of the British regime. Although the nomination of their chief executive is made by the Chancellor, the workings of the financial regulatory agencies are to a large extent independent from the executive (for a comparison with France, see Thatcher 2007). Ad hoc parliamentary committees don’t hesitate to adopt trans-partisan positions and to publicly challenge the executive, the regulatory agencies and the banks. As illustrated by the quotation at the beginning of this section, the Parliamentary Commission on Banking Standards has been particularly active in putting pressure on the Treasury to regulate banks after the crisis. The post-war cozy social ties among bankers and between bankers, regulators and the Treasury have thus been replaced by more pluralistic institutions (Vogel 1986, 2003) where actors rely on the traditional tools of organized lobbying to influence each other (Bowman et al. 2015; Froud et al. 2012).

Up until the 2007 crisis, these changes did not correspond to the weakening of banks’ political influence. The City of London, in which British banks played a prominent role, is often cited as an example of a very influential economic sector, which had accumulated a lot of power resources in the UK: a strong cultural supremacy, a lot of money, and considerable access to policy-makers (Engelen et al. 2011; Johal et al.

2014). The same pluralistic institutions have remained after the crisis. So why didn't British banks get their way? Even though it is significant, the political power of business is known to fluctuate in pluralistic contexts (Vogel 2003; Baumgartner et. al. 2009). Immediately after the crisis, state officials were infuriated by British banks, and there was no Gentlemen's club to calm them down and favor the crafting of mutually benefiting compromises rather than the conflict between antagonistic preferences (Gamble, 2009; Woll 2014; King 2016). Strong attacks against TBTF banks came from several fronts: the regulatory agencies (Martin Wheatley, FCA chief executive, famously said "we shoot first, we ask questions later"¹⁰), the Parliamentary Commission on banking standards and the Independent Commission on Banking presided by Lord Vickers. These commissions had important material and intellectual resources to investigate what type of banking reform they would like to advocate. As the quote at the beginning of this section illustrates, members of the Parliamentary Commission on Banking Standards were key in keeping the pressure high on the Treasury to take a stricter regulatory stance towards banks. Public blame on banks was also exceptionally high in the UK¹¹. The popular press led infuriated campaigns against British bankers and their potential supports among politicians.

British banks still possess important power resources, and they used them intensively: they have threatened to relocate, they have deployed active lobbying toward policy-makers, and mobilized their insiders' allies within public authorities... Their efforts sometimes paid off. For example, HSBC's threat to move its headquarter out of London helped curb the project on a special bank tax. But in the post-crisis situation of high political salience, the adversarial mode of state-bank coordination in the UK typically led to loss of otherwise powerful actors (Trumbull 2012; Vogel 2012). British banks couldn't prevent the implementation of relatively strict banking regulation promoted by most public authorities and supported by the public. Yet, this outcome

¹⁰ Martin Wheatley, cited in MeoneyMarketing, available at <https://www.moneymarketing.co.uk/martin-wheatley-fca-will-shoot-first-and-ask-questions-later/>

¹¹ The YouGov-Polis Programme for Public Opinion Research published that in 2012, 73 percent of the British population described the reputation of banking as bad, the highest figure of 26 industries tested. By contrast in France, 76 percent had a good image of their own bank, and 50 percent had a good image of French banks in general. http://cdn.yougov.com/cumulus_uploads/document/y1f7gpof19/Public_Trust_in_Banking_Final.pdf

is not necessarily stable and will certainly not remain unchallenged: the balance of power resources may change as the memory of the financial crisis fades away (Culpepper 2010).

Consequently, British banks have shrunk quite dramatically, leaving room for foreign and non-bank financial actors to dominate the global markets operated from London and increase their presence in the British domestic retail markets.

Table 3: Routine modes of coordination between public and private actors and typical locus of decision in policymaking processes in France, Germany and the UK

	Typical mode of coordination	Main locus of decision	Mediation of banks' power
France	Symbiotic	State officials-banks' top managers close elite nexus	Reciprocity in the relationship between State officials and bank managers
Germany	Dual	Local public banks when their interests are at stake. If not, Deutsche Bank	Capacity of local governments to veto policies
UK	Adversarial	Unstable –in conditions of high salience, mostly actors hostile to TBTF banks	Capacity of outsiders to trigger conditions unfavorable to the expression of banks' power

1.5. Alternative hypotheses

I argue that historically rooted institutions have fostered different routine modes of coordination between public and private actors during policymaking processes regarding banking in France, Germany and the UK. These institutionalized modes of coordination have shaped the different attitudes of states towards finance in the three countries. States have passed and enforced policies which have in turn contributed to determine the different European trajectories of finance after the crisis. There are thus two causal links in my argument (see figure 3). I present three major alternative explanations for the divergent European trajectories of finance in this section.

1.5.1 Differentiated impact of the crisis

Some explanations point to the differentiated impact of the financial crisis on banks across countries. The first hypothesis is that the differentiated impact of the crisis affected banks' market strategy directly. Policies, and state's attitude toward finance more generally, did not really matter at all. According to this hypothesis, the more the bank was affected during the financial crisis, the more it shrunk. Yet, how much and how long banks have suffered from the crisis has to a large extent been affected by the type of bailout put together by their governments, which is already in itself a very political process (Woll and Grossman 2014, Woll 2014). In particular, the French management of the 2007-8 banking crisis has allowed not to stigmatize the more fragile institutions among French banks, and thus has protected them from further difficulties (Jabko and Massoc 2012). Second, although this explanation may appear to fit the cases of BNP-Paribas – which was less impacted by the crisis – and Lloyds or RBS – which were more severely impacted by the crisis; it can't explain the cases of HSBC and Societe Generale, which were arguably impacted in a similar way in 2008 and which yet have followed different paths. The explanation also fails to account why French banks, which were very impacted by the sovereign crisis of 2011-2 (they ratings were downgraded by rating agencies and their share value plummeted), did not downsize afterwards.

The other related hypothesis is that states were more stringent on “bad” banks because they were under more pressure by their constituents to punish them. States were thus arguably more stringent on banks that fared poorly during the crisis, which were most costly to bail out and that were involved in more scandals.

The management of the banking bailouts put together in 2008 have been very different across countries. The banking bailouts were crafted and implemented in record short amount of time – often a week-end¹². The confidence crisis within markets was at its peak. Banks had no longer access to liquidity. They feared a bank run. Nobody knew who was exposed to risks and how badly they were exposed (including themselves). Differences across bailouts were not due to objective measures of the impact of the crisis on individual banks. They were due to the different modes of coordination among public and private actors (Jabko and Massoc 2012, Woll 2014). In France, a smooth cooperation between and among state officials and bankers has opened on a collective bailout. The collective dimension of the French bailout allowed for the weakest bank not to be stigmatized. The rapidity and solidity of the French state’s involvement reduced uncertainty early on, at a time where investors were craving for an ounce of certainty, while other European banks were postponing their decision to accept public bailout and governments were sending contradictory signals about their involvement. French banks and government signaled that they were able to manage the consequences of the crisis in an orderly fashion. The French management of the banking bail out contrasted with the German and British ones. In these countries, bailouts were individual. Weakest banks were stigmatized and, by accepting bailouts, they signed their incapacity to raise fund on the markets for a while. But it was also quite bad for those that did not accept public support: doubts remained regarding their solidity. Compared to France, banking bailouts’ costs were considerably higher in Germany and the UK. In the UK, two banks were *de facto* nationalized: RBS and Lloyds¹³. From the point of view of the costs of the bailouts, policymakers could have been as angry in Germany as in the UK.

Table 4: Summary of Banks Bailout in France, Germany and the UK (2008-2010) (bn€/£)

	Loans and Guarantees	Capital Injections	Asset Support	Total commitment (%GDP)	Banks bailed out	Banks not bailed out
France	134.2	8.3	-	18%	Crédit Agricole,	None

¹² A French banker very involved in the design of the French banking bailout recalls: “It was all in one week-end. The timing was tight! It was physically very tough” (Interview 12122009).

¹³ The banks were completely re-privatized in 2018

					BPCE*, Societe Generale, BNP-Paribas, Credit Mutuel, Dexia (with Belgium)	
Germany **	185.8	54.2	46.7	25%	Commerzban k, WestLB	Deutsche Bank, DZBank
UK	157.2	69.5	217.8	25%	RBS, Lloyds	Barclays, HSBC, Standard Chartered

Sources: Stolz and Wedow 2010 p20

* Both Banques Populaires and Caisses d'Epargne were bailed out before the merger in 2009.

** Banks bailed out by Lander are not included

Given the size of banking in the British economy though, British policymakers may have realized that the whole country could be wiped out in a week-end. King, the governor of the BoE, said to have lived a 'near-death' experience in 2008 when the British banks were collapsing (King 2011).

The British particularity should not be overstated though. Politicians and bankers in France too realized the potential disruption of the whole country that the banking crisis could have caused. BNP-Paribas CEO was saying in September 2008: "*Lehman is a catastrophe. But if AIG collapses, we are all dead*"¹⁴. A Senior advisor at the French Treasury told me during an interview: "*You should not forget that we were in a period... Today we can talk about it coldly, but then... It was such a crisis. With my experience, I had never seen people so worried, so anxious. We feared a collapse*" (Interview 0323009). Three years after the financial crisis, French banks were, again, a major concern during the Euro-crisis. Without liquidity support from the ECB, they would have been in serious trouble (Admati and Hellwig 2013, p192). No linear relationship can thus be established between the 'real' health of banks and the nature of the involvement of policymakers in banking reform.

¹⁴ Baudouin Prot Cited in Paris Match, 18 septembre 2009, Paris Match, available at <http://www.parismatch.com/Actu/International/L-homme-qui-a-fait-chuter-AIG-cassano-faillite-lehman-brothers-142739>

European banks were also involved in high profile scandals involving the manipulation of interest and exchange rate swaps, and the London Interbank Offered Rate (Libor). Barclays, Deutsche Bank and Société Générale were submitted to big fines. However, these scandals triggered more substantial and more persistent public anger in the UK (Howarth and James, forthcoming). Yet, with the “affaire Kierviel’ (a fraudulent trader of Societe Genrale), the exposure of Societe Generale at AIG, the exposure of BPCE’s Natixis to the US subprimes, Credit Agricole’s Greek subsidiary Emporiki, the expensive nationalization of Dexia, the revelation of the involvement of French banks in tax heavens, the perjury of banks’ top executives during parliamentary hearings... Pretexts for public anger were not lacking in France either. The lower level of public attention to banking issues in France than in the UK is itself part of the question rather than the answer to understand post-crisis different trajectories of finance.

1.5.2 Power resources and preferences of individual banks

Power theories hypothesize that the more powerful TBTF banks are (the more power resources they dispose of), the more favorable to their interests the policies adopted by their home state would be (Korpi 2006). By contrast, the preferences approach argues that outcomes are shaped by variations in the preferences of most powerful actors (Swenson 2002; Culpepper 2010). Given the immense power resources held by TBTF banks in Europe, preferences theories would hypothesize that countries where TBTF have shrunk the most are countries where, due to local context, bank managers wanted to downsize their banks. Although the former theory stresses variations in power resources and the latter stresses variations in preferences, both share the same assumption. The actors detaining the highest amount of power resources, through the deployment of these resources, will be successful in shaping the outcome in coherence with their own preferences.

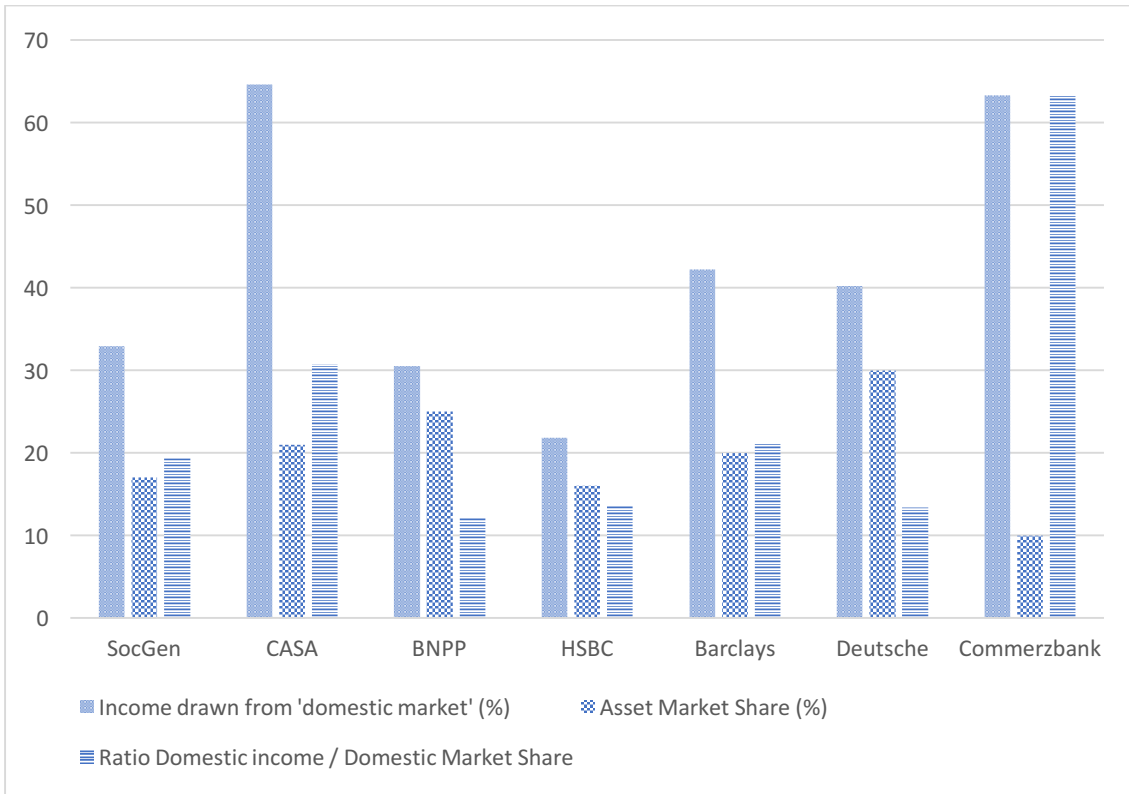
Yet, these theories lead to wrong predictions. The preferences theory would assume that preferences of TBTF banks would vary across countries. Yet, although it is always difficult to ascertain actors’ preferences (Pierson 2002; Broockman 2012), it is well documented that in all countries, top banks executives’ primary preferences were against the implementation of policies that may hinder their expansion.

On the other side, theories stressing the importance of differentiated structural power resources would predict that TBTF banks detaining more structural power resources in their home

jurisdiction managed to reach an outcome that conformed more to their preferences. By definition, because the whole financial system –and economy- depends on them, all European TBTF banks have immense structural resources. The variation in terms of structural power of TBTF banks across countries thus lies only at the margins. In addition, it is very difficult to propose an accurate measurement of structural power. Yet, let's consider two key, although imperfect, measures of structural power for individual banks within each country: a) the degree of dependence of the domestic economy on the banks' finance and, b) the proportion of net income made by the individual banks' outside of the domestic markets¹⁵.

¹⁵ I took “market share in terms of total assets”, and not “market share in terms of loans or deposits” because these were the only figure available for all the countries. The figures this tend to underscore the significance of more retail-oriented banks in the domestic economy. Some banks don't mention the proportion of income they made in their home country as opposed to other European countries where they have significant retail operations, so I used domestic European retail markets for all banks. Some banks include the income of portions of their investment banking segment in their income from domestic markets – other don't. The indicators are thus sketchy and need to be taken cautiously.

Figure 4: Indicators of structural power of major European banks (in 2013)



Sources: Banks Annual Report 2014; Moody’s Banking Profiles 2016 for France, Germany and the UK. There is no homogeneous report of “domestic markets” income across banks’ annual reports.

In Figure 4, the third column represents the ratio of income made out of the domestic market over the asset market share of the bank in its domestic markets. The smaller the column is, the ‘bigger’ the structural power of the bank is. According to those measures, we see that all the major global banks (BNP-Paribas for France, Deutsche Bank for Germany and HSBC for the UK) can be deemed structurally as powerful as each other. If we consider the strategic use of structural power, meaning the choice of bankers to threaten to exit their domestic markets (as in Culpepper and Reinke 2014), HSBC may have the advantage, as the share of its income from domestic markets (represented by the second column in figure 4) is lower than for its European counterparts. Indeed, HSBC is the only bank that has threatened to move its headquarter out of its home country on a regular basis. Yet, although it is clear that HSBC has secured some policy victories thanks to this strategy, it has also lost many important battles, including the one on the banking structural reform. Form this point of

view, BNP-Paribas, which has never threatened to exit its domestic markets, has been politically more successful. The question thus become less about the amount of structural power resources, and more about why bankers choose – or not - to use strategically the threat to exit, even though this strategy does not guarantee victory, and more about why policymakers choose – or not – to grant credibility to this threat.

1.5.3 Partisan affiliation of governments

The main assumption of partisan theories is that the partisan affiliation of elected governments has a decisive impact on the institutional features of domestic capitalism (Boix 1998; Roe 2003; Cioffi and Hoepner 2006). In the case of trajectories of finance though, the predictions of the partisan hypothesis are unclear. Indeed, left-wing governments are seen as more prone to adopt an activist policy strategy to promote their national champions, but at the same time, they are also seen as more prone to adopt punishing policies toward banks (Boix 1998; Cioffi and Hoepner 2006). Partisan theories expect right-wing governments to solely focus on domestic liberalization and thus are uninterested in promoting national champions, but at the same time, they are also seen to be more indulgent toward bankers’ interests (Boix 1998).

Whatever the prediction chosen though, the partisanship of the governments cannot explain the variations in France, Germany and the UK. Within each country, the outcomes of domestic policies have been similar whatever the majority in power was. Across countries, governments of the same partisan majority have adopted policies with different, even opposed, objectives. Table 5 illustrates this claim.

Table 5: Government Composition through the Policy Cycle

	2009	2010	2011	2012	2013	2014	2015	2016
France	Conservative majority ●			■ Socialist majority				
Germany	Conservative-liberal coalition				■	● Grand coalition		
UK	● Center-left majority	Conservative-liberal Coalition				■	Conservative majority	

The banking structural reform (symbolized by a square in Table 5) has had very different outcomes in the three countries. It has been very weak in France, under a socialist government, and Germany, under a conservative-liberal coalition. It has been stricter in the UK, under a conservative-liberal coalition.

Within country, the most striking is the continuity of the substance of banking reform across governments with different partisan affiliation. In France, the alternations between the conservative and socialist governments in 2012, and between a socialist and a center government in 2016, have had no effect on the substance of banking reform. For example, the consumer credit protection law (symbolized by circle in Table 5), in which the government has pushed back against the creation of a credit consumers' database, which could have enhanced competition in this market, has been implemented by a conservative majority in 2011. The weak banking structural reform was implemented by a socialist majority. Both policies signal a willingness to protect national champion banks. In Germany and in the UK, the conservatives have been in power since 2010, alone or in a coalition. In Germany, the regulation of peer-to-peer lending (symbolized by a circle in Table 5) has been implemented by a grand coalition, it confirmed the necessity to have a banking license to lend through a lending platform, even for small amounts. The banking structural reform has been implemented by a conservative-liberal coalition. Both signal the objective not to penalize large banks and to protect local banks. In the UK, the promotion of challenger banks (symbolized by a circle in Table 5) has been started under the center-left government, while the banking structural reform has been implemented by a conservative-liberal coalition. Both signal the objective of shrinking the largest British commercial banks.

1.6 Research strategy

The research for this dissertation began with a question: how would European countries respond to the most disruptive financial crisis that Western economies had known in the last four decades? It was immediately clear that how public authorities would deal with TBTF banks was one of the major issues at stake. Political scientists started examining how different states bailed out their banks, thus reviving essential discussions in CPE (Hardie and Howarth 2009; Jabko and Massoc 2012; Grossman and Woll 2014). Beyond social science,

there were also lively public debates among experts and citizens about the future of TBTF banks in Europe after the crisis. Much of the political agenda at the EU level has since been to deal with the issue of TBTF banks, opening the European banking union and creating a common supervision authority and resolution mechanism for Europe's biggest banks. Yet, when I began this project, the outcomes regarding the evolutions of domestic financial industries were not clear. Much time has been spent accumulating knowledge and crafting analyses in order to understand whether, and how, the evolutions of domestic financial industries would vary across Europe. Ten years after the crisis began, it has become clear that different trajectories of finance could be observed in France, Germany and the UK. The substantial importance of these three European economies as well as clear variations on this variable motivated their selection as my country cases.

The ongoing research revealed that the interest didn't lie only in the market evolutions of TBTF banks, but also in the diversity of policy adoption and policy enforcement regarding TBTF banks in the three countries, despite a common regulatory and supervisory framework at the international and European level. In order to overcome the shortcomings of many recent studies on post-crisis regulations, it was necessary to undertake an analysis that was as exhaustive as possible of as many as possible policies and cases of policy enforcement since 2007. The first mission of this dissertation was thus to produce a work of descriptive inference: first, it was about analytically making sense of TBTF banks' market evolutions; second, it was about proposing a tentatively exhaustive overview of financial regulations and policy enforcement in the three countries. I compiled data on TBTF banks' post-crisis market evolution and I develop a pool of 12 mini-case studies of policy adoption and enforcement. The second big task of the dissertation was to find out whether I could find some analytical coherence based on the massive amount of information that I had gathered. First, I found that the set of financial regulations and regulation enforcement differed significantly across countries despite a common European regulatory framework. Second, I recognized that the overall set of regulations largely coincided with TBTF banks' market evolutions. Third, I proceeded to the analytical work of deciphering the data trends and patterns that could constitute different national trajectories of finance.

The methodological approach I use to confront the causal mechanisms associated with my argument on institutionalized patterns of state-bank coordination against alternative hypotheses is primarily

one of qualitative comparison. Hypotheses which I am interested in are all complex arguments that involve interactions between actors, formal and informal institutions, and preferences shaping. This kind of complex causal argument makes the attempt of isolating the effects of specific variables vain. With country-level data that we use to test them, it is indeed impossible to disentangle the effects of variables that are often heavily correlated. Within comparative political research, the problem of how to test complex theories with simple data is endemic. In this family of research, theoretical claims mostly work through explicit predictions on observables and expected mechanisms. Following Culpepper and others, the approach adopted here is thus to take political processes seriously as a source of information for adjudicating between various mechanisms of political change. This approach is consistent with what Hall (2006) calls “systematic process analysis”: “The point is to see if the multiple actions and statements of the actors at each stage of the causal process are consistent with the image of the world implied by each theory”. The predictions and implications of each hypothesis on observables are made explicit, and their existence or non-existence is documented in a detailed way in order to adjudicate between them in the most systematic way as possible. Case studies bring more than just an illustration of a theory. Yet, they have no ambition to formulate generalizable and systematic claim for causal inference. The strength of these kinds of projects also lies on the collaborative efforts of researchers: a higher number of studies showing the validity of a specific hypothesis in detailed case studies will tend to increase the confidence in the validity of said hypothesis across contexts.

I base my analysis on data collected during more than 100 interviews with a variety of prominent market actors and public officials in my three country cases: France (Paris), Germany (Berlin, Cologne, Frankfurt, phone interviews), the UK (London, Oxford), and in Belgium (Brussels, phone interviews). My analysis also builds on both private and publicly available documentation released by administrative and business organizations.

1.7 Outline of the dissertation

The dissertation’s structure flows from the goal of evaluating competing causal mechanism to account for different outcomes in post-crisis trajectories of finance.

Chapter 2 describes the divergent trajectories of finance in France, Germany and the UK after the crisis. First, it explains the workings and roles of different models of finance. The Comparative Political Economy scholarship distinguishes three models of finance: 1) the Market-based model; 2) the Bank-based model; and 3) the Market-based banking model. Over the last ten years, there has been new arrangements between the different models of finance across Europe. The relationships between market-based, bank-based and market-based banking finance have been reorganized differently in France, Germany and the UK. These different reorganizations define specific European trajectories of finance. The chapter exposes the distributive consequences and the challenges that a particular trajectory of finance poses to the whole political economy.

Chapter 3 presents the major financial reforms that have been put together at the international level since the crisis. It then proceeds to the detailed analysis of 12 policies and cases of policy enforcement at the domestic level in France, Germany and the UK. These policies are categorized into four domains of regulation (systemic risk, competition, governance and market activities). The chapter shows that everywhere, states have been proactive in shaping the divergent trajectories of finance across Europe, but the substance of their action has differed significantly and consistently across jurisdictions.

Chapter 4 examines the different modes of state-banks coordination that led to shaping different state priorities towards finance in France, Germany and the UK. The typical, encompassing institutions that structured public and private actors' coordination in the post-war models of European capitalism have disappeared. Actors had to fall back on existing, stickier, but more limited institutions to coordinate. Different typical modes of state-banks coordination have thus emerged, determining in turn which actors occupy key positions in decision-making processes, which preferences finds political expression, and which forms of conflict ensue. The chapter present a detailed analysis of these meso-level institutions and empirically illustrates how actors have relied on them to coordinate and shape policymaking toward finance after the crisis.

The next two chapters are in-depth empirical case studies tracing mechanisms of decision-making processes. Chapter 5 is a comparative study of the policymaking processes leading to banking structural reform in France, Germany and the UK. The banking structural reform is a very significant piece of post-crisis reform. The potential disruption that it may bring to domestic financial sector is important. It is thus

relevant to examine closely the policymaking processes that led to different reforms across Europe. This chapter provides a detailed case study of this reform and tests the validity of the argument stressing the importance of different institutionalized state-banks modes of coordination.

Chapter 6 is a study of the management of Greek public debt by French and German banks during the Greek sovereign debt crisis in 2010-2011. In 2010, at the beginning of the Greek sovereign debt crisis, the French government asked French banks not only to retain plummeting Greek bonds on their balance sheets but also to buy *more* Greek sovereign debt. French banks did just that. The German government asked German banks to do exactly the same. German banks sold massively. I take advantage of an exceptionally simple empirical setting to develop a research design that allows me to consider a whole set of potential explanatory factors as “controlled”, and rule out hypotheses proposing explanatory variables like variations in actors’ preferences, variations in actors’ power resources, and variations in coalitional strength. The case is particularly interesting to test the complexity of the French case. The analysis shows that French decision-making is characterized by a symbiotic mode of state-bank coordination and is not a case of sheer capture – despite the fact that the French state’s attitude towards banks has largely conformed with banks’ preferences.

The final chapter of the dissertation concludes with a summary of the findings and a discussion about important implications of these findings for the prospects of the European Banking Union, as well as for the literature on the role of the state in the economy and the varieties of capitalism.

CHAPTER 2

The Divergent Trajectories of European Finance after the Crisis

The central function of a financial system is to connect surpluses of capital and needs for capital. There are different ways to operate this intermediation. Political economists have long been interested in analyzing different models of financial intermediation, and their consequences on the broader political economy. The Comparative Political Economy (CPE) scholarship distinguishes three models of finance: 1) the Market-based model; 2) the Bank-based model; and the 3) Market-based banking model. Domestic financial systems are hybridization between different models of finance. After the crisis, the relationships between bank-based and market-based banking finance have been reorganized differently across countries. These different reorganizations define different trajectories of finance, which in turn have raised different challenges, strengths and weaknesses for European political economies.

2.1 The Rise of Market based banking (1980s-2000s)

In 1983, Zysman defined different national types of capitalism based on the specific features of their financial systems. His main distinction was between market-based systems, exemplified by the British financial system, and credit-based financial systems, exemplified by the French and German financial systems¹⁶. In the former system, funds were mostly allocated ‘directly’ from stock and bond markets to firms. In the latter system, funds were mostly allocated to firms through banks, and their art of transforming short-term deposits into long-term loans. In the credit-based category, he distinguished between the (French) state-led credit based financial system—where the state was key to decide who will receive credit and how much they will receive; and the (German) bank-led credit based financial system – where the decision of credit allocation was mostly made by banks themselves. Zysman’s contribution to the understanding of post-war capitalisms was important not only because he offered clear categories to understand how different financial systems worked, but also because he showed how the structures of the financial system constrained (and shaped the opportunities of) the relationship between government and industry, and thus the capacity of government to influence industrial growth strategy and domestic firms’ position in the international competition.

¹⁶ From this point of view, Hall and Soskice’s (2001) distinction between bank-based and market-based financial systems does not differ much from Zysman’s.

At the very time Zysman was publishing his book, the disruption of the institutional arrangements described in his book began. Pressures came mostly from two fronts: the (de)regulation process fostered by the economic turn of the European project in the 1980's, and the competitive pressures fostered by the development of information technologies and the surplus of liquidity flooding the global economy at the beginning of the 1980's. For several reasons (on which authors widely disagree; see Moravcsik 1991; Jabko 2006; Abdelal 2007; Ash 2012), in the 1980's, the project of European integration became primarily a project of economic integration. The European project took largely the face of economic liberalization reforms. Many of these reforms concerned and affected domestic industries directly. Among other reforms, the lifting of capital controls and interest rates deregulation affected domestic banks, which had now to compete for deposits, leading to funding difficulties and diminishing returns. The first and second banking directives (implemented by member states in the 1980's and early 1990's) established the principle of mutual recognition of banking licenses and home country control. The opening to foreign competition coincided with the promotion of interior competition through the privatization of banks and the de-segmentation between different financial business lines and different types of banks. As important as liberalization processes, the non-regulation of new financial activities constitutes an important source of change. (De)regulatory disruption came with market pressures: banks had to face a historic fall in profitability, in part because they had now to face severe competition to attract both depositors and creditors. They also faced new profit opportunities due to the development of the new technologies and successive flows of abundant money in search for profitable investment; first coming from the US, then from within Europe (with British and Dutch pensions' privatization and the adoption of the single currency in the 1990's).

These new challenges and opportunities have not led to the credit-based financial systems' shifting towards the market-based model as defined by Zysman. It is true that stock and equity markets have soared everywhere (although in different proportions), but the size of banks in terms of total financial assets has soared even more. In the growth of the financial sector, banks led the way. Assets of the top 12 European banks soared from €1,400 bn. in 1990 to over €17,000 bn. in 2011 – an increase of approximately 1,114 percent. France had seen a shift towards market-based capitalism in the 1990s but the direction was reversed in the 2000s: banks have remained dominant in the process of

capital allocation (Hardie and Howarth, 2013, p55). Many authors have been puzzled by the resilience of banks in continental Europe. Moreover, the increased importance of banks in a traditionally market-based system such as the UK is not consistent with the idea of a simple shift from bank-based to market-based models. In terms of market size, British banks assets increased by 49.2% between 2000 and 2007, while private bonds market increased only by 19.2%, and equity market capitalization fell by 26.5% (Hardie and Howarth, 2013, p58). Banks have grown and they have remained major actors in financial systems. The most significant transformations of finance in the years leading to the crisis largely lied with the transformations within banks themselves.

Figure 5: Bank assets, Private debt market and Equity market capitalization as a % of total financial system assets

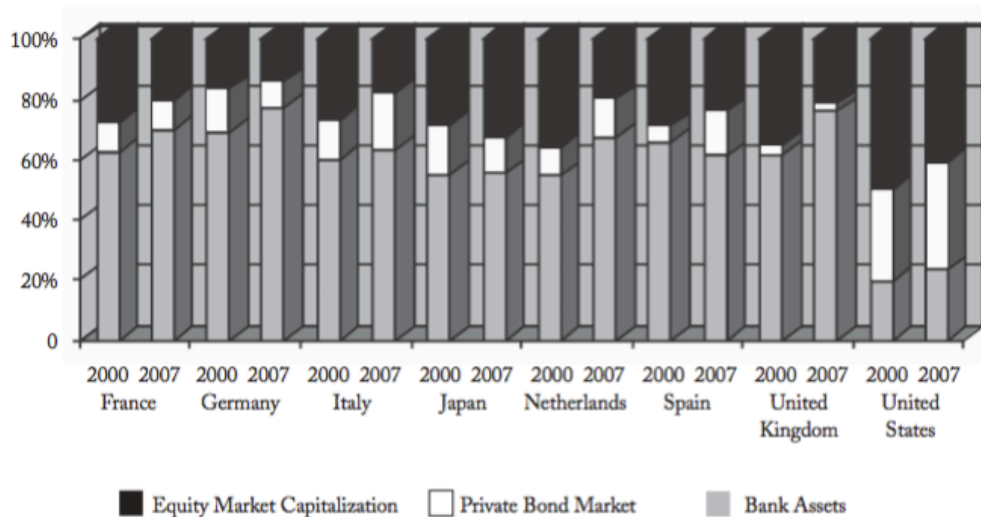


FIGURE 3
NATIONAL FINANCIAL SYSTEMS (2000 AND 2007):
BANK ASSETS, PRIVATE DEBT MARKET, EQUITY MARKET CAPITALIZATION
AS A % OF TOTAL FINANCIAL SYSTEM ASSETS

SOURCE: World Bank. See Beck and Demirgüç-Kunt 2009.

Figure reproduced from Hardie et al. (2013, p705)

In Zysman (1983), the contrast between market-based and bank-based systems depended on the specific role for banks as bulwarks against the influence of financial market. Crucially, in bank-based systems, banks must be able “not to pay much attention to market or price signals’ (Rajan and Zingales 2003, p12; cited in Hardie et al., 2013, p3). Banks draw their funds from deposits, as a result, they have ready access to the funds they need for lending. On the other side, in such

systems, banks keep the loans on their balance sheets. This means that they are, alone, responsible for the risk associated with these loans. Because they are funded through stable deposits and that they keep the loans on their balance sheets, banks are central in the decision of credit allocation. In the traditional bank-based models of capitalism described by Zysman, although private banking and investment banking certainly did exist, bankers were first and foremost guys “*who take deposits and make loans; Period*” (Retired French top banker, Interview 01182009). The banking industry was mostly characterized by its traditional function: reallocating capital from domestic households to domestic firms¹⁷.

But starting in the 1980’-1990s, banks turned away from this “boring banking” as they embarked on more innovative, and profitable, activities, such as fee-based advisory and market intermediation services (Froud et al. 2002; Erturk and Solari 2007; Engelen and Konings 2010). They also diversified their sources of funding, relying on short-term loans and daily renewed repos in the money and inter-bank markets in addition to their traditional customers’ deposits (Hardie and Howarth 2013).

Scholars have started to conceptualize changes in the business model of European banks. Könings (2008, p256) writes that financial activities “increasingly revolve not around the provision of capital to corporations but around the capacity to invent a wide range of new products and services, many of which are not directly related to corporate finance”. One of the most important changes is that banks have moved towards activities that generate non-interest sources of income, i.e fee-earning or arbitrage earning activities (Engelen and Könings, 2010). Timmermans oppose loans to “fees and commissions to banks: revenues for the origination and trading of sophisticated derivative products, trade finance, hedge funds platforms, credit insurance, guarantees for bonds, asset back securities and structured finance” (Timmermans 2007, p490).

In 2001, Aglietta and Breton already noted that banks had added a ‘new market portfolio’ to their ‘traditional credit portfolio’ (2001, p441) and the increasing importance of the former over the latter on banks’ balance sheets. The ‘traditional credit portfolio’ is composed of the loans that the bank has granted to the creditor, these loans are kept in their balance sheets until they arrive at maturity, i.e. until the loan has

¹⁷ A typical saying used to describe the typical “3-6-3” banker: the banker who borrowed at 3%, lent at 6% and was on the golf course at 3pm.

been reimbursed in totality. The ‘market portfolio’ is constituted of financial assets (including loans) that are destined to be sold in the short-term. This shift from the ‘originate to hold’ model to the ‘Originate to distribute’ model has first concerned mortgage and consumer loans, but it has also affected corporate loans more and more often. Aglietta and Breton actually described the process of securitization in which the banks are more and more involved¹⁸.

Finally, Hardie and Howarth (2013) gives an encompassing definition of market-based banking. They depict the shift of European banks from traditional intermediation activities to market-based banking, which they define as (A) Banks turning themselves to non-intermediation activities (such as investment banking, wealth management), B) The increase of securitization of loans (which is the financial technique through which financial institutions convert assets (eg. Mortgage or other loans) into tradable instruments (such as ABS or asset-backed commercial paper) which institutions can sell off to raise financing)); C) The extent to which banks finance themselves from borrowing on financial markets rather than from deposits. As noted by Hardie and Howarth (2009, p1018), the globalization of banks is narrowly linked to their shift to non-traditional financial activities.

Reading an annual report of the French BNP-Paribas is revealing of the emergence of “market-based banking”. The report starts with the bank’s high performance in its equity and derivatives business line¹⁹. The next section, in which the bank boasts about its ‘European leverage loan of the year’ award, is about the bank’s structured finance business line. The report continues with the praising of its advisory services in mergers and acquisitions in Europe and in Asia. Then, BNP-Paribas retail banking and corporate loans are advertised. Finally, the report concludes by the presentation of the asset management business line of the bank (BNP, annual report 2007).

¹⁸ The European securitization market, in which banks are central as holders, originators or sponsors, grew rapidly following the introduction of the euro, from €78.2 billion in 2000 to €453.7 billion in 2007 (Hardie et al., 2013. p712).

¹⁹ In 2007, BNP was exposed to a notional amount of derivatives instruments worth €31,710 billions, as compared to €400 billions in 1990

2.2 Bank-based and market-based banking finance: different models and roles for finance

Bank-based finance and market-based banking finance are thus characterized by the different ways banks do business: their main activities are different, as well as their main source of revenues, their sources of funding, the scale on which they operate and how they manage loans. These different ways of doing business have important implications for the broader political economy: who bears the financial risk? Who benefit the most from a given mode of capital intermediation? What are the main threats for the system's stability? Table 6 sums up the main characteristics of bank-based system versus market-based banking system.

Table 6: Summary of the main characteristics of bank-based vs market-bank based finance

	Bank-based system	Market-based banking system
Main activities are...	Transforming short-term deposits into long-term loans	Trading securities
Main source of revenues is...	Interests	Fees and commissions
Funded by...	Deposits	Financial markets
Operates...	At the local or national level	At the global level
Loans are...	Kept on the balance sheet ("originate-to-hold")	Securitized and sold ("originate-to-distribute")
Risk lies with...	Individual bank	Financial institutions (banks, insurance, investors...)
Central figure is...	Local loans portfolio manager	Investment banker
Central client is...	NFCs (above all SMEs)	Other financial institutions
Type of relationship...	Long-term relationship	Short-term relationship
Central motor of growth in the political economy...	Industry	Finance

In market-based banking, securitization reorganizes risks and incentives in ways that represent "a fundamental shift in how finance is done" (Davis and Kim, 2015, p. 208). Financial institutions transform

debt into investment by intermediating between debtors and investors who are predominantly other financial institutions. It faces the risk of a new type of bank run caused not by depositors but by other financial institutions (Hardie et al. 2013, p 15). Note that both in bank-based and in market-based banking finance, the final risk eventually lies with the public, as deposits are publicly guaranteed in both cases. The difference is that the risk is more locally situated in purely bank-based model, while it is more widespread across financial institutions in market-based banking. Risk spreading gives rise the phenomenon of interconnection between financial institutions that characterizes financial systems dominated by “too-big-to-fail” financial institutions.

In traditional bank-based systems, the main job of the banker is to “take deposits and make loans; Period”. A typical saying used to describe the typical “3-6-3” banker: the banker who borrowed at 3 percent, lent at 6 percent and was on the golf course at 3pm. The loans’ portfolio manager is the central figure in this type of banking. S/he is the one who decides to expose the bank to the risk of making a loan to a specific firm. The dependence of the bank on his/her skills in assessing credit risk is massive. In market-based banking, the central figure is rather the investment banker. S/he is the one to transform loans into securities and sell them for profit, while s/he makes the decision to expose the banks to other securities purchased on the markets. Investment bankers are the central figures in the most profitable (and riskier) business lines on the bank. The new typical banker takes the place often, is a master in complex financial engineering and makes much more money.

The shift in the central figure of the banker – and the cultural change in banking that came along- can be illustrated by the evolution of Deutsche Bank’s management in the 1990s and 2000s. In 1995, Edson Mitchell, an archetype of a Wall Street investment banker (who liked being called “a shark”, “a conquistador”, or even “God”), was hired and given *carte blanche*, along with his team of 50 investment bankers, to build up Deutsche Bank’ Global Markets division. When he died in 2000, Anshu Jain became head of the Global Markets division and continued to expand it. His division, operating mostly from New York and London, became the new core of a transfigured Deutsche Bank. Fichtner et al. (2016) write to describe the new spirit at Deutsche Bank, “*Nobody mattered much anymore except for the Americans and the Brits. The old structures, which had stood in good stead for almost a century, had been trampled. The Müllers, Meiers and Schulzes, the branch managers in Düsseldorf and Stuttgart, the former stars of the*

*Deutsche Bank empire, they were no longer valued. Their loan portfolios, still as full as ever, were mocked as antiquated*²⁰.

The rise of market-based banking has had consequences for people and firms dealing with banks. Traditional banks' business model considers Non Financial Firms (NFCs) as their primary clients. They draw their profits mainly from the interests they make on loans they grant to these firms. Small and Medium enterprises (SMEs) in particular are central, as bank lending represent their main source of funding (large public NFCs tend to rely more on stock markets to raise funds). The banker's key expertise is his/her ability to assess SMEs' credit risk. This expertise is often acquired from a close relationship with the SME's manager and a long-term knowledge of the specific profile of the firm (based on its sector, its size, whether it is a family business or not...). Another consequence of having SMEs as their main clients, banks have a vested interest in seeing them thrive – and continue paying their debt – so they don't turn their back on them as soon as they encounter financial difficulties. This is the typical "relationship" banking described by students of bank-based models of finance (Gerschenkron, 1966; Hall and Soskice 2001).

The market-based bank draws revenues from fees and commissions rather than interests, through the purchase and sale of financial assets. Its main clients are mainly other financial (bank and non-bank) intermediaries. Loans remain interesting as long as they are able to generate sellable, tradable, cash flows. SMEs credit is usually considered too risky to be securitized and sold²¹. Cash flows based on consumer credits or insurance products are more sought after. The business model of market-based banking makes it difficult to finance SMEs. As a French investment banker told me: "*You'll have trouble to finance a craftsmanship SME in the Cantal [A French department]. The market is not interested*" (Investment Banker, 01182016).

During interviews, banks' clients were aware of this difference. I have met with four representatives of SMEs (the European UEA-PME, the French CPME, the German BVMW and the British

²⁰ Ullrich Fichtner, Hauke Goos and Martin Hesse, from Der Spiegel, have investigated the evolution of Deutsche Bank starting in the 1980s. They have led several interviews with top managers and lower position workers at Deutsche Bank. Their empirically fascinating account is available at <http://www.spiegel.de/international/business/the-story-of-the-self-destruction-of-deutsche-bank-a-1118157.html>

²¹ SMEs loans' securitization remains extremely low, despite market and political attempt to develop it. In interviews, market actors agreed that it would probably remain very low given the risky and skills-demanding nature of SMEs lending.

BusinessUK). All were saying the same thing: market-based banks were not good for them. They said they needed more traditional, bank-based, banking. The German representative said that German enterprises are to this day very attached to their local banks because the system works well for them (Interview 11092016). The British and the EU representatives called for more local, traditional, banks:

“We need small and independent local banks. We want local banks where decisions for the loans are taken by local managers, who know the people personally” (Interview 05292015). The other said: *“I would like to see new cooperative banks. More local banks”* (Interview 07152016).

By contrast, a hedge fund manager also gave me his definition of the bank he likes:

“Today, banks are platforms. There is no disintermediation in terms of flows of capital. Banks have no less importance but more importance. It is really important for us to have actors who provide us with liquidity. We need banks. Very big banks.” (interview 06112015).

The divergence between visions of their ‘ideal bank’ could not be more explicit.

The models of finance affect the political economies in which they are embedded more broadly. While in a political economy dominated by bank-based finance, the main motor of growth lies with the non-financial sectors, in market-based banking finance, the main motor of growth is the financial sector itself. During an interview, an investment banker worried about the fact that some policymakers misunderstood the kind of finance that he was practicing:

“We cannot have an economic project deploying on a trajectory of 10 to 15 years. We have clients who want to get paid back within 10 years. (...) We cannot be the actors of an industrial policy. We are in a finance that is, really, a little bit ‘up in the air’. Which serves the ultimate holders of capital. But you can’t make an industrial policy out of it”(Interview 0602015).

Market-based banking is also inducing of inequalities within society. Godechot (2015, 2016) for example shows that a bigger size of the financial sector and a bigger proportion of

marketization within banks induce higher levels of inequalities within the political economy.

Boxed text 2: The financialization of the economy and society

The marketization of banking, and the corresponding dramatic growth of the financial sectors across advanced political economies go hand in hand with the processes of financialization of the economy and society, a phenomenon that has been much studied in the social science. Financialization describes a particular set of trends, associated with mature capitalist economies, which have developed markedly since the late 1970s. Although often assumed an element of globalization and neo-liberalism, it has its own distinct features (Epstein, 2005, Froud et al., 2006, Palley, 2007, Stockhammer, 2010, Krippner, 2011). Scholars from various disciplines have used the concept of financialization to describe the structural changes in advanced political economies that have arguably led to a shift from industrial to finance capitalism. They interrogate how the growing realm of global finance has altered the underlying logics of the industrial economy and the inner workings of democratic society at all levels. They focus either on the change of the regime of accumulation (Krippner 2005, 2011; Aglietta and Reberieux 2005; Boyer 2000), the ascendancy of shareholder value orientation (Fligstein 2001b; Lazonick and O’Sullivan 2000) or the encroachment of finance in citizens’ everyday life (Martin 2002, Langlely 2007; Davis 2009)²². What unites these studies is their claim that finance has gone beyond its traditional role as provider of capital to the productive economy (like in Gerschenkron 1962; Boyer 1990; Zysman 1983) and has become central on its own sake (Epstein 2001; Palley 2007; Crouch 2009; Pike and Pollar 2010). In Palley’s words (2007, p2) ‘Financialization is a process whereby financial markets, financial institutions, and financial elites gain greater influence over economic policy and economic outcomes. Financialization transforms the functioning of economic systems at both the macro and micro levels.’

²² See van der Zwan 2014 for an insightful state of the art on financialization.

2.3. The strange non-death of market-based banking finance after the crisis

In the decade leading to the crisis, market-based banking rose dramatically everywhere across Europe, although to varying degrees (Hardie and Howarth, 2013). Parallel to the marketization of banking, the de-segmentation of banking²³ and the liberalization of corporate governance rules fostered consolidation processes between banking groups, and the creation of huge and globally interconnected banking conglomerates (Boot, 1999; Berger et al. 1999), soon to be known as systematically important, or ‘too-big-to-fail’ banks. Before the crisis, only few politicians, academics and citizens were really aware of the scale and implications of these dramatic transformations in banking. Yet, only few advanced political economies have been spared. In 2008, 15 out of 29 TBTF banks were based in Europe, 8 were based in the USA, and 3 were based in Japan. Within Europe, 4 TBTF banks were based in the UK, the traditional paragon of financial capitalism, 4 were based in France, the textbook model of state-led capitalism, and 2 were based in Germany, the home country of relationship banking.

After Lehman Brothers filed for bankruptcy in the US on 15 September 2008, the near meltdown of the global financial markets pushed governments across the world to rush and rescue their banks. As Luyendijk (2015) puts it, “*the total meltdown of the global economy was averted in 2008 only through a combination of pure luck, extremely expensive nationalizations and bailouts, the lowest interest rates in recorded history plus an ongoing experiment in mass money printing*”. From that point of view, we could have expected radical reform in the workings of finance. Many policy-makers promised to do just that. Reforming global finance was the main topic of the Pittsburgh G20 summit in September 2009. In European countries, political leaders multiplied loud and ambitious commitment to reform finance (Hardie and Howarth 2009; Jabko and Massoc 2012; Bell and Hindmoor 2015).

Yet, ten years after the financial crisis, many authors have observed that post-crisis financial regulation has brought no radical

²³ The de-segmentation, also called “de-specialization” of banking to broaden the list of authorized activities for previously specialized banks. It is also sometimes understood as the broadening of the authorized geographical scale of operation for banks (See for example Underhill 1997; Pagoulatos 1999).

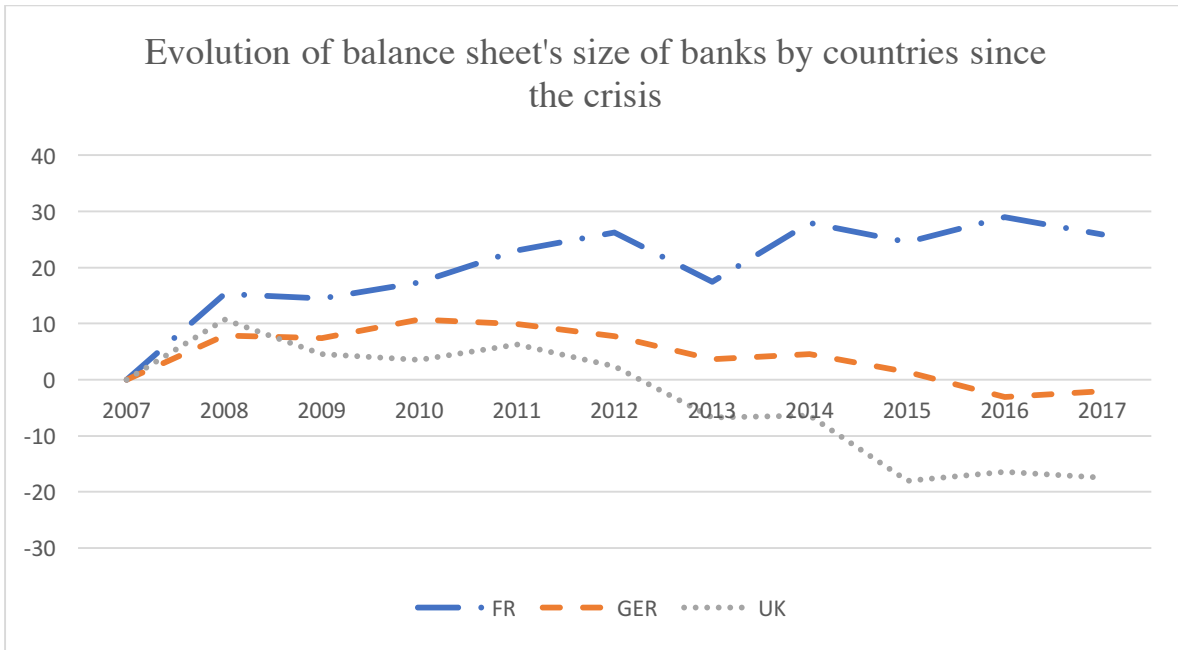
change to the workings of finance (Admati and Hellwig 2013; Blyth 2013; Crouch 2011; Engelen 2018; Helleiner 2014; Schmidt and Thatcher, 2013; Braun 2018; Gabor and Ban 2016). After some time of uncertainty, the financial sector started to grow again. Within finance, profit accumulation resumed being operated through complex financial engineering rather than plain vanilla deposit-taking and lending (Watson 2015; Rickards 2016). As a matter of fact, market-based banking finance has not simply continued, it has been renewed. In Europe, the proposed Capital Markets Union (CMU) by the European Commission – which main objective is to promote securitization - is a testimony to this (Fernandez and Wigger 2017). After the crisis, the interesting empirical question is thus not whether or not market-based banking has decreased across political economies, but how market-based banking newly inter-connects with the other models of finance, in particular traditional bank-based finance.

I define trajectories of finance by the way market-based banking and traditional banking interconnect in a given political economy. After the crisis, the interconnection between market-based banking and traditional banking has been reorganized within domestic financial systems. The next sections examine the different trajectories of finance in France, Germany and the UK.

2.4. Comparative evolution of European largest banks

As mentioned in Chapter one, large European banks have known different fates since the crisis. French banks have maintained or expanded their presence both in traditional banking (at home and internationally) and market-based banking globally. In Germany, Deutsche Bank have aggressively expanded its market-banking business lines. The bank met too many structural difficulties to continue its expansion starting in 2014, and its future developments remain uncertain. Commerzbank has become more conservative and had to a significant extent turned away from global market activities. In the UK, banks have downsized and/or refocused on their area of expertise. All British banks, including HSBC which balance sheet has yet remained stable, have reduced their international presence and their global market activities.

Figure 1 (reproduced from Chapter 1): Variation of TBTF's balance sheets' size (%) across countries with reference point 2007*



French banks grew considerably. They developed their operations domestically, internationally and despite some strategic reorganization, they have maintained or expanded their market activities. As noted by BMI regarding the French banks: “There is no sign of this expansion slowing” (BMI France 2017, p32). The expansion of French banks is particularly obvious for BNP-Paribas and Societe Generale. BNP Paribas expanded its presence in Europe, Africa and the Asia Pacific region, as well as its corporate and Investment banking and investment solutions divisions. At the time of writing, Societe Generale is about to buy Commerzbank’s equity market and commodities arm.

In Germany, Commerzbank has scaled back the trading activities of what was its investment bank. It has exited Asian and Arab markets to refocus on German and central European markets. Michael Reuther, the head of Commerzbank’s corporates and markets division explained this evolution because “We don’t want to be an all-singing, all-dancing global player”²⁴. On the other side, Deutsche Bank has made acquisition in the German retail markets as well as in

²⁴ Financial Times, 5 May 2010

international retail and global markets. Starting 2014, there has been a substantial wind-down of the Non-Core Operations Unit as well as the exit of selected Global Market business line. Yet, in 2015, the bank announced that they would re-inject capital into their business in order to pursue growth in their Global Transaction Banking and Asset and Wealth Management businesses (DB, Annual Report 2015, p22). In 2016, one could read in BMI (Germany 2016, p38) under the section ‘opportunities’ for Deutsche Bank, that the bank was expanding in North America and in emerging markets and commodities. At the time of writing, the future prospects of Deutsche Bank remain uncertain.

The evolution in the size of banks may reflect an important number of different factors, such as variations in the market prices of banks’ assets or the variation in credit demand. But according to financial analysts, “*Overall in the UK, total banking system assets decrease is due to deleveraging and divestment of non-core legacy assets by banks*” (Moody’s Banking Outlook UK, 2017). British banks have reduced their international presence. In 2013, Royal Bank of Scotland (RBS) announced its withdrawal from 26 countries as part of a strategy to ‘rationalize’ its geographical footprint and focus on its core business in the UK market. HSBC refocused on its expertise markets in Asia, and withdrew completely from Brazil and Turkey. It also significantly diminished its activities in continental Europe (BMI, UK, 2017, p43). The downsizing also concerns bank’s activities. For example, BMI writes about Barclays: “*The downsizing of the company continues: in June 2015, Barclays Capital sold off its Wealth and Investment Management unit in Florida, while in October Barclays announced that it would sell GBP650mn of its performing loan portfolio in an effort to shore up its balance sheet. The bank plans to further shrink its overseas investment banking division in the coming years*” (BMI UK, 2017).

Tables 7a, 7b and 7c show the major sales and acquisitions made by BNP Paribas, Deutsche bank and HSBC between 2008 and 2015²⁵. Light grey are acquisitions, dark grey are sales. The differences in the dominant color between the three banks are revealing of their overall evolution. Light grey is dominant for BNP, dark grey is dominant for HSBC, while Deutsche Bank is more contrasted, with a dominance of light grey at the beginning of the period.

²⁵ Same tables for the other banks are available in the appendix

Table 7a: Major sales and acquisitions by BNP-Paribas (2008-2015)

BNP	
2008	Acquired 50% interest in SREI Equipment Finance
2008	Acquired the prime brokerage activities of BoA
2008	Acquired all the shares of Banco BNG
2009	Acquired 75% of the share capital of Fortis Banque SA
2009	Acquired interest in BGL SA
2009	Acquired 25% of the share capital of AG Insurance for Eurol
2009	Acquired 12% Of the share capital of Royal Park Investments
2009	Acquired 58% of the Insinger de Beaufort Group
2009	Acquired 100% of creditFin Banco SA from the LaSer Group
2011	Acquired 100% of the share capital of Dexia Espagne Pension
2011	Acquired 6% of the share capital of TEB bank
2011	Acquired the international network of Fortis Commercial Finance
2011	Acquired 100% of BNL Vita
2012	Sold 30% equity stake in Klepierre
2013	Liquidated BNPP Capital Preferred
2013	Liquidated BNPP Capital Trust
2013	Acquired 25% interest in BNPP Fortis to 99.9%
2014	Acquired BGZ in Poland
2014	Acquired online broker DAB bank
2014	Acquired RCS (South Africa)
2015	Acquired European activities of GE Capital Fleet Services

Table 7b: Major sales and acquisitions by Deutsche Bank (2008-2015)

DB	
2008	Acquired Abbey Life Insurance
2008	Increased its stake in Harvest Fund management
2008	Acquired 100% of HedgeWorks LLC
2008	Acquired 60% Of Far Easterner Alliance Asset Management
2008	Sold DWS Vita S.p.A to Zurich Financial Services Group
2008	Sold DWS Investments Schweiz AG
2008	Acquired Pago and Transaction GmbH
2008	Acquired a significant minority interest in Rosen Real Estate Securities LLC

2009	Acquired 22.9% of Deutsche Postbank AG
2009	Acquired 100% of Dresdner Bank's Global Agency Securities Lending Business
2010	Acquired Sal. Oppenheim Group
2010	Acquired parts of ABN Amro Bank N.V.'s (commercial banking activities in the Netherlands)
2010	Sold its interest in BHF Asset Servicing GmbH
2010	Increased its participation in Deutsche Postbank AG to 51.98%
2011	Sold its 40% stake in Paternoster Limited
2013	Acquired the remaining 51% interest in Xchanging etb GmbH
2013	Completed the sale of a 20% stake in Deutsche Herold AG
2015	Increase its interest in capital share of Postbank to 96.8%
2015	Sold its stake in Hua Xia Bank






Table 7c: Major sales and acquisitions by HSBC (2008-2015)

HSBC	
2008	Acquired the assets, liabilities and operation of the Chinese Bank Co, in Taiwan
2008	Sold seven French regional banks to Banques Populaires
2008	Disposed of its share in Financiera Independencia S.A.B
2010	Sold HSBC Insurance Brokers
2010	Sold its investment in British Arab Commercial Bank
2010	Sold its stake in Wells Fargo HSBC Trade Bank
2010	Sold Eversholt Railgroup
2012	merged its operations in Oman with the Oman International Bank
2012	Acquired the onshore retail and commercial banking business of Lloyds Banking Groups in the United Arab Emirates
2013	Sold all its shares of Household Life Insurance Company of Delaware and HSBC Insurance Company of Delaware to Enstar Group

Sources: the Mergent Archives 2016, Banks' Annual reports

In terms of the total number of employees of the bank (see Table 8), British banks have also downsized their workforce quite dramatically, while banks in France and Germany have maintained or even expanded it.

Table 8: Evolution in the number of full time employees per bank

	SocGen	BNP	 CASA	Natixis *	DB	Comme rzbank	 Lloyds	 Barclays	 RBS	 HSBC
2008	163082	173188	88933	19439	80456	43169	NA	156000	226428	325000
2009	156681	201740	89172	19576	77053	53231	132000	144200	238597	309316
2010	155617	205348	87520	19576	102603	50489	122979	147500	233536	302327
2011	159616	198423	87452	20441	100996	58160	120449	141100	127500	305984
2012	154009	188551	79282	20198	98212	53601	113617	143700	119200	284186
2013	148324	184545	75529	19632	98254	52944	97869	140300	114900	263000
2014	148322	187903	72567	20287	98138	52103	84490	132300	108700	266000
2015	145703	189077	71495	20617	101104	51305	82948	129400	90158	264000

Source: Mergent Archives

* The number of employees for BPCE available only for the CIB unit (Natixis)

The differences in large banks' evolution is very clear when one reads the annual reports of banks. In 2017, the tone of Société Générale's management was very different from Barclays' for example. Societe generale writes: *"The Global Banking and Investor Solutions division is now well-positioned to strengthen its market share"* (SocGen, 2017, p12) while Barlcays writes *"Since the crisis, we have refocused the business, halving the balance sheet by £1trn and the staff by some 80,000, through the disposal of Non-Core assets"* (Barclays, Annual Report 2017, p2).

The expansion or downsizing of banks also reflect their continuous involvement to, or disengagement from, market-based banking.

Reports by Moody's show that the asset growth by segment on banks' balance sheets varies from country to country. In France, the structure of banks' balance sheet has remained quite stable between 2010 and 2015. Between the five identified categories: "Loans and advances to customers", "Cash and cash with central banks", "Financial assets", "Other assets" and "Derivative assets held for trading", only "Financial assets" has consistently increased (Moody's Banking Profile France, 2017, p4). There is no sign of this expansion in market-based banking stopping. As one can read in a Société Générale's Annual Report: *"The Group invest in the financing of natural resources and structured financing, develop 'originate to distribute' solutions, and support credit disintermediation in Europe by developing primary*

market activities (...) it consolidates its leading positions in Global Markets activities by developing its equity derivatives, structured product and bond distribution activities” (SocGen, Annual Report, 2017, p12). The trend is less dramatic, but no less obvious, among the French Mutual and cooperative groups. BPCE’s investment bank, Natixis, reorganized and expanded its investment banking division in 2016, and adopted the explicit moto “beyond banking”²⁶.

In Germany, among the six categories “Domestic loans”, “Claims on non-euro area residents”, Loans and securities issued to German government”, “Domestic interbank loans and securities”, “Loans and securities issued to other euro member states”, “Other assets”, only the category “other assets”, which includes trading financial assets diminished between 2012 and 2015, with a bounce-back at the end of the period. All banks are included in these figures. They also reflect the more conservative strategy of local public banks. Deutsche Bank has exited some market segments but remains present in the global markets.

In the UK, the structure of the balance sheets has changed more radically. All the 6 identified categories, “Domestic private sector loans”, “Non-resident loans”, “Investments”, “Domestic Monetary and financial institutions loans”, “With UK central bank” and “Other assets” decreased in absolute amount. But “Non-resident loans” category decreased more than “Domestic private sector loans”, which suggests a re-focus on domestic markets. “Investment” and “other assets” are leading the decrease (Moody’s Banking Profile, UK 2015, p5). The Head of Regulatory Developments at a major British bank told me in interview: “*It is our post-crisis strategy: going low-risk. We got back to boring banking*” (Senior British banker, interview 07112016).

The evolution in derivatives trading is an indicator of the involvement of banks in global market finance. As stated in BNP’s annual reports, “The notional amount of derivatives instruments constitutes an indicator of the volume of the bank’s activity on the financial instrument markets” (BNP-Paribas Annual Report, 2011). I ran simple regressions to determine whether the evolution in banks’ notional amount of derivatives between 2007 and 2017 reflected normal volatility or reflected a significant upward or downward trend²⁷. Out of 9 banks, the evolution (here decrease) in derivatives trading was

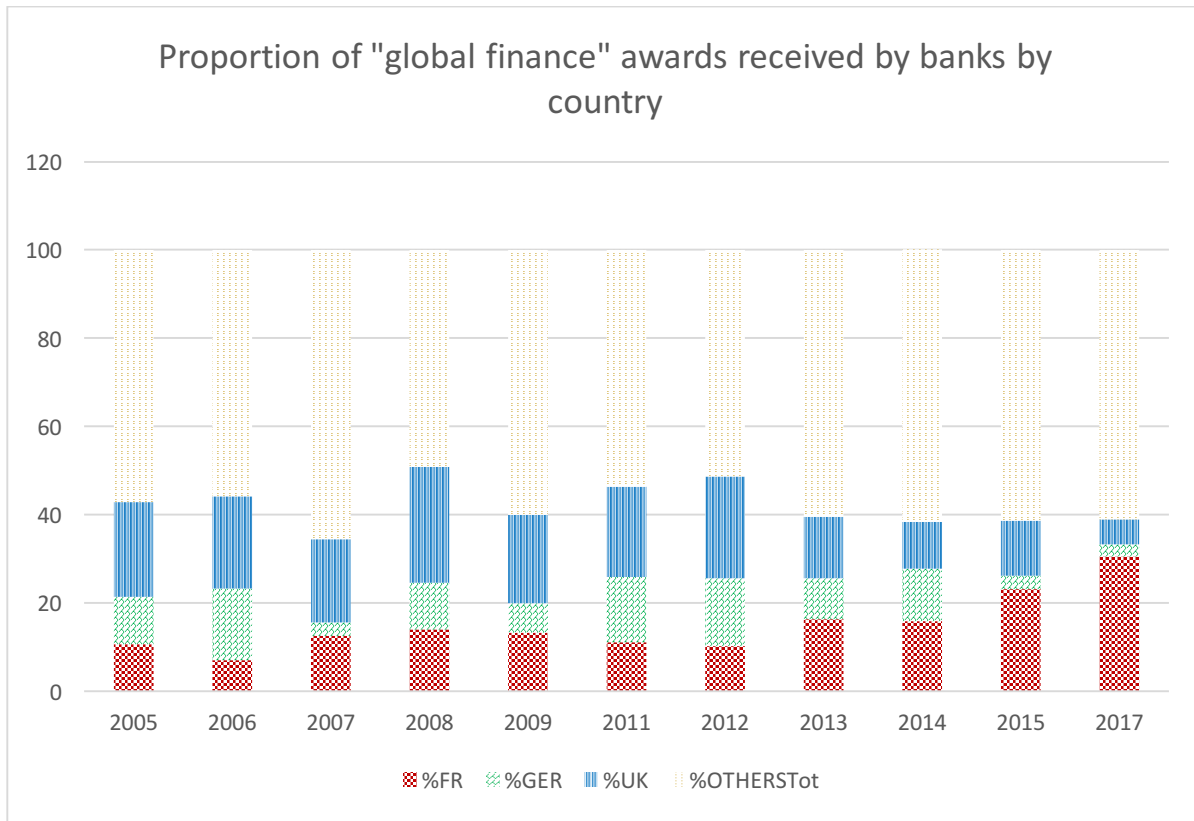
²⁶ Reuters, 15 march 2016, “Natixis reorganizes corporate and investment bank”

²⁷ The evolution over time is considered significant when $p < 0.05$

significant for only two banks: RBS and Barclays²⁸.

This finding is consistent with the evolution of global finance awards received by European banks, as presented in chapter 1.

Figure 2 (reproduced from chapter 1): Evolution of ‘global finance’ awards received by banks by country (2005-2017)*



Source: The Banker, GlobalFinance, GlobalCapital

*Data missing for the years 2010 and 2016

But large global banks are locally rooted. The differentiated evolution of European large banks has not only changed the landscape of global finance, but also impacted national political economies.

2.5 The French universalist trajectory of finance

French banks have grown considerably since the crisis. As developed in the previous section, they have expanded their global market activities and reinforced their presence internationally. To

²⁸ Regression tables available in the chapter’s appendix

consolidate their position as global players, French banks have benefited from the reinforcement of a quasi-hegemonic position in their domestic retail markets, which has given them stable sources of capital and revenues' flows. French banks have continued to expand in new segments of French retail markets (like online banking, where the expansion has been led by French banks exclusively). French banks have also extended their presence in non-bank activities such as asset management and insurance. In asset management, Amundi (a subsidiary jointly created by Crédit Agricole and Société Générale in 2010) has quickly become the market leader. Most leading insurance companies depend on bank networks to market their products, and bancassurance links are often underpinned by cross-shareholdings between banks and insurance companies (BNP Paribas, for example, is closely linked with AXA).

Market-based banking and traditional banking feed each other in the heart of the French universal banks. Because the developments of French banks' position in the global and in the domestic markets go hand in hand, the trajectory of French finance is universalist²⁹.

Boxed text 3: The French banking landscape

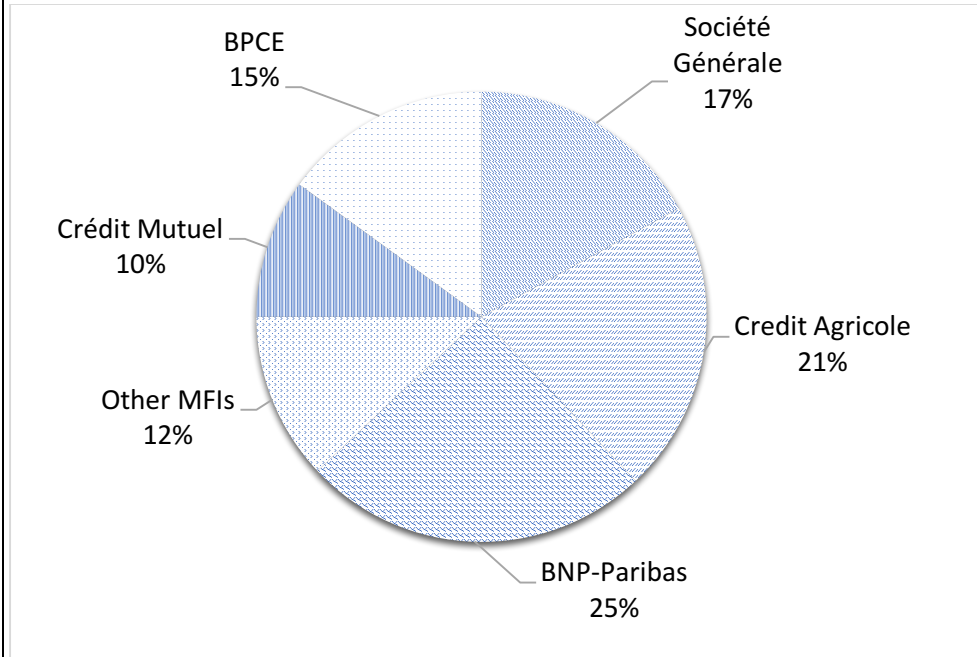
Domestic banks are dominant within the French retail banking sector. The leading five banks are BNP Paribas, Crédit Agricole (a part-mutual, part-listed bank), Société Générale, BPCE and its investment banking subsidiary Natixis (formed from the merger of two mutual banks), and Crédit Mutuel (a hybrid formed by a co-operative bank and a commercial banking subsidiary).

Three of major French banking groups are thus mutual and cooperative groups. Compared to Société Générale and BNP-Paribas, the French mutual banks entered into investment banking relatively late, with Banque Populaire (now part of the group BPCE) taking Natexis in 1999, and in 2006, merging it with the (now also part of BPCE) Caisse d'Épargne IXIS to form Natixis. In 2004, the Crédit Agricole set up its investment banking arm, Caylon. In the mid-2000's, French mutual banks were largely indistinguishable from the large

²⁹ The universal business model is well illustrated by Societe Generale: "we want to maintain our model's current balance in terms of geographic presence (about 75% of revenues generated in mature markets and 25% in fast-growing emerging markets) and business portfolio (about 60% of revenues and risk-weighted assets in Retail Banking activities, about 20% in Financing and Advisory activities, and limited to 20% in Global Markets activities)" (SocGen, AR, 2017, p10).

commercial banks in terms of the range of their operations (Bulbul et. al. 2013).

Figure 6: French banks' asset market share in domestic markets (in %, Dec 2016)



Sources: Banques de France, Moody's Banking Profile France, 2017

Other major banking institutions in France include:

- the publicly owned developmental bank Caisse des dépôts et consignations (CDC), which among other things invests in infrastructure projects, social housing and runs pension funds.
- Specialized investment banks (Lazard, Rothschild...)

French TBTF banks actively participate in the global trading system that modern finance has become. From this point of view, French banks are fully part of market-based banking finance. Yet, within France, this dimension is noticeable only to a small proportion of financial services' users, namely the big French NFCs and a few very rich families requiring complex wealth management products. As to SMEs and citizens', who use only the basic functions of banking (system of payment, deposits, loans, and simple savings' management), their relationship to their bank has not dramatically changed over the last 30 years. Proximity banking is still the rule: the proportion of agencies by inhabitant in France has remained among the very highest

in Europe and the world³⁰. Savers mostly use traditional products to manage their savings, borrowers mostly borrow traditional loans at fixed interest rates. Banks have also preserved their expertise in SME lending. A Private equity manager explained to me during an interview that he was trying to poach employees from French banks because of their skills in assessing SMEs credit risk, and he was complaining that banks were fighting hard to retain them (Interview, 03132014). Although there have been considerable changes in management practices – SMEs in particular complain about the increased turnover of their personal advisor (Interview CPME, 18012016) - the basic principles of bank-customer relationship characteristic of bank-based finance have been preserved.

State actors have always considered the development of trading finance in French banks as a good thing as long as this would not challenge the traditional functions of banking that they also expected from them. Today, the agreement seems to hold.

Yet, the most recent evolution in French banking may change this state of fact. Banks increased their use of the “originate-to-distribute” model, meaning that they sell loans instead of retaining them on their balance sheets. They sell them mostly to insurance and complementary retirement funds. As a financial analyst told me: “*At the beginning of the 2000s, we would ask: who is the most exposed to the debt of France Telecom? And we would find Société Générale and BNP. Now we find AXA or AG2R*” (Interview 04220215). This changes who would be affected – and would need to be bailed out- should a credit accident occur. New opportunities caused by the retreat of many other European banks from profitable markets, the accrued competition coming from US banks – as well as the (hubristic?) temptation of French managers to make their banks count on the global scene, could lead French banks to neglect capital-costly activities (such as SME lending) in favor of activities more likely to produce tradable assets (such as consumer credit). Revealingly, the level of debt held by French households has been steadily increasing in the past decade³¹. Customers

³⁰ International Monetary Fund, Financial Access Survey; available at <http://data.worldbank.org/indicator/FB.CBK.BRCH.P5?locations=FR-DE-GB>

³¹ The ration consumer debt to GDP increased from 68.66% to 89.47% between 2016 and 2016. Eurostat numbers available at Eurostat, <http://ec.europa.eu/eurostat/tgm/download.do?tab=table&plugin=1&language=en&pcode=tec00104>

have complained more often that banks were pushing credit on them³². French banks now seek to sell credit cards rather than debit cards (used to be reserved to wealthy customers)³³. Also, France has the highest banking fees in the EU, which increased 9% between 2013 and 2017, three times faster than inflation rate³⁴. French banks' clients are potentially losing the benefits of bank-based banking.

Another non-negligible weakness of the French banking system is the remaining exposure of retail banking to market banking. French banks claim that the interconnection between the two is a factor of stability, thus recognizing that the strength of the model lies in the intertwining of the two types of banking³⁵. If the market side of banking goes wrong, the retail side will call the cost – and along it, the public. This remains a huge threat for an already highly indebted French state - and while a single European fund is not to be set up in the foreseeable future.

2.6 The German bifurcated trajectory of finance

Deutsche Bank has maintained and even expanded their global market activities until 2014-5. Yet, contrary to its French counterparts, the Bank have lacked the support of the stable capital and revenues of their domestic markets. Indeed, local banks, both public and cooperative, have reinforced their incumbent position in domestic retail markets, including because they have remained protected from competition by law. Because global market finance and domestic retail banking are operated by two different sets of actors, the trajectory of German finance has been bifurcated.

³² For example, see the survey led by the Consumers defense organizations CLCC in 2016, available at <http://www.clcv.org/nos-enquetes/distribution-du-credit-sur-les-lieux-de-vente-la-loi-est-mal-respectee.html>

³³ See for example <https://banque.meilleurtaux.com/frais-bancaires/actualites/2018-juin/les-banques-incident-leur-clientele-a-privilegier-les-cartes-a-debit-differe.html>

³⁴ Survey realized by Consumers' group UFC Que Choisir in January 2018. Report available at CB Banque <https://www.cbanque.com/actu/66218/les-tarifs-bancaires-en-hausse-de-2,2-en-2018-selon-ufc-que-choisir>

³⁵ See Generation Libre (2016) and Finance Watch (2013) about the potential weaknesses of universal banking in France

Boxed Text 4: the German banking landscape

Germany's banking system is characterized by its three pillars. Banks are classified by BaFin, the German banking regulator, as 'Commercial' (184 banks), or belonging to either the public savings (426) or cooperative (1,083) bank sector.

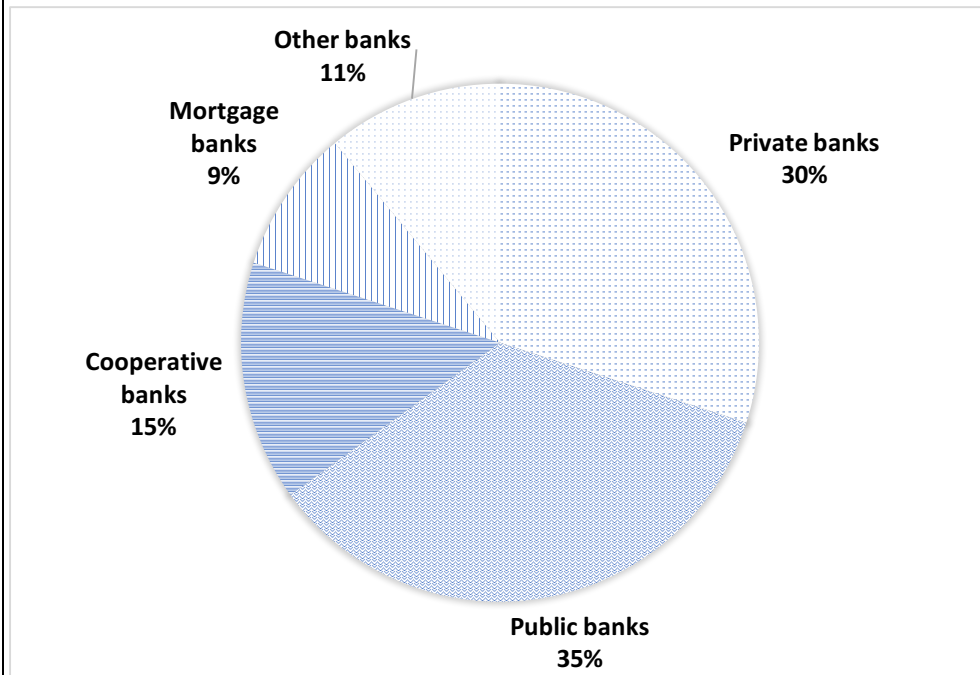
1- Commercial banks: These include larger banks providing retail, corporate and investment banking services (Mainly Deutsche Bank and Commerzbank), as well as small private banks and foreign banks with relatively limited operations.

2- Public sector banks: These include *Sparkassen* (savings banks), which fund regional economic development and provide retail and SMEs relationship banking services (*hausbanking*); and *Landesbanken* (state banks), which offer various financial services, including wholesale funding, investment banking, and cross border business facilities. *Sparkassen* are municipally owned and operate within their own region. They are members of a broad financial group (*Sparkassen-Finanzgruppe*) within which they cooperate closely with each other. *Landesbanken* are mostly jointly owned by state governments and savings banks and act as regional banks, central banks and clearing house for the savings banks. There are more than 400 Sparkassen and seven Landesbanken in 2017 (there were nine Landesbanken in 2011).

3- Cooperative banks: These include cooperative banks owned by members who are, in turn, both depositors and/or borrowers. Generally, such banks operate regionally, mainly to support their members. In addition, co-operative banks also provide banking services to the general public.

There has been regulatory convergence between the three pillars between the 1980s and early 2000s: financial activities have been de-segmentalized and banks of the three pillars could start competing on all segments of financial services. Interest rates have also been deregulated in 1981. Finally, 2005 has seen the end of public guarantees for Landesbanken. Yet, public banks still have regulatory specificities. First, they have specific public interest missions and have the legal obligation to meet the financial needs of the region's non-financial corporations. They are also bound by the regional principle (*Regionalprinzip*), which means that Sparkassen don't compete with each other. Finally, private banks are not allowed to take them over. Despite the repeated attacks of the EU Commission, this regulatory protection still holds today.

Figure 7: Loans Market Shares in Germany, by type of banks (in %, in Dec 2016)



Sources: Deutsche Bundesbank, Moody's Banking Profile Germany, 2017

The cooperative and public-sector banks dominate the German banks' market share. They also dominate lending to domestic households (54%) and collect more than half (53%) of household deposits in Germany (Choulet, 2016, p7).

Other financial institutions in Germany include:

Mortgage banks, which typically specialize in public sector and retail or commercial property lending.

Special-purpose banks, which are assigned specific responsibilities and operate in both the public and private sectors (both centrally and regionally), as well as development banks, which are owned and often guaranteed either by the local government or by the central government and pursue a public policy mandate.

Before the crisis, the Sparkassen and cooperative banks had remained centered on their traditional banking activities of taking deposits and making loans for firms and customers in their communities (Schackmann-Fallis, 2008; Schackmann-Fallis, 2011). From 1995 to 2008, the part of non-inter-banking loans in the Sparkassen had remained very stable at around 70% of their total assets

(Brämer et. al., 2011). These banks have proved particularly resilient before, during and after the financial crisis (Schmidt et al. 2014).

Inversely, the larger Landesbanken had launched themselves in market-based banking in the decade leading to the financial crisis (Hardi and Howarth 2009, 2013). In 2005, the Landesbanken lost their state guarantees, which had allowed them to borrow at cheaper rates than their commercial rivals. They started facing accrued competition from private and cooperative banks, along with shrinking profitability. They started seeking new revenues sources, investing more in the capital markets, via investment vehicles that required little capital³⁶. They became quickly and extremely exposed to toxic US securities... and to the subprime crisis.

The explicit objective of the Landesbanken is to be able to provide the Mittelstand, largely composed of export-oriented large SMEs, with the wholesale loans and market services that they need (and which are beyond the reach of Sparkassen). Yet, since the crisis, they have closed many of their international offices and market segments to refocus on their clients' more traditional needs. Their funding structure has become more conservative, with less funding from foreign banks and the capital market, and more on private sector deposits. Public sector banks turned back to their traditional banking business lines and renewed their commitment to the Mittelstand and hausbank banking that many small local banks had never stopped doing.

The reinforcement of local banks' domination in domestic retail markets has caused difficulty for commercial banks, depriving them from much-needed resources. BMI's financial analysts write: "*the lack of reform of the public-sector pillar of Germany's banking sector model keeps poorly administered financial institutions alive at the expense of growth and profitability of the private sector pillar*" (BMI, Germany, 2016, p9)³⁷. In addition to the Mittelstand's loyalty to local banks, Deutsche Bank must also face competition from French banks that have become very aggressive to get German market shares. They plan on winning over the Mittelstand not connected to local banks but those connected to Commerzbank and Deutsche Bank,³⁸

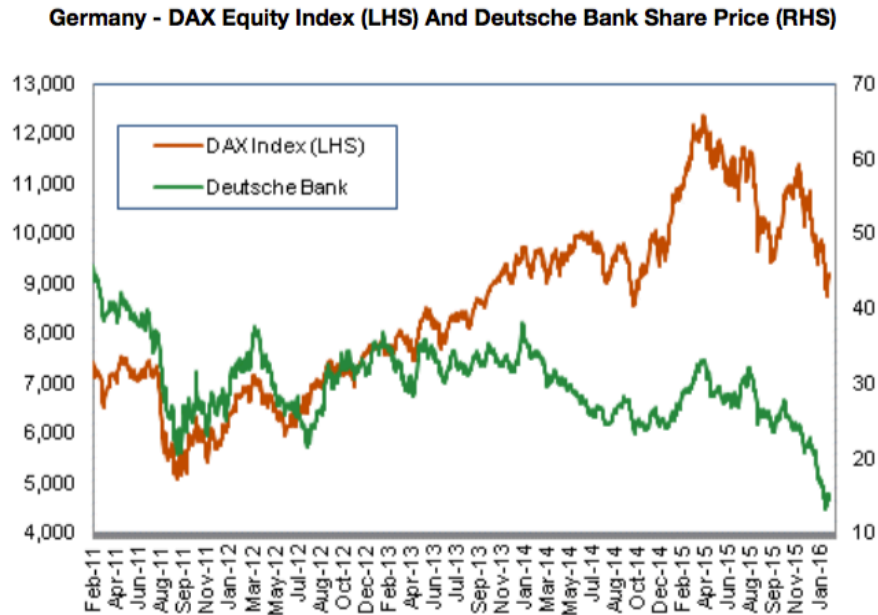
³⁶ See Financial Times, "Germany's banks face obstacles to consolidation", 26 August 2007, available at <https://www.ft.com/content/763879ae-53f2-11dc-9a6e-0000779fd2ac>

³⁷ Rating agencies and banks often criticize the lack of profitability of local German banks and their politicized management. See also Choulet (2016)

³⁸ Reuters, 19 March 2014, "French banks challenge local loyalty of Germany's Mittelstand"

The health of Deutsche Bank has been unnerving investors since 2014. The Bank's share price has plummeted. Investors' concerns about the bank's ability to meet interest repayments resulted in German Finance Minister Wolfgang Schauble taking the unprecedented step of publically affirming his confidence in the stability of the bank.

Figure 8: Deutsche Bank Share Price (Feb 2011 – Jan 2016) vs DAX³⁹



Source: reproduced from BMI Germany 2016, p14

Deutsche Bank is a problem for Germany. The Bank is structurally too flawed to continue growing in a sustainable way. If Deutsche Bank finally renounces to its role as a global investment banking leader, Germany may well definitely leave the game of global market-based banking⁴⁰. It is still too big to fail and remains an immense threat on German public finance.

³⁹ DAX is a stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange

⁴⁰ At the time of writing, there are paradoxical signals about Deutsche Bank strategy in the near future. The recent change in leadership (in May 2018), financial analysts tend to believe that Deutsche Bank is about to leave the global investment banking scene. See for example The Economist, 13 May 2018, "European Universal Banks can Succeed. But can Deutsche Bank?".

The future of German market-based banking is not clear. But German bank-based finance seems back on track – to the satisfaction of local SMEs. In 2012, when in most European countries, SMEs listed “access to finance” (as opposed to other factors such as ‘finding customers, ‘competition or ‘costs of production’...) as their most pressing problem, only 10% of German SMEs mentioned the issue (ECB, SMEs Survey, 2012, p14). In 2017, when it became a less pressing problem across Europe, German firms were still the least concerned (EBC, SMEs Survey, 2017, p10).

When asked where a fictional stateless SME should settle, the EU representative for SMEs (UEA-PME) answered: “*if you are not high tech, go to Germany! It is much easier to finance traditional companies by bank lending. They have hausbanking there. I would have told you the same thing in the 1990’s...*” (Interview UEA-PME, 05292015). Public and private delegations from Bolivia, Ecuador and Mexico have been flocking to the savings banks’ representative association DSGV (Deutsche Sparkassen- und Giroverband) seeking to find out more about the success of German savings banks. In the UK, think tanks and MPs from various parties have used the German model to argue for the development of a similar network of retail banks (Choulet 2016).

There are downsides to the German bank-based banking too. Local banks suffer from a chronic lack of profitability. Sparkassen rely on customer deposits for funding, so they are generally unwilling to lower interest rates on deposits⁴¹ despite ECB rate cuts, for fear of triggering deposit flight (and thus losing a key funding source). The competition in the sector means that the banks are also unwilling to increase interest rates for borrowers, which is squeezing bank profits. This argument is often advanced by the critics of German public banking. It is true that these banks need profitability because they can only strengthen their equity through the incorporation of profits as reserves (they can’t raise funds by issuing shares). But beyond that, are low levels of profitability really a problem? The objective of these banks is not to maximize profits. As long as they are able to promote the economic activities of their members or community, one can conclude that they do indeed fulfill their mission.

⁴¹ Note that contrary to France and the UK, simple banking deposits are remunerated in Germany.

A more serious threat to the German public banking sector comes from the Landesbanken, which are part of the public-sector banks' rescue system and remain accident prone. The rescue system *"doesn't work, because Sparkassen are not in the position to be able to truly take care of a Landesbank if it fails,"* said Gerhard Schick, a Bundestag member for the Green party and one of the few German politicians who criticize the savings banks⁴². The sustainability of German public-sector banks thus to a large extent depends on the capacity of Landesbanken to turn back to safer business model.

2.7 The British offshore trajectory of finance

The downsizing tendency has been clear and general among British banks. All British banks have shrunk in size, scaled back their international and/or market operations. At home, despite the explicit will of the British government to promote traditional banking, banks have had difficulties to develop traditional banking activities to which they are not used and for which the structures of the British political economy are not necessarily friendly. On the other side, London continues to provide major and effective market infrastructures for global players, becoming primarily an offshore financial center.

Boxed text 5: The British Banking landscape

There is no definition of a 'bank' in the Financial Services and Markets Act of 2000. However, dependent upon the country in which they are incorporated, UK banks are grouped into one of three categories, as follows:

- Banks incorporated in the UK – This category contains banks whose head office is situated in the UK, and includes the major 'high street' banks (RBS, Lloyds, Barclays, HSBC), and subsidiaries of foreign institutions (for example Santander UK).
- Banks incorporated in the EEA – This category includes banks whose head office is located in an EEA member state. These banks are entitled

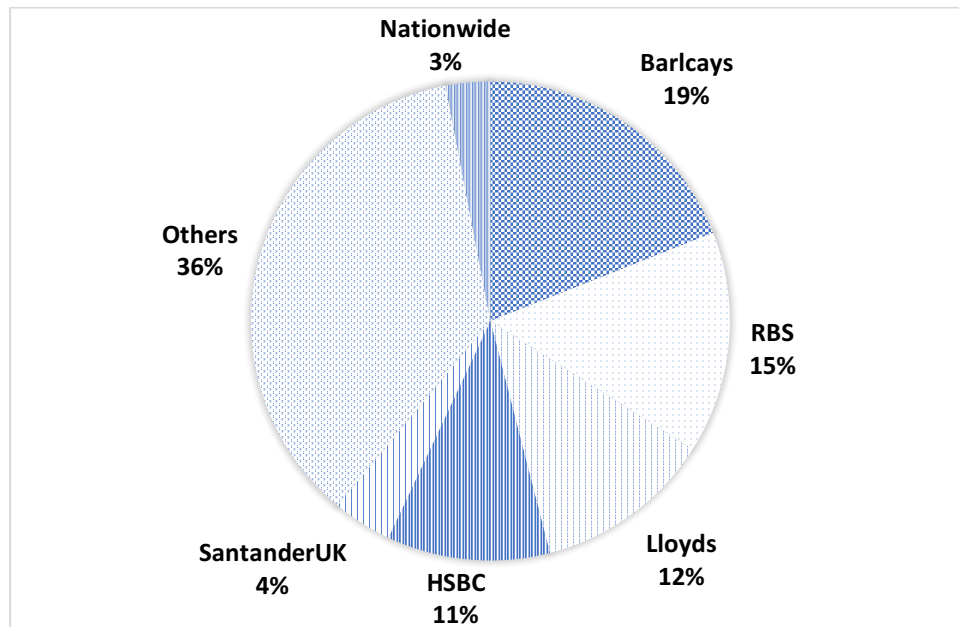
⁴² The Wall Street Journal, "German Savings Banks Flex Political Muscle", 12 November 2013.

to conduct all banking activities in the UK.

- Banks incorporated outside the EEA – This category consists of banks registered in a country outside the EEA. These banks may provide banking services through a branch in the UK, provided the whole firm has been authorized by the PRA.

- Building societies are established to provide loans secured on residential property. These loans are mainly financed from members’ savings. Nationwide is the country’s only large building society remaining.

Figure 9: British banks’ asset Market Share (in % Dec 2014)



Source: Bank of England and Moody’s Investors Service

British authorities have sought to put pressure on high street banks in order for them to get back to the simpler banking function of “taking deposits and making loans” banking. Their priority has been, in particular, regarding SME lending. As of now, their attempts have not been successful. British banks, which staff are mostly used to market-based banking, lack the willingness and the expertise to turn back to traditional banking. During an interview, a British private equity manager was complaining about a shortage of staff with expertise in SME lending among British banks. He had to turn to foreign countries

to find competent employees (Interview 06062016). While turning back to their domestic markets, banks have focused on developing activities susceptible to produce tradable assets (like consumer credit and credit card businesses) rather than SME lending. Lord Eatwell, who was leader of the opposition in the debates on Banking reform and Financial Services Act in the House of Lords, and is also an advisor to Palamon Capital Partner said in interview: “*British banks have niches, like credit card companies, niche financial services*” (Interview 06022016).

It is a persistent problem in the UK: there is a lack of satisfactory system for financing SMEs. A British banker confirmed: “*In terms of business model, what is the incentive to lend to SMEs?*”, and he continued that the only way to have the banks do that was to subsidize them (interview 7192016). Consequently, British small businesses are the most dissatisfied with banking in Europe (FSB 2012).

Other retail customers are not very happy either with British banks. In a low competitive environment, the FCA reported that many consumers go to their current bank rather than shopping around when looking for other financial products.⁴³ They were charged higher fees than in other European countries, for relatively poor services. Overdraft fees in particular are extremely high in the UK, where one in 10 customers generate between a third and a half of all profits from British banks’ current accounts. In 2016, a Financial Times survey found that clients of ‘challenger banks’ in the UK are likely to be happier with the service they receive than those that use the biggest high street lenders⁴⁴.

Since the crisis, small businesses and the government have believed that the creation of challenger banks and community banks is the answer. For example, Business Secretary Vince Cable claimed that “*The gradual decline in relationship banking needs to be reversed. Part of the answer may lie in the new challenger banks - like Handelsbanken - but another key element may be more community lending, through Community Development Finance Institutions (CDFIs) and credit unions. The government is encouraging them, through a new £60m fund to help finance CDFIs and a tax relief on this form of lending (...)*”⁴⁵.

But is it possible for local, cooperative or community banks to

⁴³ Reuters, 27 June 2018 available at <https://uk.reuters.com/article/uk-britain-banks-regulator/high-fees-make-up-bulk-of-uk-banks-retail-account-profits-watchdog-says-idUKKBN1JN13I>

⁴⁴ Financial Times, 11 January 2016, “Small businesses prefer challenger banks” available at <https://www.ft.com/content/71c17f0e-b782-11e5-bf7e-8a339b6f2164>

⁴⁵ Vince Cable, Speech delivered at Which? 26 July 2011.

thrive in the UK? Benefitting from an abundant source of stable deposits is *a sine qua non* condition to relationship banking. For example, Germans hold a high proportion of their savings in bank accounts. By contrast, British households invest their savings primarily in pension plans or real estate investments. Bank deposits represented 37% of the financial assets of German households in September 2015, compared to 23% in the UK (Choulet 2016). Fostering a solid and lively network of local banks in the UK would require structural and cultural changes that even an important political involvement may not be able to trigger.

British banks are not good at bank-based finance while at the same time it has become difficult for them to expand their market-based banking dimension. The UK is in a paradoxical situation of being a global financial center in which British actors have been marginalized. The UK has indeed in parallel continued its effort to develop infrastructures for global finance. As noted by BMI (2017), "*the City of London's infrastructure in terms of both physical and human capital means it maintains its vital role in the global financial industry*". The impact of Brexit on the City of London and the country's financial services sector as a whole is likely to be meaningful. Finance firms in the UK rely heavily on the passporting to do business on the continent, and vice versa, but this is under threat from Britain's impending departure from the European Single Market, to which the passport is closely tied. As the German financial regulator Andreas Dombret said: "*The current model of using London as a gateway to Europe is likely to end.*"⁴⁶ Also, the European Central Bank has tried unsuccessfully to ban the clearing and settlement of euro-transacted deals in the UK, in part because the European courts have respected the importance of equal treatment for all countries in the EU internal market. This may change post-Brexit. At the time of writing, the conditions of Brexit are not set and it is too early to know what impact it will have on the UK's political economy.

Troubled times may lie ahead, as the UK depends more on foreign institutions and investment but lacks the skills in bank-based finance that may help it re-invigorate the non-financial sectors of its economy. It would require a lot of political will from the British government to change its "*somewhat anomalous position as a large*

⁴⁶ UK Business Insider, 22 February 2017, available at <http://uk.businessinsider.com/brexit-government-support-industries-ranked-high-priority-low-leaked-document-2017-2?IR=T>

*offshore banking center with a medium sized country attached*⁴⁷.

2.8 Conclusion

Ten years after the crisis though, we can observe that financial systems have not converged towards a single European model of finance. In France, bank-based and market-based banking finance have grown in the heart of the largest universal banks - the French trajectory of finance is universalist. The intertwining of market and traditional banking may eventually have dire consequences for captive retail customers and taxpayers who remain, in the end, responsible for bailing out their massive universal banks. In Germany, public and cooperative local banks have largely turned back to traditional bank-based finance, while the largest commercial bank Deutsche Bank has sought to develop its market-based banking model – the German trajectory of finance is bifurcated. The future of German market-based banking appears gloomy, but bank-based banking has rather been bolstered after the crisis, to the satisfaction of local banks’ traditional clients. In the UK, British banks have downsized their market-based banking activities, but they have failed to foster traditional banking activities. London has continued to offer the market infrastructures necessary for market-based banking activities of foreign financial institutions operating from London – The British trajectory of finance has been offshore. With Brexit, troubled times may lie ahead, as the UK depends more on exit-prone foreign institutions, but lacks the skills in bank-based finance that may help it re-invigorate the non-financial sectors of its economy.

⁴⁷ Vince Cable, Speech delivered at Which? 26 July 2011, speech available at <http://www.vincecable.org/speeches.html>

CHAPTER 3

Regulating Banking after the Crisis: The Different Priorities of European States Towards their Largest Domestic Banks

This chapter examines the different priorities of states towards large banks after the crisis, as observed through banking policies passed and enforced at the national level between 2008 and 2016. The chapter demonstrates that the substance of policies is quite consistent across different policy areas within each country, revealing national patterns in the influence of the state towards finance.

3.1 Regulating TBTF banks: theoretical perspectives

US Federal Reserve Chair Ben Bernanke defined the term “Too-big-to-fail” in 2010: “A *too-big-to-fail firm is one whose size, complexity, interconnectedness, and critical functions are such that, should the firm go unexpectedly into liquidation, the rest of the financial system and the economy would face severe adverse consequences.*” He continued that: “*Governments provide support to too-big-to-fail firms in a crisis not out of favoritism or particular concern for the management, owners, or creditors of the firm, but because they recognize that the consequences for the broader economy of allowing a disorderly failure greatly outweigh the costs of avoiding the failure in some way... If the crisis has a single lesson, it is that the too-big-to-fail problem must be solved*” (Bernanke, 2010).

After the crisis, there was an effort to theorize the too-big-to-fail phenomenon. The Financial Stability Board⁴⁸ coined the name: “systematically important financial institutions” (SIFIs). According to the FSB, SIFIs are financial institutions “*whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity*”. The notion of systemic risk is central in this notion. It refers to the potential damage one institution’s failure can create for the financial system or the economy as a whole, for example, through “*spillover effects leading to widespread depositors runs, impairment of public confidence in the broader financial system, or serious disruptions in domestic and international and settlement systems*” (Moyer and Lamy 1992, p21). It is not merely about the size of an institution, but about the size of the damage induced

⁴⁸ The FSB was created in 2009 and is an international body that coordinate national financial authorities and international standard-setting bodies and that monitors and makes recommendations about the global financial system.

by its failure to the rest of the economy. Every year since 2011, the FSB publishes the list of Globally Systematically Important Banks. It ranks these banks in different brackets according to criteria of size, global interconnectedness and complexity.

There is certainly no easy way to deal with TBTF banks. The prescriptions to regulate them build on the identification of what the main problem with TBTF is and on the theoretical assumptions made by the prescribing person.

Identifying what the main issues with TBTF banks are

Moral hazard

Moral hazard refers to the undesirable side effect of insurance: one who knows that the costs of their actions will be borne by somebody else will have greater tendency to engage in risky behavior. For large institutions, their failure could damage the entire economy. The failure of big institutions can trigger a crisis of confidence and lead to contagion throughout the banking sector. The banking sector is in turn essential to the whole economy. In case of difficulties, governments will extend credit to such institutions when everybody else is no longer willing to do so. They can do it through guarantees, capitalization, or by giving their central banks the mandate to act as lender of last resort. Banks thus engage in risky behavior, knowing that they will not have to carry the full costs in case of failure. This leads to the “privatization of profits and socialization of costs”: reaping private profits made out of risky financial practices, and transferring the costs of failure to the public safety net, or the taxpayer. Moral hazard is thus a major perverse incentive for banks to engage in risky behaviors.

Implicit public subsidies to large banks

The implicit public subsidies of TBTF banks refer to their lower funding costs due to the state guarantee from which investors know they would benefit in case of difficulties (Baker and McArthur 2009). Rating agencies explicitly take the subsidies into account when grading the banks (which grades in turn affect the funding costs of these banks). They differentiate in their analysis between the intrinsic solvability of a bank (“stand-alone rating”) and the indirect support of the state (“support rating”). Implicit subsidies improve rating from 1.5 to 4 points. Consequently, banks are willing to pay an added premium for mergers that will put them over the asset sizes that are commonly viewed as the thresholds for being too big to fail (Brewer and Jagtiani

2013). Implicit subsidies also skew market competition: better graded banks can endeavor riskier behaviors at lower costs, which in turn affects their returns and consolidates their incumbent advantage.

“Too Big To jail”

TBTF banks adopt riskier behavior because they won't bear the costs of failure and they do it for cheaper. Another problem with TBTF banks that has been identified is that they won't bear the costs of penal or criminal misbehavior. On March 6, 2013, United States Attorney General Eric Holder testified to the Senate Judiciary Committee that the size of large financial institutions has made it difficult for the Justice Department to bring criminal charges when they are suspected of crimes, because such charges can threaten the existence of a bank and therefore their interconnectedness may endanger the national or global economy. In addition, some authors have pointed to the fact that these banks are simply so big that it may be impossible to trace penal responsibility for taking solvency risk (Luyendijk 2015).

Dealing with TBTF banks: theoretical perspectives

Although there is a relative consensus about the major problems with TBTF banks identified in the previous section, there are different theoretical perspectives as to what cause these problems (What is wrong?) and how to deal with them (What is the solution?).

Market orthodoxy perspective

What is wrong? Bad regulatory incentives and the intervention of government skew the laws of markets (Campbell 2010).

What is the solution? Market discipline is the most reliable guarantee against moral hazard and implicit public subsidies. A solution to the TBTF problem would thus be to revert to a completely private and competitive sector, with no regulation and no central bank in charge of issuing currency and acting as a lender of last resort (Hayek, 1990). The “free banking” era, as in pre WW1 United States, constitutes a model from this point of view (Rockoff 1974; Rolnick and Weber 1983). As noted by Woll (2014), a completely “free” banking sector may be an interesting thought experiment but it is not actually doable. Very few academics and politicians actually champion this option.

Structural perspective

What is wrong? The problem lies in the structure of universal banking: their risky, volatile and highly profitable operations are backed by their traditional, stable and ‘public-service’ oriented banking operations⁴⁹. The *de facto* solidarity between these different types of activities are causing the problems identified in TBTF banks.

What is the solution? The prescription is simple: breaking up banks. Public interest lobbying organizations, such as Finance Watch or Better Markets, consumers’ protection organizations, as well as some left-wing as well as pro-market politicians, and think tanks are in favor of this option.

Regulatory perspective

What is wrong? Inappropriate regulation or the lack thereof has created bad incentives in banking (Stiglitz 2010).

What is the solution? Re-design regulation to create better incentives for banks. For example, higher capital requirements make the costs of risk higher and proportional to systemic importance, they compensate the advantage of implicit subsidies. Also, bail-in resolution procedures make banks’ own capital, shareholders and creditors contribute to the resolution of the firm, establishing a wind-down plan of contributions to safety funds that would finance emergency interventions.

Cultural/ethical perspective

What is wrong? The individual behavior of a minority of “bad apple” bankers have caused damage to otherwise well-functioning markets. The banking culture that has allowed these bankers to prosper is wrong.

What is the solution? The culture of banking needs to change. In order to do that, banks need to establish new codes of conduct, and business schools need to introduce courses on ethics in banking.

⁴⁹ Richard Fisher and Harvey Rosenblum, in the Wall Street Journal (op-ed), “How Huge Banks Threaten the Economy”, 4 April 2012.

3.2 Major regulation at the international level aimed at tackling the “Too Big To Fail” problem

There has been a little bit of all these perspectives in post-crisis regulation. Yet, at the international level at least, the most successful has been the regulatory perspective. Structural reforms have been discussed, but to a large extent abandoned (with the partial exception of the UK – as will be discussed in chapter 5).

Banks are affected by regulations adopted at different levels. Global institutions such as the G20, the Financial Stability Board (FSB), the International Organizations of Securities Commission (IOSCO) and the Basel Committee on Bank Supervision (BCBS) are regulatory arena where national regulators agree on common standards for regulation (for a discussion of the role of international regulators, see for example Rottier and Veron 2010). The European Union adopts directives, which require member states to achieve a particular result but leave to the member states important leeway in the implementation to reach that result. Some policies examined in the rest of this chapter are different implementations by member states of an EU directive⁵⁰. The project of European Banking Union also affects European banks. Finally, because global European banks operate in the US through their foreign branches or subsidiaries, they are impacted by banking reforms implemented in this country. The next section offers a quick insight of the major pieces of regulation taken up at the international level or regulation adopted in the US that would affect global European banks operating in this jurisdiction.

3.2.1 Reinforcing Capital ratio Requirements

A major problem identified during the financial crisis in 2007-2008 was that banks did not hold enough equity capital to absorb unexpected losses in conditions of extraordinary stress. For example, the unwillingness of counter-parties to extend credit to Lehman Brothers or Bear Stearns (which eventually led to their respective bankruptcies) was due to fear that these banks were inadequately capitalized to sustain losses from the mortgage-related investments they owned. In the aftermath of the crisis, one of the top-priorities of the G20 leaders was thus to improve capital requirements for banks.

⁵⁰ Directives must be distinguished from regulations, which are self-executing and do not require any implementing measures.

The G20's April 2, 2009 Declaration on the Strengthening of the Financial System called for internationally consistent efforts aimed at improving the quantity and quality of capital in the banking system⁵¹.

In 2010, the members of the Basel Committee on Banking Supervision, an organization comprising the biggest world economies' central bankers, agreed to double the capital ratio requirement for banks. In other words, they committed to double the amount of shareholder equity that banks are required to hold for a given amount of assets, adjusted for how risky these assets are. This means that the bigger the bank is and the riskier its assets are, the bigger the amount of "safe capital" – mostly in the form of common equity- it needs to hold. The Third Basel Accord – commonly named Basel III - was scheduled to be introduced internationally from 2013 to 2015. In the European Union (EU), Basel III was implemented through the Capital Requirements Directive IV (CRD IV) in 2013. The objective of "Basel III" is to strengthen the resilience of banks and the stability of the financial system. The key points of the legislation include: the increase in quantity and quality of banks' capital requirements; a more accurate definition and stricter limit of banks' leverage ratio; and higher liquidity requirements.

Under Basel III, total bank capital must increase to at least 10 per cent of risk-weighted assets by 2019. Basel III also requires that at least 75 per cent of bank capital be high-quality "Tier 1" capital. It introduces new additional capital buffers, including a 'capital conservation buffer' of 2.5 per cent and a further counter- cyclical capital buffer of up to 2.5 per cent, the latter to be used in periods of 'excessive aggregate credit growth'. This means that total required bank capital could be as high as 13 per cent, rising to 15 per cent in 2019.

Reinforcing banks' capital ratio requirements is arguably the most significant piece of regulation adopted at the international level after the crisis. It has far-reaching potential effects on how banks are doing business. It is also very important in that, although with different scale and enforcement, the reform of the capital ratio requirement has been implemented throughout the world. Nevertheless, as it will be developed in the next section, differences in the degree of enforcement of capital ratio requirements across jurisdictions remain.

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http://www.fsb.org/wp-content/uploads/london_summit_declaration_on_str_financial_system.pdf

3.2.2 *The European Banking Union*

The ambitious tasks of “breaking the vicious circle between banks and sovereigns” (Euro-Area Summit, June 2012) and the potential impact of the European Banking Union for the argument developed in this dissertation will be discussed in more details in the conclusion (Chapter 7). In this section, I briefly present the three so-called “pillars” of the banking union—1) The Single Supervision Mechanism (SSM); 2) the Single Resolution Mechanism (SRM) and 3) the European Deposit Insurance Scheme (EDIS)⁵².

The Single Supervision mechanism (SSM) transfers the supervision of largest banks to the European Central Bank (ECB), so that banks can no longer benefit from the soft spot of their national supervisors. It has been operational since 2014. Under the SSM, banks are categorized as ‘significant’ or ‘less significant’. Smaller banks remain under the supervision of their national supervisory authorities.

The Single Resolution Mechanism (SRM) sets out rules for the ‘bail-in’ of struggling and failing banks that enable authorities to recapitalize a failing bank by writing-down liabilities and/or converting them to equity with the aim of continuing a bank as a going concern, decreasing financial system instability and giving authorities the opportunity to reorganize the bank or resolve it. It also creates a European single resolution fund so that bailing-out banks no longer rest on the shoulder of national taxpayers. It has been operational since 2016. It shall reach the target level of at least 1% of the amount of covered deposits of all credit institutions within the Banking Union by 31 December 2023. In July 2017, the fund reached €17bn.

The European Deposits Insurance Scheme (EDIS) aims at ensuring that all EU banking deposits up to €100,000 are protected by public European guarantees. EDIS is still discussed at the time of writing and there is no sign of it being implemented in the near future.

Membership to the European banking Union is automatic for Euro area countries. Countries that are not members may join on a voluntary basis. The UK had opted out before it decided to leave the EU in 2016.

3.2.3 *US regulatory extra-territoriality*

European banks’ US activities and operations are subject to

⁵² For further discussion of the European Banking Union, see among others Howarth and Quaglia 2014, 2016; Véron 2013, 2015; Hellwig 2014; Spendzharova 2014

umbrella supervision by the Board of Governors of the Federal Reserve System (FRB), as well as additional supervision, requirements and restrictions imposed by other federal and state regulators. The main post-crisis financial reforms are the Dodd Frank Wall Street Reform and the Consumer Protection Act of 2010 (For studies of these reforms, see among others Wilmarth 2010; Coffee 2011; Skeel 2010; Kastner 2016). But in some cases, US requirements may impose restrictions on banks' global activities, such as OTC derivatives trading, by way of extraterritoriality, meaning the enforcement of US rules beyond the US jurisdiction. Dodd-Frank acts repeatedly indicates that it is to apply extraterritoriality⁵³ (Coffee 2014, p1261)⁵⁴.

3.3 Summary presentation of banking policies in France, Germany and the UK

States have actively sought to influence the evolution of their large domestic banks after the crisis. They have done so through passing different banking policies or enforcing international rules differently. Comparing banking policies across countries allows us to observe different state's priorities in terms of banking. In this section, I present 12 cases of financial reform in France, Germany and the UK in order to achieve a meaningful comparison across these countries. I have analyzed these policies from the perspective of whether they tend to hinder/permit/enhance the expansion of TBTF banks at home or abroad, regarding retail and trading activities. There are four categories of policies, based on what the policy aimed at regulating in banking: systemic risk, competition, governance and market activities. State's priorities as observed through national banking policies are consistent with the empirical trajectories of finance described in Chapter 2.

In France, banking policies reveal that the priorities of the state have been to allow for the further expansion of large French banks, both globally and at home, and concerning all the segments of (market and traditional) banking. In Germany, banking policies reveal that the priorities of the state have been to permit the expansion of domestic commercial banks globally, but they also reveal that the priority at

⁵³ US Congress has been very attached to extraterritoriality after the debacle of AG that US taxpayers were exposed to the activities of the subsidiaries of US global groups.

⁵⁴ For a discussion of the politics of extraterritoriality in Dodd-Frak Act, see Painter 2011, Baquizal 2010.

home has been to preserve the turf of local non-commercial banks. In the UK, banking policies reveal that the priorities of the state have been to shrink large domestic banks, both globally and at home.

Table 9: Sum-up of each piece of regulation in the three countries, categorized by type.

	France	Germany	UK
Systemic risk	Regulation a minima	Regulation a minima	Relatively constraining regulation
Banking structural reform	Unambitious and low-impact law on banking separation	Unambitious and low-impact law on banking separation	Relatively ambitious and high-impact ring-fencing law
Capital Ratio Requirements	Strict compliance with Basel III recommendations – lenience in the use of risk-weighted asset models	Strict compliance with Basel III recommendations – lenience in the use of risk-weighted asset models	More stringent compliance with Basel III recommendations – strict stance on the use of risk-weighted asset models
Competition	Cosmetic measures unchallenging of incumbents	Strong protection of local-public sector banks	Active promotion of competition in banking
Promotion of challenger banks	No promotion of challenger banks	Nothing done to reduce formal protection from competition of public-sector banks	Pro-active promotion of challenger banks
Competition in payment services	Low-impact reforms to reduce obstacles to competition (facilitate switching accounts)	Low-impact reforms to reduce obstacles to competition (facilitate switching accounts)	Proactive stance to promote competition (high street banks required to put cash into a fund to help customers switching accounts to challenger banks)
Consumer and SMEs data sharing	No implementation of national credit register	No implementation of national credit register and opposition to data	High street banks required to declare individual loans' information to

		sharing with ECB for local banks	private agencies, which make this info available to all credit providers
Competition in alternative finance	P2P platforms no longer need a banking license	P2P platforms still need a banking license	Active promotion of P2P (tax breaks and easy licensing)
Governance	No significant reform	Ambitious legal accountability reform, beyond that no significant reform	Loose enforcement of moderately ambitious reform
Executives legal accountability	No reform	Specify criminal action in cases of severe breaches of duty; burden of proof	Stricter managers' regime; burden of proof abandoned
Banking levies	Designed to raise funds without penalizing large banks	Designed to avoid penalizing 'stable' banks	Designed to change risk behavior in large banks, but watered down
Salaries and bonuses	Regulation a minima and loose enforcement	Regulation a minima and loose enforcement	Slightly stricter regulation but loose enforcement
Market activities	No measures aimed at hindering market activities	Cautiously restrictive regulation	No measures aimed at hindering market activities
Hedge Funds	No reform beyond MiFid	Institutional investors are prohibited to deal with hedge funds	No reform beyond MiFid
HFT	Cosmetic measures on transparency Tax on HFT	Strict measures on transparency Hard restriction on some HFT activities	Cosmetic measures on transparency
Derivatives	No reform beyond MiFid	Attempt to ban or restrict certain operations on derivatives, but partial failure	No reform beyond MiFid
States' priorities as observed through policies	Expand large banks at home and globally	Expand large banks globally and protect local banks at home	Downsize large banks globally and at home

The next section presents each of these policies in more details.

3.4 Regulating Systemic risks

Regulating systemic risk is the most important task undertaken to reform TBTF banks after the crisis. Systemic risks regulations' purpose is to tackle major problems in banking such as excessive risk taking and leveraging, moral hazard and implicit subsidies. This type of regulation may affect the structure of banks' balance sheet (on the sides of assets and liabilities), and has the potential capacity to affect banks' business models considerably.

More stringent policies addressing systemic risk may limit the expansion of large banks, especially regarding their riskier global trading activities.

The analysis of the regulation of systemic risk consists of two pieces of regulation: the banking structural reform and the strengthening of banks' capital ratio requirements.

3.4.1 Banking structural reform (BSR)⁵⁵

The important overall issue of functional separation between retail and trading activities for the banks lies in the extent to which the deposit-taking bank is prevented from supporting the trading bank during its operations. A lack of support from the deposit-taking bank would increase the financing costs of the trading bank, limiting its profitability. This might result in the larger universal banks scaling back their trading operations – opening the door to foreign trading institutions. This is why BSR has been a major regulatory stake for banks and policymakers after the crisis.

The need to limit the exposure of retail banking to trading activities was a central theme of the G20 Pittsburgh summit (G20 2009). What followed was a host of Banking Structural Reform (BSR) projects and recommendations: the Volcker rule in the US; the Vickers Commission proposals in the UK (Vickers 2011); and then the EU's Liikanen Report (Liikanen 2012) and EU Commission proposals in 2014. Yet, the three biggest European countries anticipated on the EU project of directive and implemented their own BSR. Arguably, the French and German “national authorities were using their [own] reforms to protect the status quo” and the trading activities of their champions (Hardie and Macartney 2016, p504).

⁵⁵ The policymaking processes leading to the BSR in France, Germany and the UK are the object of a detailed case study analysis in Chapter 5

The French and German versions are extremely weak – de facto, they do not entail a separation of investment and retail banking. The French Law on the Separation and Regulation of Banking Activities (*la loi de séparation et de régulation des activités bancaires*) separated out banks' proprietary 'speculative' activities -that is market operations operated in the account of the bank itself. The law thus sought to distinguish these proprietary trading activities 'from those activities that are considered useful to financing the economy', by incorporating a series of exemptions focused on market-making activities (AMF 2013). This concretely means that the proposals were not focused on market-based trading activities in general, as Liikanen and the Commission proposals were, but rather on a minor part of these activities. As a matter of fact, it is extremely difficult to distinguish proprietary trading from other market operations (done in the account of the bank's clients) and straightforward proprietary trading represented only 1 to 4% of the bank's activities. In the words of Hardie and Macartney: "*the law was deliberately intended to protect the domestic banking system, clearly weaker than the EU proposals, and involved minimal threat to the strengths of French universal banks*" (Howarth and Macartney 2016, p511).

The German draft bill (*Entwurf eines Gesetzes zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen*) also deviated quite dramatically from the Liikanen recommendations. The German government established thresholds above which proprietary speculative trading would have to be separated out. First, this is consistent with the German aim of shielding its smaller banks from change, as this meant that only 10–12 German banks would be affected by the reform. However, this protection of smaller banks did not conflict with EU proposals, which were also focused on the larger banks. Even for the largest banks, though, the German proposals were more benign than the Liikanen report and Commission's proposals. Similar to the French case, only the blurry domain of 'proprietary trading' shall be separated out, with no major impact on largest banks' trading businesses.

By contrast, the UK has implemented a more ambitious structural reform, which operates, to a certain extent, the separation of market and retail activities. The British approach is called "ring-fencing" because the separate entities may still be part of the same group, but they must be operationally separate and economically independent. The British ring-fencing grants the regulatory with the possibility to 'electrify' the ring-fence – operate a full separation - in

case of necessity (Bell and Hindmoor 2015). The Banking Reform Act of 2013 largely built on the ambitious report produced by the Independent Commission on Banking, presided by Sir John Vickers. It prevents any bank housing over £25bn in domestic, personal, or small business retail deposits from trading in financial instruments and commodities. This encompassed six banks in total, but its most punitive effects stood to be felt by the four largest banks with substantial trading and retail operations (HSBC, Barclays, Lloyds and RBS). It calls for banks retail activities to be placed in a separate and ‘operationally and economically separable’ ring-fenced subsidiary which is no longer permitted to trade most derivatives and securities (Vickers 2011). Individual members of the government under the Liberal-Conservative coalition, such as Business Secretary Vince Cable, as well as the members of the Parliamentary Commission on Banking Standard, invested a lot of their political resources to see the British ring-fencing reform adopted and implemented. As of 2018, the reform has already been implemented by the major British banks.

3.4.2 Enforcement of Capital Ratio Requirements

In 2010, the members of the Basel Committee on Banking Supervision, an organization comprising the biggest world economies’ central bankers, agreed to double the capital ratio requirement for banks. In other words, they committed to double the amount of shareholder equity that banks are required to hold for a given amount of assets, adjusted for how risky these assets are. This means that the bigger the bank is and the riskier its assets are, the bigger the amount of “safe capital” – mostly in the form of common equity- it needs to hold. The Third Basel Accord – commonly named Basel III - was scheduled to be introduced internationally from 2013 to 2015.

The key contribution of Basel III to financial regulation is the requirement that banks increase their capital ratio. Capital ratio requirements define the minimum amount of regulatory capital (mostly shareholder equity) a bank needs to hold for a given amount of assets. This ratio is arguably a key indicator of a bank’s solvency and resilience. The calculation of the capital ratio is based on Risk-Weighted Assets (RWAs). Banks’ assets are weighted depending on their risk profile. In other words, riskier assets will be assigned more weight, and the bank will have to hold more capital for this asset. Basel III requires banks to hold 4.5% of common equity (up from 2% in Basel II) of risk-weighted assets. This ratio is thus calculated as follows:

$$\text{Capital/RWA} \geq 4.5\%$$

Consequently, the bigger the numerator (Capital) and the smaller the denominator (RWAs), the better the capital ratio.

In the European Union (EU), Basel III was implemented through the Capital Requirements Directive IV (CRD IV) in 2013. The 1600 pages of the final CRD IV text are a testament to its level of detail and complexity. Scholarship in public policy has shown that detailed and complex regulations tend to be easier to arbitrage (Epstein 2009).

There are variations in how banks use internal models of risk assessment to weight their assets, and thus to determine the level of capital they have to hold (Massoc 2017b). Differentiated enforcements of capital rules through different calculations of RWAs is not new. In 1999, the Basel Committee had already noted that “*with increasing sophistication of the banks and the development of new innovative techniques in the market, the largest banks have started to find ways of avoiding the limitation which fixed capital requirements place on their activities relative to their capital. For certain banks, this is starting to undermine the comparability and even the meaningfulness of the capital ratios maintained*” (BIS 1999, p4). Financial scholars also stressed that banks had reduced substantially their regulatory capital requirements with little or no corresponding reduction in their overall economic risks (Jones 2000).

With the caveat that market reality is a lot more nuanced and complex than what can be described here, it is possible to lay out significant observable variations in RWAs across jurisdictions. It has actually been abundantly documented that different banks can give very different risk weights to identical assets. For example, a 2009 study by Standard & Poor’s showed that the risk weights attributed to corporate exposures by a sample of banks ranged from less than 40 percent to almost 160 percent, depending on the bank; a ratio of one to four for similar exposures. This study also stresses important variations across jurisdictions. Consider the example of the UK and France. In the UK, corporate exposure of banks is weighted on average at 65 percent. In France, corporate exposure of banks is weighted on average at 47percent. The same trend is observed in exposure to residential mortgage: in the UK, this exposure is weighted on average at 18 percent, against only 11 percent in France. Concerning the exposure to other financial institutions, British banks give them an average weight

of 18 percent against 14 percent in France. In short, French banks apply much lower weight than their British counterparts to similar assets⁵⁶.

These models take several dimensions into account in their calculation of the risk of an asset. Consequently, variations in bank RWAs may be due to multiple, different factors, such as differences in domestic economic cycles and foreign market exposures, business models, and lending practices or provisioning practices (Le Lesle and Avramova 2012). It is extremely difficult, and beyond the scope of this section, to determine to what extent each of these factors influence banks' RWAs. However, there is enough evidence to assert that a significant proportion of the variation is due to the incentive banks have to artificially minimize their RWAs and, in this manner, reduce the overall level of capital they are required to hold.

Several studies have shown that banks have improved their capital ratios by spinning off unwanted assets and recalculating the risk weightings attached to some assets. For example, the Financialization, Economy, Society & Sustainable Development Project, funded by the EU (FESSUD) released in 2014 a working paper that asserts that banks have long anticipated higher capital requirements and are therefore concentrating their efforts more on adapting their internal risk models than on increasing their core capital. As an illustration of such practices, it is noted that Deutsche Bank reduced its RWAs by €55 billion in the last quarter of 2012 to achieve a higher capital ratio. This could not possibly be due to an actual reduction of balance sheet positions and estimates show that about 50-75 percent of the reduction was actually due to "finer calibration" of risk model. According to a large rating agency, the ratio of RWAs to balance sheet size in the banking sector was reduced between 2007 and 2012 from 75 percent to 35 percent. The report concludes that this can "hardly be explained by the reduction of risky business" (Detzer et al. 2014, p21). The difference is due to different applications of RWAs models by banks. And to the relative stringency of their regulator. In the UK, "*Risk analysts at the PRA are seriously monitoring internal models. They got a good understanding of how firms were exploiting loopholes. It could never be a perfect*

⁵⁶ Study presented in Risk Magazine, 24 June 2011, "FSA's Turner: RWA Divergence Would Undermine Basel III," available online at: www.risk.net/risk-magazine/news/2081533/fsas-turner-rwa-divergence-undermine-basel-iii and Risk Magazine, 24 June 2011, "Europe lax on RWA Calculations, Says Bair," available online at: www.risk.net/risk-magazine/news/2081139/europe-lax-rwa-calculations-bair

regime, but there is a lot of scrutiny” (PRA senior official, interview 13072016).

The differences in capital ratio requirements enforcement across jurisdictions are not only due to the more or less lenient use of RWA models. More formally, the UK government has also decided that TBTF banks should hold more capital than recommended under Basel III. The 2012 Treasury White Paper committed to a primary loss-absorbing capacity of 17 per cent of risk-weighted assets for large systemically important institutions (against a minimum of 10% in Basel III) (HM Treasury 2012, p35). As a senior manager at the Bank of England confirmed in interview that *“The UK has decided to fast-track the implementation of Basel rules. It is ahead of time on agreed deadlines. It added a stricter application of the EU minimum. The toughest regime applied to UK banks”* (interview 07142016).

3.5 Regulating Competition in banking

Competition policies signal the willingness of states to challenge large banks’ position as incumbents. More competition may potentially create less structural importance for large banks, as well as typical new challenges that come with accrued competition. This category of policy may potentially shape the competitive landscape of banking and thus the opportunities / challenges for banks to expand.

More competition in banking may limit the expansion of large banks, especially at home.

There are different ways for policymakers to promote competition directly in banking. They can voluntarily skew competition in favor of challenger banks through regulatory advantages – for example by granting new banks easier access to banking licenses, or imposing lower capital requirements on them, or through direct investment, for example by granting extra cash for challenger banks. Regulators can also erase identified obstacles to competition in banking - for example, they can make it easier for customers to transfer their banking accounts by obliging banks to make this process free.

The UK has been proactive in the direct promotion of competition in domestic banking. Not much has been done in France and Germany. The respective incumbents in the domestic markets of those two countries (the large banks in France, the local banks in Germany) have not been challenged by policymakers.

3.5.1 Promoting challenger banks

In France, nothing has been done to directly promote challenger banks. In terms of competition in the domestic retail banking market, Germany's remains noticeable by the reform that it has not introduced. Although it is contrary to EU guidance and that Germany has been lectured by the Commission multiple times, the public-sector banks remain protected from competition. By law, commercial banks cannot acquire public sector banks. The continuous refusal by Germany to allow competition with local cooperative and public banks annoys, but forces resignation of private market players. Rating agencies write that reform of competition laws regarding the regional banks "look elusive at best" (BMI Germany 2016, p18). A German commercial banker lamented: "*there is nothing to be done*" about that (Interview 04092014).

By contrast with France and Germany, the UK has considerably toughened the competitive environment for large domestic banks. The British government has made it its explicit priority to promote challenger banks. As a Senior Treasury official explained to me during an interview: "*the critical debate has been on how to reach the critical mass and challenge the incumbents*" (Interview 07130216a). The final report of the powerful Independent Commission on Banking, otherwise known as the Vickers Commission, made two sets of recommendation: a first set aimed at addressing the financial stability issues identified earlier; and a second set aimed at boosting competition in the UK financial sector⁵⁷.

Much regulatory effort has been made to open the market to new entrants and foster further competition. The Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) formed in 2013 have been given the explicit mandate to promote competition. An investigation by the Competition and Markets Authority (CMA) into the retail banking market was opened between 2013 and 2017. The CMA published the results of its market investigation into retail banking, identifying features of the market that were having an adverse effect on competition and setting out a number of measures to remedy the shortcomings⁵⁸.

⁵⁷ ICB final report available at <http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf>.

⁵⁸ CMA reports on competition in retail banking available at <https://www.gov.uk/cma-cases/review-of-banking-for-small-and-medium-sized-businesses-smes-in-the-uk>

Following the CMA recommendations, fifteen new banking licenses have been granted between 2014 and 2017. Both regulators have worked to make the new bank application process easier and have reduced both the capital and liquidity requirements for new banks⁵⁹. The regulators committed to meeting with challenger banks at least four times a year to make sure that they don't lose to larger banks with more capacity to lobby.

3.5.2 Promoting competition in Payment Services

The second Payment Services Directive (PSD2) require banks to let customers easily and securely share their financial data, including transaction history and spending behavior with other banks and regulated third-party providers. This is supposed to facilitate switching banking accounts.

In France, an “aid to banking mobility” has been introduced by the Macron Law in 2015. Before this date, if they wanted to switch accounts, customers had to inform by themselves all the organisms to which and from which they were transferring money about their new banking account. The 2015 law obliges the bank to which the account is transferred to do that, free of charge. Yet, the promotion of banking mobility is not expected to have a big impact on customers' behavior. The law has not changed the fact that banks keep it difficult and expensive for customers to transfer savings accounts (as opposed to checking accounts). It is probable that French customers will thus remain particularly faithful to their bank - French customers stay in the same bank for on average 17 years, turnover is 4.5% versus 8% in most European countries (Rapport Mercereau, 2014). Moreover, if the 2015 law does something, it will promote mobility only within the current incumbents in the retail market. As repeatedly underlined by Consumers' organization, banking fees for retail customers in France increase despite the regulation (9% between 2013 and 2018). This contrasts with their European counterparts that are more subject to competition and propose lower fees⁶⁰.

A law on banking mobility similar to the French 2015 law has been implemented in Germany. It may give some opportunity for commercial large banks to poach public and cooperative banks'

⁵⁹ Brooke Masters, Capital rules relaxed for new UK banks, Financial Times, 26 March 2013.

⁶⁰ UFC Que Choisir 2018, <https://www.cbanque.com/actu/66218/les-tarifs-bancaires-en-hausse-de-2,2-en-2018-selon-ufc-que-choisir>

customers, but it is unlikely to introduce any significant change in the retail market.

In the UK, banks were asked to make customers' account data available in a "simple standardized format" to allow those customers to assess more easily, whether switching account providers would be in their interests. Even more, high street banks have been required to participate to a fund aimed at facilitating the switching of customer accounts to eligible challenger banks. The "Incentivized Switching Scheme" will see £275m of funding handed to market challengers to promote their offering to small business customers. The fifteen challenger banks have been financed by the scheme to encourage small business customers to move their accounts from high street banks.

3.5.3 Consumers and SMEs credit data sharing

The European directive of 23 April 2008 on consumer credit has two objectives. First, it endeavors to protect consumers from abuses in the consumer lending industry. Consumer lending has been a business yielding very high margins, often to the detriment of good service to customers. Second, it endeavors to increase indirect competition in the consumer lending business by increasing access of credit institutions to consumers' credit information. Indeed, smaller firms are often hesitant to embark on consumer lending because of the risk to do so without thorough access to borrower's information. The Directive states in broad terms "*Creditors should bear the responsibility of checking individually the creditworthiness of the consumer*". The key point of credit consumer protection regarding the indirect promotion of competition is the creation of a national consumer credit database available to all credit institutions for them to decide whether to lend to a customer. The directive has been implemented differently across Europe.

In France, the national register of consumers credit loans has been rejected. In this country, consumer lending is concentrated in the five biggest banking groups. The 2014 Loi Hamon sought to establish such national consumer credit database, along with the possibility for consumers to launch class-action lawsuits. Banks lobbied hard against the two provisions. The Constitutional Court to which they had appealed upheld the class actions, but they were successful in striking down the database. As accounted in the specialized newspaper La Tribune, "*The idea of this "national consumer credit register" is a sea*

*snake that the banking lobbying has always managed to make fail*⁶¹. Only the “obligation for banks to seek information about the borrowers” has been adopted⁶².

In Germany, commercial banks (Deutsche Bank and ING) as well as public banks (Deutsche Kreditbank AG, and KfW) are leaders in the market for consumer credit. In Germany, cooperative banks sometimes only give easy credit installment loans that have different banks behind them as the true providers. The 2009 “*Gesetz zur Umsetzung der Verbraucherkreditrichtlinie*” contains a specific provision obliging the bank to inform the customer about the ‘credit intermediary’. Sellers must be clear about whether it is an intermediary (and the amount of compensation) or directly provided offer. In terms of indirect promotion of competition though, the national register of consumers credit loans has not even been mentioned. Customers’ information is a well-defended jewel of the local banks.

As the German SMEs BVMW representative told me:

“There have been discussions about whether we would have to standardize SME credit information to make it cheaper. This is a high risk for the local banks. This would ruin the qualitative assessment done by the local banks and their business would become more difficult. Large international banking groups would like to see that, but not our small local banks” (BVMW, interview 11092016).

The national credit register was not created in Germany.

German local banks are so eager to preserve their precious lending information that they have also sought protection against the Analytical Credit Dataset (AnaCredit), or “Datenkrake” (data octopus) according to the German press, set by the European Central bank (ECB) in the euro area. AnaCredit aims at creating new fine-grained statistics of bank lending in Europe. Only corporate loans are for now concerned by the data gathering, although the ECB explicitly claims that it wants to broaden its reach to consumer credit. Local banks’ organizations, joined by the Mittelstand association⁶³, opposed the implementation of

⁶¹ La Tribune, 14 March 2014, “Le Fichier des credits à la consommation consuré par le Conseil Constitutionnel” .

⁶² For a more historical perspective on the refusal by France to implement a credit consumer database, see Turnbull 2014 pp 198-201.

⁶³ See for example the anti-data gathering statement of BVR on 10 July 2015, available at https://www.bvr.de/Presse/Mittelstand/Mittelstand_durch_enorme_Meldeanforderungen_im_Kreditwesen_belastet

AnaCredit. "*AnaCredit creates a cemetery of figures in which any degree of proportionality is buried*⁶⁴," commented Jürgen Gros, member of the Bavarian Cooperative Association (*Genossenschaftsverband Bayern - GVB*) Executive Board. Even the president of the Federal Financial Supervisory Authority (BaFin), Felix Hufeld, made it clear that the register is dispensable. In implementing the data gathering process, the Bundesbank has reduced data sharing requirements for smaller banks. Most cooperative and public banks are required to share only 25 individual characteristics of the loan, instead of 89 for the other banks⁶⁵.

By contrast, in the UK, the Open Banking Working Group, a body established at the request of HM Treasury, issued a report outlining how an ecosystem allowing the sharing of bank and customer information could be established, operated and governed. According to Barclays, "*open Banking will have a profound impact on the banking landscape by allowing customers to choose to enable third parties to access their data*" (Barclays, AR 2017, p10).

But the UK went further away by requiring the largest UK banks to share their credit information about SMEs. Harriett Baldwin, the Economic Secretary to the Treasury, said: "*The best way to deliver this [SME financing] is to increase competition in the banking sector and remove the barriers to new sources of finance for SMEs. Requiring banks to share data is a major structural reform that will level the playing field between banks and alternative finance providers*"⁶⁶. In agreement with this statement, in April 2016, the government required nine banks⁶⁷ to share, with the SME's permission, the credit information they hold on SMEs with the designated private Credit Rating Agencies (Experian, Equifax and Creditsafe). These agencies must then share this data equally with all finance providers.

⁶⁴ Jürgen Gros, 25 May 2016, cited in the GVB presseportal, available at <https://www.presseportal.de/pm/24076/3332485>

⁶⁵ See Handelsblatt, 18 July 2016, available at <https://www.handelsblatt.com/finanzen/banken-versicherungen/kreditdatenbank-anacredit-eine-datenkrake-macht-diaet/13893954.html?ticket=ST-887910-1knAq3OSPOSrTfd4vlg-ap3>

⁶⁶ Harriet Baldwin cited in HM Treasury News Story, 20 April 2016, available at <https://www.gov.uk/government/news/boost-for-small-businesses-seeking-finance-thanks-to-government-data-sharing-scheme>

⁶⁷ The nine banks are RBS, Lloyds, HSBC, Barclays, Santander, Clydesdale and Yorkshire Banks, Bank of Ireland, Danske Bank and First Trust Bank

3.5.4 Promoting alternative finance

Peer-to-peer lending (P2P), is the practice of lending money to individuals or businesses through online services that match lenders with borrowers. P2P is still a niche market, although it has grown rapidly over the last decade. The key point concerning competition of P2P to established banks is whether the lending platforms need a banking license to operate. If they do, P2P platform will seek to be supported by established banks, which put banks in competitive advantage. If they don't, P2P platforms can grow outside of established banks' shadow and compete with them for lending.

In France, since 2014, there is no longer need of a banking license for loans of less than one million euros. In Germany, there has been no change: there still need a banking license to lend. This has hindered the expansion of non-bank operated P2P businesses, because they need to be backed by a bank to operate, even for small loans. The growth of P2P has been very slow in Germany compared to France and the UK. As a German expert of alternative finance writes, “*unlike the UK, the German government is indifferent – at best – to alternative finance*”⁶⁸.

In the UK, P2P has been promoted. Platforms only have to be registered under FCA and apply for permission to operate. In the 2014 budget, the Government confirmed that peer-to-peer loans would be made eligible for inclusion within Individual Savings Accounts (ISAs) and therefore subject to the tax benefits that the ISA wrapper entails.

3.6 Regulating governance

Governance reform aims to tackle the toxic culture of banking, conceived as systematic mismanagement of risk and individual short-term profit-seeking to the detriment of the long-term interests of the clients. It has the potential to discourage certain practices by making them punishable, or less profitable.

More stringent rules on banking governance may limit the expansion of large banks.

The policies under study are: the reform of the legal accountability of banks' executives, the establishment of bank levies, and the caps in top executives and traders' salaries and bonuses.

⁶⁸ Claus Lehmann in AltFiNews, 25 November 2015, “The State of P2P lending in Germany”

3.6.1 Bank executives' legal accountability

The reform of banks' executives' penal and criminal responsibility seeks to tackle the discrepancy between (individual) risk-taking and profit-making and (collective) cost-bearing. The idea is that individual managers who put their institutions at risk to carry individual profits must also bear legal responsibility for it. Their legal responsibility must go beyond the notion of proper felony (such as sheer money laundering, diversion of funds or funding of illegal operations). The key point in this reform is thus the ability to prosecute individual executives for deliberately making decisions putting at risk their institution. The credibility that prosecutions could actually be engaged is also important. Concerning the latter, the "reversal of the burden of proof" – which consists in holding senior managers responsible to account for failings on their watch ("guilty until proven innocent") – is particularly striking

In France, there has been no reform, nor even talk of reform. Answering a question about legal accountability during an interview, a French senior banker asked: "*Is that even a thing?*" (Interview banker 03152915). The *Cour des Comptes*, an administrative body in charge of verifying the uses of public funds and making recommendations to improve them, advocated for the adoption of a law concerning the personal responsibility in case of a problem in a bank⁶⁹. But Karine Berger of the Socialist Party, speaker for the 2013 banking law, bluntly retorted: "*We wanted the text to respond to the financial crisis, but penal responsibility of the banker brings no solution to that*"⁷⁰.

Germany already had a relatively strict regime of individual legal accountability for executives⁷¹. It has been strengthened after the crisis. In 2009, CDU Christian Wulff, the Prime Minister of Lower Saxony – who later became President of Germany in 2010, demanded

⁶⁹ Les Echos, 19 August 2013, "Où sont passés les banquiers de la crise"

⁷⁰ Karine Berger, cited in Les Echos, 16 September 2013, "Responsables mais pas coupables"

⁷¹ The clause of "Untreue" (criminal breach of trust) under Section 266 of the German Criminal Code is often cited in the prosecution of bankers. The provision reads: "Whoever abuses his authorization, being granted by law, official mandate or private legal act, to dispose of third parties' property or to obligate a third party, or breaches duties, being imposed upon him by law, official mandate, private legal act or fiduciary relationship, to safeguard third parties' pecuniary interests, and thereby causes financial loss to the third party whose pecuniary interests he is responsible for, will be punished by imprisonment of up to five years or by fine. (German Law Journal 2010)

that “public prosecution and criminal courts take a hard line on those responsible for the financial crisis”. He stated, “blowing a bank’s money contrary to managers’ duties is a criminal offense” (cited in Krey 2009, p19). The 2013 Law on shielding credit institutions and financial groups against risks and planning their restructuring and winding-up (*Trennbankengesetz*) clarifies the ability of authorities to take criminal action in cases of severe breaches of duty that could get an entire bank or insurance company into difficulty. The violation of important risk-management duties became punishable with a maximum of five years’ imprisonment should it threaten a credit institution’s viability or if it jeopardizes insurance companies’ abilities to meet their obligations relating to insurance policies. Managers bear the burden of proof in the event of a dispute as to whether or not they have employed the care of a diligent and conscientious manager. Note that this stringent regime applies to banks in all three pillars of the German banking system. It does not protect local bankers in particular, but it *de facto* concerns executives in charge of risky market activities more than retail banking.

In the UK, the 2013 Banking Reform Act seeks to ensure criminal liability and personal responsibility in case of “reckless misconduct”. The crime of ‘reckless misconduct’ in managing a bank has three constituent elements: the manager’s decision, whether active or passive, caused the failure of the financial institution in question; at the time the decision was taken, the manager was aware of the risk that such a decision might cause the failure of the financial institution (or its group companies); the manager’s conduct was ‘far below’ the reasonable standard expected from a person in such a position.

The original version of the Act provided for the reversal of the burden of proof. Banks were extremely concerned by the proposal and they had high-level meetings with the Bank of England about it⁷². According to interviewees involved in the making of the 2013 Act, banks’ lobbying was particularly active concerning the reversal of the burden of proof (Interviews 05042015, 07122016b, 0602106). The withdrawal of the provision was also the opportunity for the new Conservative coalition (freed of the LibDem) to make a political gesture in favor of the banking community. The section on the reversal of the burden of proof was thus abandoned. Senior managers have a statutory duty to take all appropriate steps to prevent a regulatory breach from occurring, but it is up to the watchdog to prove that such

⁷² Financial Times, 15 October 2015, “Treasury abandons senior bankers’ accountability rule

steps were not followed⁷³.

On 7 March 2016, the PRA and FCA introduced new measures to increase the individual accountability of senior managers and other covered individuals in the banking sector. The new regime comprises the ‘Senior Managers Regime’, which applies to a limited number of individuals with senior management responsibilities, and the ‘Certification Regime’, which is intended to assess and monitor the fitness and propriety of a wider range of employees who could pose a risk of significant harm to the firm.

3.6.2. Special Tax on systemic risk

In 2010, a report produced by the International Monetary Fund suggested a levy to be paid by all financial institutions at a rate that reflects the individual institutions riskiness and contribution to system risk (Claessens et al. 2010). The same year, the European Council agreement stated “member states should introduce systems of levies and taxes on financial institutions to ensure fair burden-sharing and to set incentives to contain systemic risk”. The bank levy has two objectives: 1) imposing higher costs on large banks to compensate the implicit public subsidies from which they benefit; and 2) Influencing banks’ behavior by making risks more expensive. Yet, evidence relating to the actual effect of taxation on bank behavior is relatively scarce (Sobiech et. al. 2017; Devereux et al. 2015; Capelle-Blancard and Havrylchuk 2013).

Different dimensions of the tax influence its potential impact on banks’ governance.

- 1) The base used to calculate the amount of the tax is important to determine what objectives the tax is supposed to fulfill (see Lepetit 2010, pp73-81).

Taxing “relevant Liabilities” consists of taxing liabilities that are considered volatile and risky (Such as inter-bank loans and other types of short-term loans) and not taxing long-term, safer liabilities (such as customer deposits or sovereign-backed securities). This design penalizes highly leveraged banks and banks that fund themselves through market funds. This design may negatively impact the expansion of large banks, in particular of their market trading activities. Germany and the UK have used this design to calculate the tax. Note

⁷³ Financial Times, 15 October 2015, “Treasury abandons senior bankers’ accountability rule”

that a much higher rate has been established in the UK than in Germany, on a comparable base.

Taxing “Asset-weighted capital ratio” consists of calculating the tax based on the risk profile of the bank. This design tends to favor market-based banking because lending activities are more highly weighted than bonds’ trading. The design is thus signaling a relatively permissive stance towards the expansion of banks’ trading activities. France has used this design to calculate the tax.

Taxing “potentially illiquid assets” penalizes banks involved in riskier activities. Germany has used this design to calculate the tax along with the “relevant liabilities” base, to the detriment of its largest commercial banks⁷⁴.

2) The retroactivity of the tax anticipates that when in year n, profits are too low, payment of the tax for year n is due in year n+1, when profits are higher. As stated by Finance Minister Schaeuble, the provision “*serves to compensate for differences between banks with volatile earnings and those with stable, sustainable incomes*”⁷⁵. Only Germany has established the principle of retroactivity. Revealingly, Karl-Peter Schackmann-Fallis, Managing Director of the German Savings Banks and Giro Association (*Deutscher Sparkassen- und Giroverband*), praised the German version of the banking tax.

3) The tax applies to the consolidated group (as opposed to only domestic activities). This provision does not promote highly internationalized banking group. France applies the tax on a consolidated base. German tax does not apply to foreign subsidiaries, which is better for its globalized banks. The UK government faced a strong lobby from HSBC concerning this provision. The bank threatened to move its headquarter to Hong-Kong explicitly on this issue⁷⁶. The Treasury capitulated on this point. As a Treasury official recalls in interview:

“The bank levy was initially on the entire balance sheet. Now it is only on the UK balance sheet. So HSBC can escape the tax since a lot of its profit is made out of the UK. The whole tax

⁷⁴ Financial Times, “Concerns rise over German bank levy”, 11 January 2011

⁷⁵ Wolfgang Schaeuble, cited in Frankfurter Allgemeiner, “Die bankenabgabe soll nachgezahlt werden”, 13 January 2011.

⁷⁶ Bloomberg, “UK banks seek Tax review as HSBC threatens to leave London”, 5 June 2015; Bloomberg, “Osborne Reins In British Bank Levy Following HSBC pressure”, 8 July 2015

policy was actually designed in order to keep HSBC here” (Interview 06082016).

4) Despite important lobbying in Germany⁷⁷, only France allows for the deductibility of the levy on corporate tax.

Funds raised through the levy are allocated to the Treasury (France and the UK), or to the national resolution fund (Germany).

To sum-up, in France, although the rate is comparable, the design generally signals a willingness not to penalize large domestic banks (although the tax applies to the consolidated balance sheet). The German levy is above all characterized by the willingness not to penalize small and stable banks (See Buch et al. 2016 for an overview of the German tax). The UK had the levy most detrimental to TBTF banks, but it has watered it down considerably over the years, specifically for highly internationalized British banks like HSBC.

3.6.3 Salaries and Bonuses in banking

The regulations stem from the fact that many believe that the 2008 financial crisis was largely caused by an unrestrained bonus culture that encouraged risky trading. The European CRD IV (Capital Requirement Directive IV) rules that banks will not be able to give more than 100% of the salaries on bonus. If the bank shareholders agree the bonus could be up to twice the salaries. 25% of any bonus exceeding 100% of salary must be deferred for at least five years. CRD IV is applied to risk takers in banks (managers, traders for instance). France and Germany stuck with the application of the directive. The UK went a little but further, with the 2010 FSA remuneration clause. According to the clause, at least 50% of any variable remuneration should be paid in the form of shares, share-linked instruments or other equivalent non-cash instruments of the firm. Seniors bankers have to wait 7 years to collect their annual bonus in full and can start collecting it 3 years after it was granted. Risk managers have to wait 5 years, traders and other risk-takers 3 years. Deferred remuneration should be subject to an appropriate form of “performance adjustment”. Finally, firms must not offer guaranteed bonuses unless they are “exceptional”. The UK has put together a stricter reform of bonuses. Yet, banks’ remunerating practices in this country have traditionally been far more relying on bonuses than the other two.

⁷⁷ Der Spiegel, “Bankenverband haelt Strafzins fur moeglich”, 10 November 2014

3.7 Regulating Market Activities

This category of reform endeavors to shape the type of finance that is hindered/allowed/promoted in the jurisdiction: market-based banking finance or more traditional banking.

Enhancing market activities can be to the benefit of large banks or not. In France, market activities have been promoted, to the benefit of large domestic banks. Germany took a more cautious stance regarding market activities. In the UK, market activities have been promoted, but mostly to the benefit of non-UK banks.

I look at different policies aimed at regulating market activities: High Frequency trading, Regulation of hedge funds, and derivatives trading.

3.7.1 Regulating High Frequency Trading (HFT)

HFT is an automated trading platform used by large investment banks, hedge funds and institutional investors which utilizes powerful computers to transact a large number of orders at extremely high speeds. These high frequency trading platforms allow traders to execute millions of orders and scan multiple markets and exchanges in a matter of seconds, thus giving the institutions that use the platforms a huge advantage in the open market. The frontier between HFT and market manipulation is blurry: 95% of HFT transactions consist in cancelling orders less than half a second after they were passed⁷⁸.

In 2014, the Markets in Financial Instruments Second Directive (MiFID2) established the possibility for national regulators to instantaneously freeze electronic markets in case of overheating in the trading algorithms. MiFID2 also requires operators to submit their algorithms of the regulators in an effort to improve HFT transparency.

In an amendment to the 2013 Banking Separation Law, France established a tax of 0,01% on all orders executed, but also on orders cancelled or modified within half a second after they were passed. If more than 80% of the orders passed by the same operator are cancelled, the tax applies on the orders cancelled beyond that point (even if they were cancelled more than half a second after the order was passed). Arguably, the impact of the tax is very low, as it applies only to orders passed from France and that it is easy for banks to pass the orders from

⁷⁸ Sylvian Fontan in La Tribune, 1 January 2011, “Faut-il réguler the trading à haute fréquence?”.

their foreign subsidiaries. In 2017, the Cour des Comptes lamented that the “*tax on HFT, highly speculative activities, has practically no yielding*”⁷⁹. No further regulation on HFT has been introduced in France.

In June 2011, Joachim Nagel, board member of the Bundesbank stated that “*the financial industry must create a code of conduct for high frequency trading*”. Nagel proposed giving the financial industry some time to design this code of conduct, otherwise German lawmakers would begin drafting a law on HFT⁸⁰. Confronted with the inertia of the sector, the government decided to move forward, with the active support of the Bundesbank⁸¹. The 2013 High Frequency Trading Act (*Gesetz zur Vermeidung von Gefahren und Missbräuchen im Hochfrequenzhandel*) made Germany the first country to crack down on HFT. It requires that a license, issued by the German regulator BaFin, be held by high frequency traders, regardless of their physical location, if they trade the German markets.

The German regulation is quite extensive. Two points deserve particular attention. First, firms trading exclusively on their own account and providing no additional banking services were not supervised by BaFin before the introduction of the German HFT Act. The Act explicitly introduced BaFin supervision for all firms operating HFT. This requirement covers not only German trading firms but also any foreign trading firm even if it trades only indirectly on German markets. Firms with other European license are not exempted from obtaining BaFin licensing. Second, the Act broadens the definition of market abuse. It adds certain behavior to the definition of market abuse, such as entering an order without the intent to trade but with the aim to signal misleading or incorrect information. The German legislation is quite ground-breaking because regulating HFT necessitated to define it in the first place (Coombs 2016). Germany was the first country to put in place parameters that defined HFT⁸².

⁷⁹ Report cited in Bulletin Quotidien, “La taxe sur les transactions financières n’atteint aucun de ses objectifs, selon la Cour des Comptes”, 6 July 2017.

⁸⁰ Joachim Nagel, cited in Handelsblatt, “Bundesbank fordert Tempolimit an der Boerse”, 6 February 2011.

⁸¹ Bundesbank, “Stellungnahme zum Entwurf eines Hochfrequenzhandelsgesetz”, 10 January 2013.

⁸² HFT is defined by German HFT Act as followed:
Trading for own account, or proprietary trading firms.
Trading algorithmically without human intervention.
Trading using low-latency infrastructures.
Trading that generates a high intraday message rate.

By contrast, the UK government has repeatedly rejected the EU proposals to clampdown on HFT⁸³. The UK government's Foresight Project, headed by Sir John Beddington, published a report in 2012 which main conclusion was that HFT did not increase price volatility⁸⁴. Andrew Bailey, chief executive of the PRA, said in April 2015 that the PRA will scrutinize “*governance and controls around the introduction and maintenance of trading algorithms, and the potential system-wide impact of crowded positions and market liquidity*”⁸⁵. Yet, no actual regulation was passed to enforce this tougher scrutiny.

In short, after MiFID2, all the countries have increased transparency and supervision of HFT. Only France has established a tax on HFT. Germany has been relatively stricter than the two other countries by establishing licenses for algorithms and restrictive provisions on certain HFT operations.

3.7.2 Regulating Derivatives Trading

The main breakthrough in derivatives regulation is the European Market Infrastructure Regulation (EMIR), which established a minima rules on transparency and risk management. The bigger point is the settlement of Central Clearing Counterparties for OTC trading in the EU. Also, the 2014 Directive on markets in financial instruments (MiFID II) includes a number of changes to the regulation of commodity derivatives, notably by creating an EU-level regime for position limits and new reporting requirements.

Beyond that, the three countries issued a ban on naked short selling⁸⁶ during the peak of the financial crisis in an attempt to stabilize markets. During the euro-crisis, France and Germany renewed the ban in 2010. The French ban concerned only the shares of the ten largest domestic financial institutions (banks and insurances). The German ban included the shares of the country largest financial institutions as well

⁸³ See for example The Guardian, “Britain opposed MEDs seeking ban on High Frequency trading, 16 September 2012.

⁸⁴ The Foresight Project report is available at <https://www.gov.uk/government/publications/future-of-computer-trading-in-financial-markets-an-international-perspective>

⁸⁵ Andrew Bailey, cited in Financial Times, “High-Frequency trading faces tougher Bank of England scrutiny”, 15 May 2015.

⁸⁶ Short-selling consists of selling borrowed shares in the hope that their price will fall and that they can be bought back at a profit later on. Naked short-selling is short-selling but without borrowing the shares first. Short selling is thus speculating that the price of short-sold assets will decrease.

as Eurozone government bonds and their credit default swaps⁸⁷. The German unilateral move on the ban of short-selling was criticized by the EU Commission and fellow member states⁸⁸. Yet, the finance ministry circulated a draft law that would extend the share ban to cover all German companies, and also extended the credit default swap ban to cover regional and municipal bonds. The German parliamentary finance committee considerably watered down the bill⁸⁹. Intraday short-selling transactions were finally exempt from the ban.

3.7.3 Regulating hedge funds

Hedge funds are alternative investments using pooled funds that employ numerous different strategies to earn high active return for their investors. Hedge funds are often aggressively managed and make use of derivatives and leverage in both domestic and international markets with the goal of generating high returns. Hedge funds face less regulation than mutual funds and other investment vehicles. Their relationship with banks is multiple. In particular, banks participate to hedge funds' highly leveraged strategy by lending them and hedge funds act as sources of risk counterparty for banks. There are two ways to regulate hedge funds. The first way is to regulate them directly, but hedge funds are often located in opaque tax heavens, which makes them difficult to reach. The 2011 Alternative Investment Fund Managers Directive (AIFMD) requires all covered AIFMs to obtain authorization, and make various disclosures as a condition of operation. The second way is to regulate the relationship between banks and hedge funds.

The objective of the ring-fencing reform was to prevent investment banks from acting as hedge funds or doing business with hedge funds by relying on the retail banking units within their groups. Given the different outcomes of the banking structural reform in France, Germany and the UK, it has become more difficult for British banks to act as hedge funds, but not really for French and German banks.

Beyond ring-fencing, the UK and France have adopted no requirements beyond the ones set up by AIFMD. Germany went

⁸⁷ A swap is a derivative contract through which two parties exchange financial instruments. A credit default swap is a particular type of swap designed to transfer the credit exposure of fixed income products (such as sovereign bonds) between two or more parties.

⁸⁸ Der Spiegel, "Verbot von Leerverkaufen: Finanzpraxis schimpfen über deutsche Zockerbremse", 19 May 2010.

⁸⁹ The Wall Street Journal, "Germany passes diluted Naked Ban", 2 July 2010

further. German private investors – including banks- are no longer allowed to invest in hedge funds, unless the investors are considered “semi-professional.” The German implementation is especially strict in that it does not allow fund managers of mutual funds to invest in hedge funds, even, if the investment only serves as an additive to increase the yield of the fund.

3.8 Conclusion

Post-crisis reform has not challenged the workings of market-based banking (Ban, 2016; Blyth 2013; Crouch 2011; Engelen 2018; Helleiner 2014; Schmidt and Thatcher, 2013). After the crisis, states have not sought to jeopardize the paradigm of financialized capitalism, but they have sought to shape how their own financial industry would fit in this paradigm. Some authors have stressed that states have tended to protect and/or promote their national champions (Clift 2011; Young 2014; Howarth and Quaglia 2015). The quite exhaustive view of regulation that was presented in this chapter shows that this statement must be nuanced. States’ defending their national champions is not systematic. It varies in degree, across areas and across countries. Through the analysis of 12 policies, categorized into 4 domains of regulation (systemic risks, competition, governance and market activities), this chapter has shown that states have been proactive in shaping their domestic financial industries after the crisis, but they have done so with different priorities and with different consequences for large banks in France, Germany and the UK. What do shape states’ different priorities towards finance?

CHAPTER 4

Institutionalized Modes of State-Banks Coordination in France, Germany and the UK

Although they are structurally and instrumentally powerful, large banks' preferences have not always prevailed in shaping post-crisis state priorities towards finance. Different institutionalized routine modes of coordination between public and private actors have been key in shaping these priorities. This chapter analyzes and gives empirical illustrations of the typical state-banks modes of coordination as well as the institutions on which they build in France, Germany and the UK.

4.1 Typical institutionalized modes of state-banks coordination

The radically new political context (e.g. the emergence of European and international arenas for financial regulation) and market challenges and opportunities (e.g. development of globalized financial markets) that have emerged since the 1980s have transformed state-banks relationships, but they have not suppressed them. In some respects, states and banks need each other even more than before. The structural interdependencies between banks and states have arguably been tightened, not loosened. Banks depend on “their” state today more than ever. Indeed, banks’ competitiveness on international markets largely depends on 1) the capacity of their state to bail them out if need be, and 2) the assets acquired through deposit-taking, which is still mainly operated at a national scale. Being systematically important gives a premium to these banks—and their capacity to access cheap funding largely depends on the perceived health of their state (Acharya 2012; Alter and Schuller 2012). States depend on “their” banks for survival too because the banks still have an upper hand in the allocation of capital to corporations and households. It is true for capital allocation through banking credit, on which SMEs disproportionately rely in all three France, Germany and the UK. It is also true for capital allocation through market channels, either because banks own the entities deciding of the market allocation (through their asset management subsidy for example), or because they hold a key position of market intermediary in the allocation process.

Across all advanced political economies, because they are inter-dependent, bank managers and government officials interact on a regular basis. During the post-crisis decades, banks and state actors had to coordinate in the making of financial reform. The typical,

encompassing institutions that structured their coordination in the post-war models of European capitalism have largely disappeared. Actors had to fall back on existing, stickier, but more limited institutions to coordinate. Because these institutions differ across countries, different typical modes of state-banks coordination have emerged. Those have in turn determined which actors occupy key positions in decision-making processes, which preferences finds political expression, and they have shaped different state priorities towards banking.

In this chapter, I present these key institutions for each country.

- On the side of the financial industry, I examine the different composition of markets for financial services in the three countries, the organization and role of the associations of banks and other financial firms, as well as the typical internal organization of banking.
- On the side of the state, I examine the typical organization and role of the different regulatory agencies and branches of the government in financial law-making: the Ministry of the Economy, the Treasury bureaucrats, the central banks, the different regulatory agencies, and the Parliament.
- In terms of the involvement of other potentially significant actors, I examine the typical role of the press and other stakeholders (such as SMEs, unions, consumers' interest groups).
- In terms of the links between state and banking actors, I examine the practices of lobbying, the practice of the revolving doors, the typical channels of communication used by these actors and their social proximity.

Building on these examinations, I present the typical state-banks modes of coordination in policy-making processes in France, Germany and the UK. I identify the main locus of decision in these processes. To do so, I show:

- How power relations are institutionally mediated, in particular whether typical institutions allow for venue shifting, the voicing of outsiders' idea and the emergence of political salience on specific banking issues.
- How the preferences of state and banking actors are shaped in the process. In particular, it examines how different state actors adjudicate between different, sometimes conflicting priorities such as financial stability, economic (and financial) growth, the promotion of national champion, sustainable SMEs' funding.

- Whether and how actors decide to use the power resources available to them.

The empirics laid out in this chapter is largely based on interviews of state officials, bankers and regulators, public and private corporate documentation, secondary sources and newspapers. The chapter is a description of general patterns of state-banks coordination in policy-making processes, illustrated by anecdotal empirics. A detailed account of specific cases of policy-making and causal hypothesis testing will be presented in the next two chapters.

4.2 France, a symbiotic mode of state-banks coordination

In France, government officials and bankers are able to agree in policymaking processes because they belonged to a small elite group in which social interactions were governed by powerful norms of cooperation and reciprocal favors in the face of adversity. The construction of non-conflicting interests between public and private actors enabled them to proceed in a cooperative rather than confrontational mode. Far from leading to a mainstreaming of France in a free-market era, the liberalization and privatization of the French financial sector has thus reinforced the interpenetration of France's private and public elites (Jabko and Massoc, 2012).

4.2.1 The undermining of the post-war French state-led model of capitalism

The (de)regulation process fostered by the economic turn of the European project in the 1980's put an end to most of the legal institutions characteristic of post-war capitalism. In France, the formal institutions that ruled the interactions between banks and states under the *dirigiste* model almost completely disappeared. Among other reforms, the lifting of capital controls, interest rate deregulation, as well as the privatization of major commercial banks were key in the dismantling of the policies and institutions of dirigisme. The death of the National Credit Council in 1986 and the de facto euthanasia of the Planning Commission at the beginning of the 1990's were the highlights of the end of *dirigiste* capitalism. Since then, scholars have stressed how dramatic of a rupture French capitalism has undergone in a relatively small amount of time (Hall and Palier 2008; Levy 1999, 2006). For

example, Levy states: “*The reforms after 1983 left no dirigiste stone unturned. Looking across the wealthy democracies, one would be hard-pressed to find any country that shifted so far away from its post-war economic strategy as the France of François Mitterrand and Jacques Chirac*” (Levy 2006).

Yet, less encompassing, but stickier institutions have remained:

- A banking sector dominated by five large universal banks, closely organized and which governance is centered on top managers.
- A centralized government dominated by the Executive branch, in particular the Minister of Finance and the Treasury’s bureaucrats.
- A very narrow elitist network between state officials and banks’ managers, fostered by their common educational background, intertwined professional careers and even affective relationships.

These institutions are fostering the typically *symbiotic* mode of state-bank coordination during policy-making processes, and have been key in shaping the French state post-crisis priorities towards large banks, namely allowing them to expand both globally and at home.

4.2.2 The centrality of large banks’ top managers in French banking

Highly concentrated domestic markets for financial services, in the hands of top five universal banking groups

France is characterized by the concentration of all the domestic markets for financial services in the hands of five universal banking groups. This situation is the result of an intense process of consolidation and acquisition by banks of other financial entities during the 30 years. Foreign banks are virtually absent in French markets for financial services. At the end of 2003, foreign banks held only 12% of bank assets (IMF, 2004, p103). Domestic banks are protected from undesired takeovers through both formal and informal arrangements (see Goyer and Real, 2014). In the late 1990s and early 2000s, a number of new entrants tried to establish themselves in the French banking market, typically by setting up internet-based operations focused on deposit taking and offering high-interest deposit schemes. Most of these ventures were foreign owned. With the partial exception of ING Direct Finance, most of these new entrants failed and closed down within a short period. Other foreign players exited the retail market after failing to seize sufficient market shares and sold their subsidiaries to French groups (for example the former Banque SanPaolo was sold in 2003 to

Caisse d'Épargne)⁹⁰. Only HSBC France has managed to survive, although it remains relatively small.

A closely tied banking community: The Federation Bancaire Française (FBF)

The degree of concentration in the French banking sector does not say much about how banks may coordinate during decision-making processes. The British banking sector is also highly concentrated, yet inter-banks' relations are mostly conflictual. In France, good inter-banks relationships and close coordination prevail. Although it has more than 500 members, the French Banking Federation (FBF) is dominated by the largest five banking groups, which make up its Executive Council. The president of the FBF is always chosen from the ranks of the management of the large groups and presides over weekly meetings among the banks' top executives. These meetings allow them to raise individual issues and settle possible conflicts among themselves. During these meeting, top managers also meet with Treasury and state officials during crisis or when a specific regulation needs to be discussed. For example, during the crafting of the banking bailout, a senior banker recalls: *"Everyday, there was a conf-call of the FBD, with Mme Lagarde [Minister of Finance], M. Noyer [Governor of the Banque de France], M. Muscat [Secretary General of the Elysée], M Pérol [special economic advisor of the Elysée] (...) The functioning of the Place de Paris was remarkable"* (Senior banker, interview 12122009).

In France, and with the important exception of the hostile takeover of Paribas by BNP against Société Générale in 1999 (Lordon 2001), inter-banks' relationships have always been characterized by peaceful cohabitation and mutual deference. There are even traditional relations of corporate loyalty that are perpetuated by French banks' top managers. A journalist specialized in banking and former banker herself told me an interesting anecdote about the acquisition of Société Générale's asset management vehicle by Credit Agricole in 2009:

"Credit Agricole has always been close to Société Générale. It is something like its "devoted knight". Credit Agricole said: 'I'll buy out your asset management (-they pretended it was a merger but it was an acquisition-), and then, I'll manage the extinction of your rotten assets'. It went very well. They managed it very well. They were also very careful to treat

⁹⁰ Moody's Outlook, Banking System, France, 2006

Societe Generale's teams well. Not to humiliate them"
(interview, French specialized journalist 042315).

This organization allows for early management of potential disagreement, the crafting of mutually benefiting compromises, and unity in the strategy and wording when it comes to go to the public or public officials (Jabko and Massoc 2012).

Domestic large banks' domination paralyzes the emergence of alternative voices within the financial industry

There are other financial actors in France, who may have divergent interests with the large banks and may be willing to voice them. For example, there is a vibrant and dynamic community of relatively small asset managers, composed of nearly 600 independent so-called "French boutiques". Their interests may differ from the large banking groups. For example, small asset managers complain that large banks are the main operators of High Frequency trading (although the latter consistently deny it). Small boutiques don't have the infrastructure to keep up with large banks' HFT. De facto, banks have the capacity to influence markets' price considerably. The French boutiques were thus in favor of the regulation of HFT to the extent that it was used as an instrument of price manipulation. Yet, the *Association Française de Gestion* (AFG), which gathers French asset managers, is characterized by the sur-representation of large banks, on behalf of their Asset Management subsidiaries. "*The small ones are neutralized. They are squashed by the universal banks within the AFG. There is no chance that the AFG will take position against the HFT*" (interview, French lobbyist 05052015).

The organization of the French financial sector thus prevents the emergence of voices from within finance that may contradict the interests of the largest French banking groups.

An internal organization of banks that concentrates the power in the hands of the CEO and retrained team

The organization of French corporate governance has formally followed the general trend toward a US-style governance: a duality between the Administrative Board and the Executive Board. Yet, specificities have remained: decision power remains located with the top managers, with limited involvement from administrative board members and shareholders (Goyer 2006, 2011).

4.2.3 State centered on the Ministry of the Economy and Finance and the Treasury

The executive, the Minister of Finance and the Trésor

A defining characteristic of state power in France is its extreme centralization in the executive branch. Although the formal system of government in France is semi-presidential, many authors and observers of French politics have noted the prevalence of the executive in the making of the law (Touhari 2010; Keeler 1993). For example, both the parliament and the government have the initiative of law. Yet, only 15% of actual law proposals are made by the parliament – and 85% by the executive branch. In financial matters, the involvement of the Minister of Finance and his/her team, and sometimes the president and his advisors in person, is key (Bronnec and Fargues 2012). Between 2008 and 2017, there have been four ministers of Finance: two conservatives (Christine Lagarde and François Baroin) and two socialists (Pierre Moscovici and Michel Sapin), under two presidents (Nicolas Sarkozy and François Hollande). In all the cases studied here, the role of the Minister has been proactive, no matter their personality or partisan affiliation.

The Minister and his/her cabinet are supported by a team of highly selected bureaucrats from the Direction of the Treasury (the famously known “*Trésor*” in French), who are key in writing projects of laws concerning financial and banking matters. This team of bureaucrats remains the same despite changes in the partisan affiliation of the governmental majority. The Direction is the home of the best alumni of the Ecole Nationale d’Administration (ENA), from which the vast majority of top bankers and a significant proportion of elected officials are also alumni. The significant role of this “*corps d’Etat*” has not significantly changed since it was first described by Zysman (1983) or Clift (2003).

2.3.2. French regulators: the discreet banks’ allies

French regulators are not at the frontstage of policy-making in banking. In sharp contrast with British regulators, they do not take part in the politicization of banking regulation. By contrast, the national central bank, the *Banque de France* (BdF) is often perceived as an active champion for the cause of French large universal banks, particularly through its governors.

The lead banking regulator is the Prudential and Resolution Control Authority (ACPR), an independent administrative authority

monitoring banks and insurance companies under the auspices of the French central bank. The BdF governor until 2015, Christian Noyer, repeatedly came to the defense of the Socialist-led government during the debates on the banking structural reform, arguing that a stricter separation, similar to the British, would have hurt “the national interest” by weakening French banks⁹¹. The BdF is said to be overprotective of data on the French banking sector, and is unwilling to release it to the BCE (See Interviews with academics Gunther Capelle-Blancard and Jézabel Couppey-Soubeyran⁹²; also mentioned in interviews with Brussels-based lobbyist (interview 21052015) and European Central Bank (interview 05292015)).

Among the latest five governors at the Banque de France, all were alumnus of the Ecole Nationale d’administration (ENA), and three were also former bankers. The nomination of François Villeroy de Galhau, another alumnus of the National Administration School (ENA) and Polytechnique, as well as former manager of BNP-Paribas’s Cetelem, in 2015, did certainly not change this trend.

The Autorité des Marchés Financiers (AMF) is a quieter regulator. Yet, it often also acts as the ally of the French banks. The most illustrative domain of the protection of banks by the AMF is the placement of their own investment products by French banks with their clients. They also apply relatively high fees to do so. Small investors have thus virtually no access to foreign investment products, at a high cost (EU 2005; Deloitte 2015). As the regulator of competition, the AMF has remained passive despite pressure from the the EU Commission to intervene. An anecdote told by a French asset manager in London is also revealing. He said that it was difficult to get French institutional clients, because the regulator informally intervenes directly near them to push them to invest mainly in French products (designed and sold by French banks) (interview, 06112015).

2.3.3. The ghost of the Parliament

Although the French Parliament organized large-scale hearings to evaluate the (insignificant) impact of the French structural reform, its role has been extremely limited in shaping the post-crisis sectoral

⁹¹ Christian Noyer cited in Financial Times, ‘France unveils bank reforms’, 19 December 2012

⁹² Challenges, ‘Pour ces deux économistes, les Banques doivent payer plus d’impôts’, 25 January 2013, available at https://www.challenges.fr/finance-et-marche/pour-ces-deux-economistes-les-banques-doivent-payer-plus-d-impots_7692

strategies towards finance. It remains a “registration room” (member of lower Chamber, interview 04272009) constrained by majoritarian discipline (consisting for the MPs in the majority of not contradicting the government) and powerless in an exercise of power that in some aspect remains “monarchic” (ibid). The role of the Parliament has been slightly more important concerning consumers’ rights. During the discussion of the Hamon Law of 2014, more stringent amendments were passed and shaped the final version of the consumer credit law.

The silence of the other stakeholders

Although French banks faced a series of high profile scandals involving the manipulation of interest and exchange rate swaps, money laundering, fraud, financing of rogue nations, and the London Interbank Offered Rate (Libor), there was relatively few high profiled press coverages of these scandals⁹³. This contrasts with Germany, and even more with the UK. The only large-scale scandal has been the “affaire Kerviel”. Kerviel was a Societe Generale trader who held €50bn secret exposure to future derivatives and caused massive loss to the bank. Interestingly, this scandal largely focused on the rogue trader. Although public discussions were held about whether Kerviel ‘really could have acted alone [without his superiors knowing about his risky positions]’⁹⁴, they did not extend beyond to any potential systemic malpractices of French banks.

SMEs associations remained absolutely silent on the questions of banking regulation, although “SMEs financing” is often presented both by the banks and the government as a central priority to them. The bigger employers’ association, the MEDEF, remained mostly quiet too, except to defend the banking national champions during the debate on the banking structural reform. Only Finance Watch, a Brussels-based NGO, has tried and been vocal about banking reform in France, but with relatively limited publicity and impact.

These elements have contributed to an environment of relatively impressive low salience surrounding issues of banking regulation in France. Along with the French parliament, stakeholders that may have been able to capitalize on banking scandals remained mostly passive.

⁹³ Le Figaro, 19 July 2012 ‘Scandale du Libor : deux banques françaises suspectées’.

⁹⁴ See for example Le Monde, Procès Kerviel : la théorie du complot, un "gigantesque mensonge", 13 June 2012.

4.2.4. Social homogeneity and group identity

Scholars have noted the persistent social homogeneity between French banking and political elites. The literature on capture has identified mechanisms of how business actors, and especially financial actors, could capture policy-makers. French scholars have stressed the big influence of French banks on government's policy-making and position at the European level. But if mechanisms of social capture such as identified by Kwak (2013), namely group identification and network relationship, work in one direction (from bankers to policy-makers), they should work in the other direction as well.

French elites' sociological homogeneity is a well-known feature of French capitalism since at least the work by Bourdieu (Bourdieu 1989). But its persistence is striking (Dudouet and Gremont 2010; Chavagneux and Philipponnat 2014). Véron (2007) even talks about 'archaic caste features at the heart of French capitalism'. Today still, actors stress the importance of educational networks in the conduct of business in France, especially (but not exclusively) in banking. A top French banker says: "*Everybody knows how these networks are important in France*" (interview 14052015). Another confirms: "*All the heads of the French banks have worked in public administration, including HSBC France. Of course, they are competitors in normal times, but they share a common language, a common experience, which means that in times of crisis, they have been extremely united*"⁹⁵ (Woll 2014, p125).

These observations are in line with sociological findings about the narrowness of the French elite's educational background (Bourdieu 1996; Dudouet and Gremont 2010). Nowadays like decades ago, government officials and top bankers have been educated in the National School of Administration (*École Nationale d'administration* or ENA) and are members of the Treasury's *Inspection Générale des Finances*, an elite corps of the French public service. Those who didn't go to ENA went to the elite engineer school, Polytechnique or to the elite school *Institut d'Études Politiques* of Paris (IEP Paris or Sciences-Po Paris), which provides the vast majority of students admitted to ENA. Figure 10a and 10b illustrates this educational homogeneity and contrasts it with the German case. This figure takes into account the members of the cabinet of the Finance Minister only. But the Direction of the Treasury, which consists of the team of expert supporting the

⁹⁵ Interview cited in Woll 2014, p125.

Minister in his/her policy, is also the home of the best alumni of the Ecole Nationale d'Administration (ENA).

Figure 10a: Educational background of top executives of Société Générale, BNP-Paribas, Crédit Agricole and Finance Cabinet members in 2011

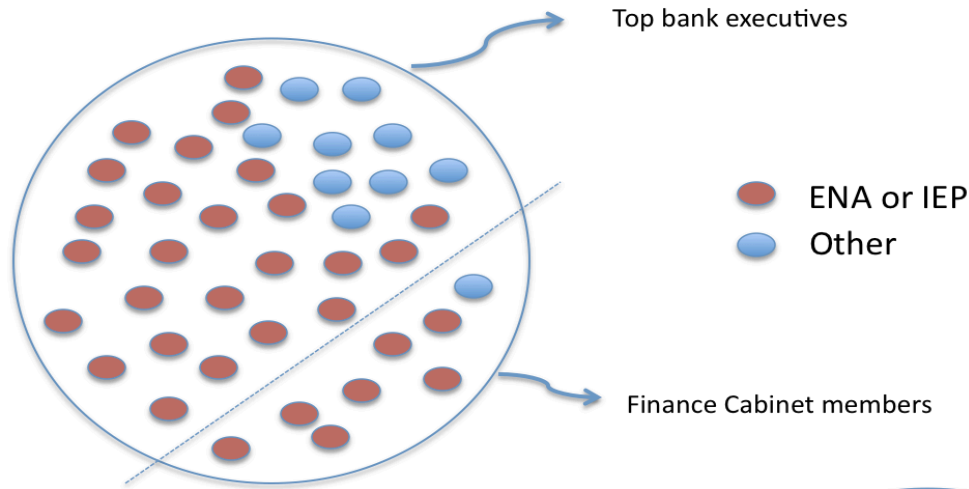
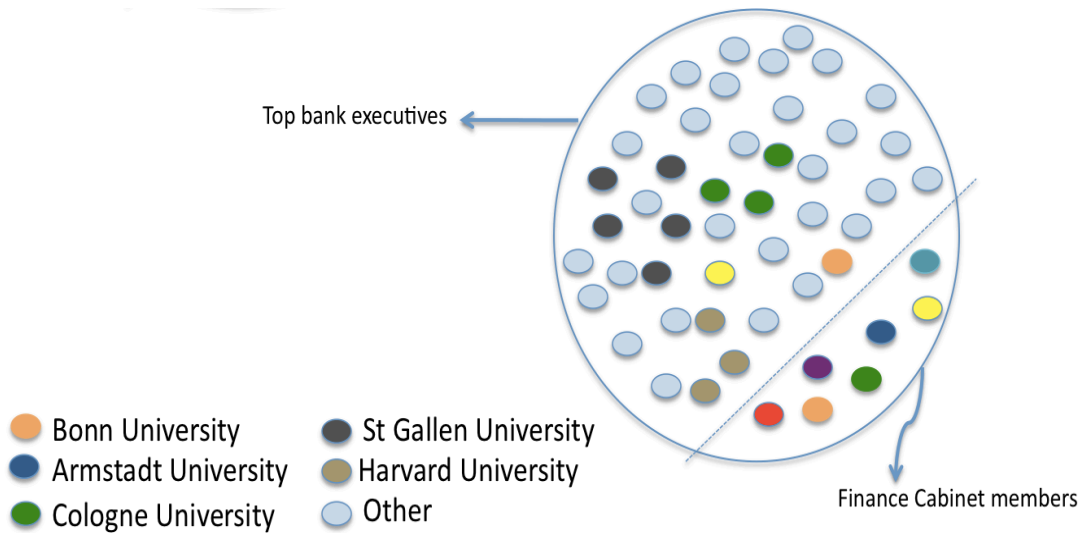


Figure 10b: Educational background of top executives of Deutsche Bank, Commerzbank, LB Bayern and Finance Cabinet members in 2011



The careers of state officials, and even more of regulators, bureaucrats and bankers are closely intertwined. It starts with ENA and the integration of the Inspection des Finances, goes through banking, then public functions, to get back to banking eventually. Because it is the typical career of the French elite, it is a different mechanism than the revolving door, which describes the poaching of regulators by the industry. As Jabko and Massoc (2012, p566) write: “*The social circles and career trajectories of private bankers and high-ranking state officials do not just intersect on occasion, but are almost indistinguishable from each other. The boundary between the public and private financial elites is so porous that there is almost no need for doors*”.

Despite several efforts towards transparency in the relationships between state and private interests (like the creation of a register for lobbying organizations), it has been noted that France’s regulation of lobbying is very weak. The NGO, Transparency International, gave a grade of 2.7/10 (10 being the best grade) and said “France is not up to democratic exigence” (Transparency International 2014)⁹⁶. Yet, it is interesting to note that the French typical mode of state-bank coordination goes far beyond traditional lobbying channels.

4.2.5. Typical symbiotic state-banks mode of coordination

The institutions described above are fostering the typically *symbiotic* French mode of state-bank coordination during policy-making processes. The main locus of decision making is centered on a very narrow and closed elite nexus composed of state officials from the Ministry of Finance and banks’ top managers. Jabko and Massoc (2012) called it an “informal consortium”.

In terms of how these institutions mediate banks’ structural power, we have seen that there is no opportunity of venue shifting, no room for other voices to be heard, and limited leeway for the emergence of political salience, for a lack of actors willing to play the card of conflict expansion. One could argue that this is the perfect institutional context for complete capture of state officials by banking interests. It is true that the developmental strategy put together in France is most consistent with banks’ preferences. The banking structural reform (see Chapter 5; Howarth and Macartney 2016) shows in more detail how French banks made their preferences prevail in a reform process that

⁹⁶ Le Monde, 10/21/2014, La France, mauvaise élève du lobbying

went as politically salient as it could get, and which was backed by the EU. Yet, I argue that the French state-banks mode of coordination is actually more nuanced. It is not captured but *symbiotic*. As it will be developed in chapter 6 of this dissertation, bankers also listen to state officials and comply with their demands, although arguably to a less extent than the other way around. The nuance is also in the mechanisms of coordination.

Concentrated banking organization, centralized government and sociological proximity foster shared beliefs and expectations among government and banking elites for reasons identified by the students of collective action. Kwak (2013) identifies group identification and relationships network as mechanisms that contribute to creating these informal institutions. Group identity matters, because in helping my own group I help myself as a member of that group. Identification with a group has several effects that go beyond material self-interest. People seem to gain utility from behaving in conformity with their group identities. In what Meindinger called a ‘regulatory community’, “members of the community frequently influence each other, act with reference to each other, and desire each other’s respect” (Meindinger 1985, cited in Kwak 2013). This is the familiar effect of relationships, Kwak writes: “you are more favorably disposed toward someone you have shared cookies with, or at least it is harder to for you to take some action that harm their interest”. Relationships matter because we care about what other people think of us, in particular those people whom we come into contact regularly. Ostrom (2000) also stresses that face-to-face communication considerably increases the likelihood of cooperation. This is made easier thanks to the small number of actors involved.

This nurtures the complete homogenization of public and private actors’ preferences. The close nexus of banking and state elites collectively shape narratives which prevent them from perceiving different interests as contradictory. Financial stability, economic growth and the financing of SMEs are all objectives ranked under the umbrella of promoting national champions. When interests conflict, they are managed early on and compromises are found.

The puzzling aspect of the French politics of banking is that the narratives constructed between banks’ top managers and Treasurers are adopted by most French stakeholders. For example, French actors interested in financial reform have integrated the idea that French banks should not be penalized at the risk of favoring US banks. These are illustrative citations from public and private interviews:

- The Governor of the BdF said: “*the French would have found itself with only the big Wall Street banks to place its debt. [French] companies would have found only Wall Street banks to finance their operations*” (Christian Noyer, President of the Banque de France, about the banking structural reform)⁹⁷
- The minister of Finance said: “*we didn’t want to be ‘giving a gift to Anglo-Saxon banks*” (Moscovici, Minister of the Economy and Finance)⁹⁸
- A French senior banker said: “*It is also really a question of national interest. Do we want to open a royal path to Wall Street banks?*” (interview 06032015).
- A French specialized journalist said: “*It is unfair. The crisis came from the USA and now the markets are going to shift towards the Anglo-saxons*” (interview 04222015)

State officials don’t see state and banking interests as contradictory. They see them united below the national interest. It is possible that bankers don’t see them as contradictory either. There is a strong discourse of public interest and national loyalty among the French bankers, more than in any other banking community. A very influential French former banker told me that, in order to manage a French bank, one had to “*have a devotion to the general interest*” (interview, 01182009). French bankers often publicly talk about the “national interest”⁹⁹. This may not be genuine, and may well be a strategic or cynical misrepresentation of their interests. It may be a mixt. It is impossible to know for sure.

Some would argue that these mechanisms of interaction functionally equate to the total ideational capture of public actors by bankers (Blyth, 2002, 2013). But even in that case, it is interesting to see that this capture builds on at least the partial involvement of banking actors to give back. As a British banker noted after lamenting that the French treated their banks as national champions, and not the British, “*British banks want domestic protection, but at the same time, when the government asked them to step in, they did not!*” (Senior UK banker, 06072016). Conceiving the French state-banks mode of coordination as symbiotic rather than captured, allows us to explain both why the state

⁹⁷ Christian Noyer cited in Financial Times, ‘France unveils bank reforms’, 19 December 2012

⁹⁸ Pierre Moscovici cited in Le Parisien, ‘Une loi en chantier pour mieux encadrer les banques’, 19 December 2012

⁹⁹ See for example Pébereau in Les Echos, 09/23/2009; Lemierre cited in Libération. “Jean Lemierre, un banquier qui change”, 1 March 2015.

listens to its banks and why the banks listen to the state. It also allows us to better understand the mechanisms of decision-making and question their sustainability.

Repeated interactions in this narrow and closed circle entail stable expectations and no demonstrative use of power resources. State and banking actors are embarked in a long-term “win-win” relationship. State actors do what they can to accommodate bankers, but the other way is also true. One senior banker’s statement illustrates this claim. The EU Commission was trying to get the emissions of the SFEF -the entity put together by the French state to guarantee French banks’ emissions right after the crisis- counted as state aids. He said: “*the French state played its role well vis-à-vis the banks. Banks have absolutely no interest to trap the state by refusing to find a solution to get this debt out of the state debt. We’ll do what we can to find a solution*” (French Senior Banker, Interview 12122009).

This dissertation shows that French banks tend to take the demands made by their state seriously. Yet, it must be noted that state actors sometimes fail to influence banks’ major investment decision (for example when banks refused to “save” Euronext in 2013¹⁰⁰). A defection from the institutional arrangement is always possible (Culpepper 2005). If a big actor defects, the typically French symbiotic mode of coordination may start eroding.

4.3 Germany, a dual mode of state-bank coordination

4.3.1 The separate worlds of German banking

The German banking system is divided into three groups: the private banks, the cooperative banks (*Genossenschaftsbanken*) and the public banks (which includes the savings banks – *Sparkassen*, and the state banks – *Landesbanken*)¹⁰¹. There has been regulatory convergence between the three pillars between the 1980s and early 2000s: financial activities have been de-segmentalized and banks of the three pillars could start competing on all segments of financial services. Interest rates have also been deregulated in 1981 in Germany. Finally, 2005 has seen the end of public guarantees for Landesbanken

¹⁰⁰ <https://investir.lesechos.fr/actions/bercy-veut-que-des-banques-entrent-au-capital-d-euronext-presse-868289.php>

¹⁰¹ See Boxed text X, Chapter 2 for a more detailed presentation of the German three pillar banking system.

(*Gewährträgerhaftung*). Yet, public banks still have regulatory specificities. First, they have specific public interest missions and have the legal obligation to meet the financial needs of the region's non-financial corporations. Sparkassen are also bound by the regional principle (*Regionalprinzip*), which means that they don't compete with each other. The different banks are in so-called group competitions: they are legally shielded against takeovers of banks by other groups and compete as the entire group with the other groups (Deeg 2001). Despite the repeated attacks of the EU Commission, this regulatory protection still holds today. The three-pillar banking system reflects on the political organization of German banks.

Each group has its own representative association. German banking associations are also responsible to manage resolution and deposit guarantee schemes for their banking group, which further contributed to make them impervious to each other. The political weight of these associations varies. The Association of German Banks, which represents all private banks operating in Germany (including foreign subsidiaries), is almost absent from political debates. Its role is mostly limited to inform its members about regulatory changes. The political representation of private commercial banks is de facto monopolized by Deutsche Bank and, to a lesser extent, Commerzbank. By contrast, the German Savings banks Association (DSGV) is very active, both at the state and federal levels.

Boxed text 6: The patchwork of German banking associations

- The National Association of German Cooperative Banks (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken, BVR*) – operates a statutory Deposit Guarantee Scheme (DGS) and an Institutional Protection System (IPS) for credit cooperatives and their regional institutions through its wholly-owned subsidiary BVR Institutssicherung GmbH (BVR- ISG).
- The Association of German Banks (*Bundesverband deutscher Banken – BdB*) – operates a statutory DGS and a voluntary DGS for other private credit institutions.
- The German Savings Banks Association (*Deutscher Sparkassen- und Giroverband, DSGV*) – operates a statutory DGS and an IPS for sparkassen and Landesbanken.
- The Association of German Public Banks (*Bundesverband*

Öffentlicher Banken Deutschlands – VÖB) – operates a statutory DGS and a voluntary DGS for other public credit institutions.

Banks are not only separated legally and politically, but also socially. As Tables 10a and 10b illustrate with the executive boards of the commercial Deutsche Bank and the Landesbank BayernLB, bankers in the three pillars come from different educational backgrounds, banking cultures and even nationalities. At Deutsche Bank, executives are often non-German nationals and have been educated abroad, mostly in Anglo-American universities. At BayerLB, all the members of the executive board are German and educated in Germany.

Table 10a: Education and nationality of Deutsche Bank’s Executive management team (2008-2016)

Members of executive board (2008-2016)	German education	German national
Achleitner	NO	YES
Ackerman	NO	NO (Swiss)
Banziger	YES	YES
Cohrs	NO	NO (US)
Cryan	NO	NO (UK)
de Weck	NO	NO (Swiss)
Faissola	NO	NO
Fitschen	YES	YES
Frieden	NO	NO
Hammonds	NO	NO (US)
Jain	NO	NO (US)
Koch-Weser	YES	YES
Krause	YES	YES
Lamberti	YES	YES
Leithner	NO	NO (Austria)
Lewis	NO	NO (UK)
Matherat	NO	NO (FR)
Neske	YES	YES
Parker	NO	NO (US)
Price	NO	NO (UK)
Ritchie	NO	NO (South Afr)
Ritchoffe	NO	NO (US)
Schenck	YES	YES
Sewing	YES	YES
Steinmuller	YES	YES
Urwin	NO	NO (UK)

von Rohr	YES	YES
Waugh	NO	NO

Table 10b: Education of BayernLB’s Executive management team

Members of executive board (2008-2016)	German education
---	-------------------------

Bücker	YES
Dreesen	YES
Ermisch	YES
Haeusler	YES (also Geneva)
Hanisch	YES
Harnischmacher	YES
Kemmer	YES
Kramer	YES
Niermann	YES
Riegler	YES
Schmidt (Ralph)	YES
Wingelmann	YES
Winkelmeier	YES
Woitschig	YES
Zoller	YES

From a legal, political and cultural points of view, the three German banking groups to a large extent remain impervious to each other. As a representative of public-sector banks insisted on this point during an interview: *“It is not because we are all called a bank that we do the same thing. We are nothing like Deutsche Bank”* (VOB representative, 11/10/2016).

Banks don’t discuss financial regulation across groups. Discussions are made through ‘their own’ politicians. The banking organization follows the political organization of the German polity. On one side, the largest commercial banks – especially Deutsche Bank, can count on the elected officials of the federal government and Treasury’s bureaucrats to listen to, and advocate for, their preferences concerning financial reform. On the other side, although there are internal tensions within the public-sector banking group, the cooperative and public local banks can count on local government to defend them actively.

4.3.2. *The government and Deutsche Bank*

“*Germany also wants a national champion*” (DG FISMA, interview 05282015b).

Elected officials of the federal government and Treasury bureaucrats have long been concerned about the position of Germany in the global financial markets. Students of German capitalism have pointed out that Germans have been susceptible to the attractions of 'American' economic culture (Albert 1993; Streeck 1997). A home grown financial champion capable to compete with US investment banks in the global markets has become a matter of national pride. Because it is a political power in the international arena, “*it is [also] normal for Germany to have a financial champion*” (Treasury Official, Interview 11122014).

As a matter of fact, after the crisis, the acquisition of Dresdner by Commerzbank was seen by the bank -and the government - as a way to preserve the capacity of the bailing bank to remain competitive on the global markets (Bundestag, Interview 11142016a). “*It's good for Germany as a business location and strengthens it as a financial centre,*” Finance Minister Steinbrueck's spokesman Torsten Albig said about the acquisition in 2008¹⁰².

The deference of elected officials and bureaucrats to Deutsche Bank

Within Deutsche Bank, the deference of traditional managers toward the ‘modern’ investment bankers coming from the US has explained strategic decisions at the bank starting in the 1990s. Journalists from *Der Spiegel* have investigated the fascination of German bankers for a finance they did not understand very well but which, at the same time, engrossed them. They write:

*“At Deutsche Bank, [German] managers either didn't understand the deals they were being asked to evaluate or they wanted to act cool in the presence of the Anglo-Americans. The Americans, in any case, were often told by the German risk management division: "What a great deal! Good luck!" They often couldn't believe what they were hearing and, at their parties, laughed about their colleagues back in Frankfurt.”*¹⁰³

¹⁰²Cited in BBC News, “Commerzbank buys ailing Dresdner”, 1 September 2008

¹⁰³ <http://www.spiegel.de/international/business/the-story-of-the-self-destruction-of-deutsche-bank-a-1118157-4.html>

Similar attitudes arguably characterize German Treasury officials towards commercial banks' top managers. The German high bureaucracy has traditionally been trained in Law. This still holds true today for the generalist highest civil servants (Derlien 2003, p10). Under Finance Minister Schaeuble in 2014, the three top positions at the Directorate general VII of the Ministry, in charge of Financial Market policies were filled by highly trained lawyers. Dr Levin Holle, the head of the Directorate General VII, had a doctorate in Law. Under him, Dr Thorsten Pötzsch in charge of financial markets regulation (who later became Chief Executive Director of the Resolution Directorate at BaFin) and Dr. Marcus Pleyel in charge of federal credit institutions, were also Doctors in Law. Although the lack of expertise in financial matters may partly explain the influence of bankers' in Treasury's circles, the *a priori* deference of the bureaucrats towards bankers may even be more important. A German journalist explained why Treasury officials listened to what the largest commercial banks were saying about financial regulation after the crisis: "*They still think that they [the bankers] are the smart guys*" (Interview 11172016).

An anecdote told during an interview can illustrate the complexes of German bureaucrats in front of Anglo-American investment bankers. A Treasury official recalled the language difficulties of German representatives during an international meeting on accounting standards: "*The Americans, they talk with the British. We struggle behind. We need to ask for them to repeat. In these contexts, it is difficult. The Americans, they show off... They say they are the best, that we don't have a clue about how financial markets work...*" (Treasury Official, Interview 11122014). From this point of view, it is less surprising that public officials may rely on Deutsche Bank's managers, who by contrast are extremely familiar with the US investment banking culture.

3.2.3. "*The State within the State*" (EU lobbyist, Interview 05052015)

Deutsche Bank has an important ally in the German government. In 2016, when Deutsche's stock price dived, finance minister Wolfgang Schaeuble took the unusual step of publicly guaranteeing public support. A German official close to chancellor Angela Merkel said Berlin would stand by the Bank no matter what¹⁰⁴. Deutsche Bank's managers tend to deny in interviews that the bank has a particular

¹⁰⁴ <http://uk.businessinsider.com/r-for-deutsche-banks-cryan-profit-can-wait-2016-5?r=US&IR=T>

access to policymakers, although they would recognize that it is *normal* that government top officials, especially the Finance Minister, would listen to its major bank. Only through secondary sources (some of them arguably biased – because they are mostly EU officials angry at German policymakers or pro-regulation lobbyists) can we document the face to face between Deutsche bank CEO until 2013, Joseph Ackermann, described as “*the absolute sovereign of Deutsche Bank*”¹⁰⁵ and the Minister of Finance, Wolfgang Schaueble.

As an EU official involved in the crafting of the European proposal recalls: “*The EU was united behind this [BSR] approach. But Germany came and refused! Deutsche Bank was key to push for the refusal by Germany*” (Interview, 05282015b).

4.3.3. The strong local coalitions

Internal dissensions between Sparkassen, Landesbanken and Landers' governments

In Europe, only Germany has such an important share of state-controlled credit institutions in the banking sector (Bluhm and Martens 2009, p594). Historically the ownership of the Landesbanken was equally split between the Länder and the Sparkassen. But it has shifted since the financial crisis, with the burden of recapitalizing the regional banks falling largely on the Landers.

Boxed Text 7: Organization of public-sector savings banks (Sparkassen) and State banks (Landesbanken)

German savings banks have mainly remained consistent with one of their original features, i.e. their focus on collecting savings from and lending to retail customers. They comply with a "regional principle" (*regionalprinzip*), that restricts their activities to a specific local or regional area. Their local focus gives them a relatively large deposit base, while their close ties with customers mean that they have good knowledge of local risks.

They belong to very dense networks comprising legally autonomous institutions with distinct business models. Those networks have a two-tier architecture (local and regional) that works according to the principle of subsidiarity: the local savings banks carry out the main functions of a bank branch, and the other regional banks do the things that the local bank cannot do itself, such as securities trading, financing of exporter customers and support for their foreign operations, access to hedging products, cash

¹⁰⁵ <http://www.spiegel.de/international/business/the-story-of-the-self-destruction-of-deutsche-bank-a-1118157-4.html>

management and payment methods. This network organization allows banks to operate under a common brand name, achieve economies of scale (by pooling certain functions, particularly back office functions) and offer customers a wide range of products and services (by outsourcing certain businesses and/or functions to other institutions specializing in areas such as asset management and investment banking).

Networks also have centralized liquidity management. Local banks place their surplus funds with central institutions, which act as central banks and clearing houses for all members of the network. Local banks are traditionally shareholders in and net creditors of these institutions. The flow of liquidity within the network makes the central institutions, which generally lack a stable deposit base, less dependent on market financing and allows local banks to pass on part of their maturity transformation risk. Finally, one specific feature of savings-bank networks relates to the mutual support commitments, contractual or statutory, that bind their members (See Bramer et. al. 2011; Choulet 2017).

The cohesion within the public pillar of the banking industry was seriously shaken during the financial crisis. At the beginning of the 2000s, the Landesbanken anticipated the effective withdrawal of public guarantees by issuing a large stock of guaranteed debt, because they feared a significant increase in the cost of resources after the end of public guarantees. In the meantime, they increased their borrowing from the Sparkassen and expanded their balance sheets in areas far removed from their core business. They used Sparkassens' resources to finance non-domestic customers, most notably investing in higher-risk markets (such as structured products backed by US sub-prime mortgages). In other words, they went "*everywhere, without being qualified to do so*" (Constantin von Oesterreich, NHS Nordbank chief executive¹⁰⁶).

Exposed to toxic assets, the Landesbanken were thus hit very hard by the subprime crisis (Bramer et. al. 2011; Hardie and Howarth 2009; Choulet 2017). The Sparkassen sought to minimize their role in the rescue of the landesbanken experiencing the greatest difficulties. The burden of recapitalizing the regional banks thus failed largely on the states, which fought hard to save their banks – arguably motivated more by political than economic reasons (Hellwig and Weder di Mauro 2009).

¹⁰⁶ <https://www.economist.com/finance-and-economics/2015/01/08/lost-a-fortune-seeking-a-role>

The tensions between Landers and savings banks over the bailouts of landesbanken can be illustrated by the case of BayernLB. In 2008, the bank reported a loss of five billion euros. Savings banks initially considered getting out and letting the bank fail. But Bavaria's Prime Minister Horst Seehofer intervened alongside BayernLB's CEO Michael Kemmer to secure the support of the savings banks, by engaging billions in state aid¹⁰⁷. The savings banks consequently agreed to retain their stake in BayernLB, but at much public cost for the Bavarian taxpayers.

In the following years, rumors suggested that regional groups of savings banks intended to create informal alliances with a view to potentially vetoing assistance to a Landesbank in difficulty (Choulet 2017). Indeed, unlike the protection of depositors, the triggering of the mutual support structure is not legally mandated. Savings banks have been angry because “[they] have subsidized wall-street like ambitions of landesbanken before the crisis”. They are now pushing to put an end to landesbanken’s misbehaviors but they fear that the protection of these banks by local politicians will prevent them from doing so (DSGV, interview 11142016b). A Landesbank manager complains: “We have always been caught in battles between the local politicians and the savings banks associations” (Public-sector banker, interview 05192015).

The savings banks and Landesbanken are thus “far from a happy family,” (senior advisor to German banks cited in Choulet 2016). Yet, they remain an effective family when it comes to advocate for their preferences during policymaking processes.

The Verflechtung (intertwining) of Landers’ governments and public-sector banks

In 2005, commercial banks managed to circumvent existing national policy-making structures in order to obtain the abolition of state guarantees by appealing to the EU state aid rules (Grossman 2006). The abolition of the guarantees has yet not broken the link between Landesbanken and Lander’s governments. Revealingly, ratings agencies and investors alike continue to take account of the close ties between the Landesbanken, the Sparkassen and the Länder in their assessment of the quality of Landesbank debt (BMI Germany, 2017).

¹⁰⁷ Manager Magazin, « Vizechef Harnischmacher geht », 27 April 2009, available at <http://www.manager-magazin.de/unternehmen/karriere/a-621297.html>

The Landesbanken have traditionally played an important role in provincial-level politics, because governments use them to pursue policy goals, such as supporting new industries. A prominent example is the role WestLB played in the economic transformation of North Rhine-Westphalia from an economy based on steel and coal to one based on services. The government became a major actor in regional adjustment process, using its large Landesbank to intervene extensively in regional industries (Deeg 1999, p125-157). In one interview led by Deo et.al. (2015, p167), a senior official of the German Federal Agency for Financial Market Stabilisation (FMSA) explained the mechanism of using Landesbanken to promote the regional economy as follows: “*While every single euro of the state budget results in one euro public spending, the possibility to use leverage means that one euro in the Landesbank translates into ten euros of public spending*”. More controversially, German savings banks systematically adjust lending policies in response to local electoral cycles (Vins 2008; Englmaier and Stowasser 2017).

As illustrates by Table 11, states’ local politicians are very well represented in Landesbanken’s supervisory boards. The Lander’s Minister of finance him/herself often sits on the board, as well as the mayors of major cities of the state.

Table 11: political actors sitting in the supervisory boards of four Landesbanken (2017)

Table 11a: Bayer LB

Dr. Kurt Gribl	Mayor of Augsburg
Harald Huebner	Director Bavarian State Ministry of Finance, for State Development and Home
Dr. Thomas Langer	Director Bavarian Ministry of Economic Affairs, Energy and Technology
Judith Steiner	Director Bavarian State Ministry of Finance, for State Development and Home

Table 11b: Helaba (Landesbank Hessen-Thuringen)

Edith Sitzmann	Minister of Finance of the State Baden-Württemberg
Wolfgang Dietz	Mayor of Weil am Rhein
Fritz Kuhn	Mayor of the City of Stuttgart
Klaus-Peter Murawski	Minister of State and Head of the State Chancellery of the State of Baden-Württemberg

Table 11c: SaarLB

Stefan Crohn	Ministry of finance of Rhineland-Palatinate
Daniela Schlegel-Friedrich	District administrator for the district of Merzig-Wadern
Peter Strobel	Minister, Ministry of Finance and European Affairs (and Deputy Chairman of MIT Saarbrücken (CDU's SMEs Association))

Table 11d: Landesbank Baden Württemberg (LBBW)

Dr. Werner Henning	District Administrator Eichsfeld Heiligenstadt
Andreas Bausewein	Mayor of Erfurt
Manfred Michel	Administrator of Limburg-Weilburg
Thorsten Schafer-Gumbel	Member of the Hessian State Parliament
Uwe Schmidt	District Administrator Kassel
Wolfgang Schuster	District Administrator Lahn-Dill-Kreis-Wetzlar
Dr. Heiko Wingenfeld	Mayor of Fulda

The politically charged nature of the mergers between Landesbanken after the crisis indicates how important these banks are for regional politicians. A key example is the failed acquisition of WestLB by Landesbank Baden-Württemberg (LBBW) in August 2007. The Premier of North Rhine Westphalia at the time, Jürgen Rüttgers,

rejected the plans, because he feared they would reduce the significance of Düsseldorf, a key city in his Land, as a leading financial center¹⁰⁸.

Powerful local nexus

State governments use public-sector banks to achieve political objectives, and the former protect the latter against undesirable reform at the federal level. A German MP confirmed that “*There is a consensus among local politicians, across parties, to safeguard public-sector banks*” (interview 11142016a). Even after the crisis, market actors underline the “*Länder's commitment to protecting their banks*” and the advantages that they draw from it (German private banker, Interview 04092014).

Since long ago before the crisis, political power networks have shielded regional state banks and saving banks from domestic the political attacks of private banks (Seikel 2017, p155). Despite difficulties, they remain a powerful nexus able to influence national politics. “*The Sparkassen are better positioned politically than any other group of banks,*” according to Jorg Rocholl, president of the European School of Management and Technology and an adviser to the German finance ministry¹⁰⁹.

Formally, the Bundersrat, the German ‘upper chamber’ is involved in lawmaking. The Bundersrat is composed of delegates from Lander’s governments. Public banks’ supervisors and representatives are also politicians involved in party politics. For example, Heinrich Haasis, the president of the Sparkassen’s DSGV, is also an important figure of the CDU, the federal coalition’s majoritarian party.

The political machine to protect local banks can be seen at work in the example of the exemption of Sparkassen from the European Resolution mechanism in 2013. The EU proposal aimed at forcing states to build up *national* deposit-guarantee funds. As soon as the proposal was made, German members of the European Parliament sprang into action. They maneuvered themselves into the powerful negotiator positions in all four major parties -- from the far left to the conservatives -- and rewrote the bill so the Sparkassen rescue mechanism could remain separate. A Wall Street Journal journalist reports Burkhard Balz, a representative for German Chancellor Angela Merkel's conservative party, saying: “*You cannot put a sheet of paper*

¹⁰⁸ Handelsblatt, “NRW muss wegen WestLB Milliarden zurückstellen”, 2010.

¹⁰⁹ The Wall Street Journal, “German Savings Banks Flex Political Muscle”, 12 November 2013.

between me and the Socialist negotiator on the bill” to the Danish diplomat who was leading the talks for EU member states. Special deals for the Sparkassen are a "precondition" when negotiating financial laws with German policy makers, said Martin Bresson, the Danish diplomat. Bresson continues: "You're not subdued with massive lobbying, where you feel your arm being twisted and you are forced into it. But you just know". According to the Wall Street Journal, Germany's public savings banks have become the most powerful little lenders in the world¹¹⁰.

The coalition between public banks and Lander’s governments is furthermore supported by the Mittelstand. As the German Mittelstand representative clearly stated during an interview: “*We have an alliance with the saving banks and with the cooperative banks*” (Interview BVMW, 11092016).

4.3.4. Absence of other political actors

Politically uninvolved regulators

Jens Weidmann, the president of the Bundesbank, deemed the ringfencing recommendations of the Liikanen Group and the European Commission, as ‘sensible approach’ but did not push actively on the matter¹¹¹ (Howarth and James, forthcoming). Weidmann remained faithful to the tradition of German fragmented sovereignty (Streeck 1997, p142) between the federal government and independent authorities insulated from electoral pressure, in particular the Bundesbank. Policy objectives like monetary stability and competitive markets are in this way removed from government discretion and depoliticized in Germany. In reciprocity, the Bundesbank does not intervene in political matters.

A BaFin Senior official asked about why they didn’t take a more active role (as in the UK), answered that it was not their role to take side against the Treasury and even less to politicize issues from their own initiative: “*It doesn’t work like that*” (interview BaFin 11192016a).

¹¹⁰ The Wall Street Journal, “German Savings Banks Flex Political Muscle”, 12 November 2013.

¹¹¹ Jens Weidmann, speech at the London think tank Chatham House on 03/29/2012, cited in CS Monitor, “EU leaders agree on need for more money”, 03/29/2012

3.4.2. A low-ambition experts' Commission

As soon as 2008, the Merkel government established an 'Expert Commission' (*Expertenkommission*) on the new architecture of financial markets (*Neue Finanzmarktarchitektur*) which operated officially until 2011. The Commission was chaired by Ottmar Issing and consisted of a small number — at most six members including Issing — of very high-level public sector and academic experts on finance. Arguably, the Issing Commission had the intellectual resources and expertise needed to investigate the desirability and feasibility of banking reform in Germany. Ottmar Issing was the former chief economist and European Central Bank Executive Board member¹¹². Klaus Reglin was a former director-general of Economics and Financial Affairs at the European Commission. Jens Weidmann (who left the commission prematurely), was former economics and finance advisor to Angela Merkel and then head of the Bundesbank. Jörg Asmussen was former state secretary at the ministry of finance. Jan Krahen was a finance professor from Goethe University. Finally, William Whit was a Canadian economist and former head of the Monetary and Economic department at the Bank for International Settlements.

In contrast with the British Independent Commission on Banking, the commission lacked material resources to launch a truly original investigation in banking. They had no secretary. The members did not dedicate the majority of their time to the Commission either. Simultaneously, Issing was for example sitting in a newly set up advisory board with EU Commission President José Manuel Barroso. The experts were closely chosen by Merkel and then Finance Minister Steinbrück. While in the UK, the governor of the BoE and LibDems politicians got involved to put forward personalities renowned for their critical stance toward finance (such as Martin Wolf), in Germany, the picked personalities were closer to the orthodoxy. First, the Chancellor had proposed former Bundesbank President Hans Tietmeyer. This choice triggered protest from the coalition partner SPD, for which Tietmeyer was mainly held liable for his activities with the ailing real estate financier Hypo Real Estate (HRE). Merkel renounced to this initial choice, but it is revealing of the kind of personalities that the government wanted in the commission. A German politician described

¹¹² Issing is a monetary policy hardliner. He vehemently advocated a strict anti-inflation course. He is also known to be the "secret ruler" ("*Süddeutsche Zeitung*") of the European Central Bank and the "architect of European monetary policy". See *Der Spiegel*, 20 October 2008, 'Finanzexperte Issing soll Reformkommission leiten'

them as “*less wild*” than the members of the British Independent Commission on Banking (interview 11142016a).

A quiet Parliament

The Bundestag created a special commission to focus upon the management of specific failed institutions — notably HRE and Dresdner Bank — but this commission did not examine broader banking reform issues

There was a day-long hearing in the *Finanzausschuss* in November 2012 (28 November 2012)¹¹³. Infamously, the head of Deutsche Bank, Anshu Jain, was invited to appear before the select committee to answer questions on his bank’s involvement in rate manipulation but he failed to show up and there was no follow-up.

4.4 The UK, an adversarial mode of state-banks coordination

4.4.1 The many deep transformations of UK political economy

The UK has undergone many economic and political transformations since the middle of the 20th century. First, the events surrounding the 1976 IMF loan request, and the arrival of the new Thatcher government of 1979, had far-reaching effects across government. The tripartite consensus, that had balanced the interests of organized labor, the corporate sector, and the state, fell apart. Then, close social, political, and cultural ties between the City, the Treasury and the Bank of England were characteristic of post-war UK. The top executives of the handful of old and prestigious high street banks composed a distinguished “gentlemen club”, prone to playing bridge while sealing agreements together (Gilligan, 1997). The sweeping and radical reforms of finance undertaken at the very beginning of the 1980s, known as the “Big Bang”, and which led to the increasing presence of foreign firms in London and to the integration of British banks into global markets, dramatically transformed the social character of the City (Clemons and Weber 1990; Plender 1986).

Ties in the banking sector loosened a long time ago, but British

¹¹³ For a short report of the hearing, see: http://www.deutschlandfunk.de/der-libor-skandal-und-die-deutsche-bank.769.de.html?dram:article_id=229206.

banks could rely until the crisis upon the trust and deference of all successive British governments, and regulators. Many observers of British politics have ironically recalled the Labour PM Gordon Brown's praise of British bankers during his first press Q&A as a Prime Minister on July 4 2007¹¹⁴. In agreement with other scholars' findings (Bell, 2002; Davis and Walsh 2016; Froud et. al. 2012; Bell and Hindmoor 2015), a lot of people that I interviewed mentioned the trust of state officials in the superior capacity of the City and British banks to govern themselves. As a British Senior banker recalls: before the crisis "[the regulators] *were happy to see us. They said: 'do what you want!'*" (interview, 07112016b). Many authors have stressed this relationship of trust and deference that developed between the Treasury, the Bank of England and the banks since the late 1970s (Ingham 1984; Fine and Harris 1985; Anderson 1987; Theakston, 1995; Hutton, 1996). This trust relationship was broken after the crisis. There was a serious backlash. Banks were at first not aware of the change in attitudes. "How could these guys come and think that they would be bailed! Incredulity of Darling! Of course they thought they would bargain, that's what they always do" (interview House of Lords, 07122016d) A member of the Committee on Banking Standards explains the change in attitude: "Because nothing of this was institutionally set up, it can change very quickly dramatically" (interview 07130216).

To coordinate, actors had to fall back on existing institutions that had stuck:

- A domestic banking sector dominated by the four large British banks, each one holding a significant amount of power resources, but which lacked effective structure of coordination. The multiplicity of global market-oriented financial firms, organized in well-endowed association, operating from London.
- A government composed of several relatively autonomous and vocal entities. These entities are primarily composed of the Treasury, the regulatory agencies and the Parliament.
- Strong lobbying practices from individual banks, especially targeting the Treasury, and intense practice of the 'revolving doors' between the financial industry and regulators and Treasury members.

¹¹⁴ Video available at <https://www.youtube.com/watch?v=ZyQ00YqB3lo>

These institutions are fostering the typically *confrontational* mode of state-bank coordination during policy-making processes, and have been key in shaping the British *disciplinary* post-crisis sectoral strategy toward finance.

4.4.2 The adverse environment of UK banking

Concentrated domestic markets for financial services

Until the end of the 1960s, the British financial sector was composed of multiple commercial banks, mutual and cooperative banks, and building societies. The consolidation process and demutualization led to the virtual disappearance of local banks, the survival of one single building society and the flourishing of five universal banks. Consolidation in the decade prior to the crisis meant that UK retail banking had become dominated by a small number of very large universal banks, with the ‘big 4’ accounting for 77% of personal current accounts and 85% of small business lending (Hardie and Maxfield 2013).

Although they have all become universal banks, British banks have different defining characteristics. HSBC is primarily an Asian bank that rebased in London when Honk-Kong became Chinese. It has a retail presence in London but is above all a global bank, both in terms of retail and market banking. Barclays has developed its global market activities, but at the beginning it had quite a big retail franchise in the UK and it has kept some aspect of it. As a British banker described them: “*Barclays is an investment bank backed on UK retail banking. HSBC is an investment bank backed on global retail banking*” (interview 071206a). Royal Bank of Scotland and Lloyds developed global market activities but remained relatively more domestically focused retail banks. Building societies are established to provide loans secured on residential property. The loans are mostly financed from members’ savings. Nationwide is the only large building society that remains.

Although it is less extreme than in France, British banks are dominant players in most important domestic markets for financial services. The mortgage and consumer lending market is characterized by a *profusion of mostly UK-based banks and non-bank actors*. High street banks such as the Royal Bank of Scotland, Barclays, HSBC and Lloyds TSB are the leaders in this otherwise extremely fragmented market. Note that pawnbrokers and door-to-door lenders are relatively common in the UK market. The asset management market is

characterized by a patchwork of UK-based specialized financial. Most of these firms have specialized business models: they rely exclusively on the fees and commissions generated by their asset management business line. However, many of these are affiliated to the major banks and insurance groups. “In terms of “true” outside players, the landscape is relatively sparse”¹¹⁵.

The City of London

Although they dominate domestic markets for financial services, UK banks are far from the only financial firms operating in London. The UK has developed London as a global, off-shore, financial center, which means that non-UK financial institutions have subsidiaries there to conduct business. The turning of the UK from an industrial economy to an economy focused on services, and finance in particular, has been well documented (Fine and Harris 1986; Allen 1988; William et. al. 1990; Coates and Hillard 1995; Golding 2003; Davis and Walsh 2015). By the time of the financial crisis (2007-08), the UK’s financial sector relative to its economy was bigger than any other G7 nation. In contrast, UK industry has suffered a faster decline than all its economic rivals in that same period (Davies and Walsh 2016). In 2014, financial services accounted for approximately 7.5% of total national income and contributed to 11.5% of total government tax receipts. It employed more than one million people.

Until the crisis, major British banks dominated retail British markets but they were also important actors of the City. Since the crisis, and the bailouts, public officials became aware that British taxpayers were responsible for the UK banks, but not for the other non-UK based City actors. The latter may be as risky as they wish, they could stay in London as long as they bring profit to it and are bailed out by another state. Also, they became aware that UK banks’ fragility could disincentivize international investors to come to London and feed the growth of the City. This opened a new discrepancy between UK banks and the British financial sector. The significance of the City and the necessity to promote it was never challenged in the UK. A big stake for British policymakers and bankers was to evaluate to what extent large British banks were significant for the City.

¹¹⁵ quoted from Moody’s Banking Outlook UK, 2006

The virtually useless British Banks Association (BBA)

British banking is relatively highly concentrated into the hands of old major UK banks. One could have expected similarities between the BBA and the French FBF. In reality, the BBA has mostly been paralyzed by internal tensions and dissensions and was not a significant actor in the policy-making process during the years of post-crisis reform.

A senior UK banker says about the BBA: “*there is a huge degree of competition between UK banks so it is complicated for them sometimes*” (Senior UK banker 06072016). In general, institutions don’t generally want to share their data with the BBA (UK banker, 07142016). The Treasury speaks directly with Senior bankers. A Senior Treasury Official describes his interaction with bankers in policymaking process: “*They’ve not always been efficient at the BBA, most of the time the Treasury talks to Senior bankers (there are only four of them)*” (Senior treasury Official 06082016). To justify its role, the association took an aggressive stance in the defense of the banks during the policy-making process, which contributed to discrediting it in the eyes of both regulators and bankers. “*BBA is a failure. The regulators didn’t like it because it defended the banks too harshly*” concluded a Senior banker at a UK-based foreign bank’s subsidiary (interview 07122016).

Interestingly, the BBA has merged in 2017 with Asset Based Finance Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association, to become an umbrella association mostly focusing on diffusing information and codes of conduct.

Well-endowed and encompassing other financial associations

The Association for Financial Markets in Europe (AFME) gathers all the global banks and other market players operating in wholesale markets. The association benefits from its huge resources and very clearly defined objectives: the promotion of capital markets in the UK and the defense of the business-friendly environment of the City. AFME is described as a “big gun”. UK banks are part of ASME. Indeed, their interests as global market-oriented banks align with their foreign counterparts, but they represent only a minority within the association. AFME actively lobbied to prevent the UK government from regulating market activities (Financial Tax Transaction, HFT,

Hedge Funds...), but it was not vocal in the defense of the UK banks per se.

4.4.3 Fragmented state agencies

UK Treasury: a central decision-maker under pressure

Davis and Walsh (2016) have argued that a key part of the policy shift favoring finance over industry in the British economy in the late 1970s was linked to the rising power of the Treasury within the British government. While until the 1970s, the departments of trade and industry were given a central voice in government, the Treasury little by little, overcame them in the 1980s and 1990s. “*Ultimately, the private, inward-looking and insular Treasury, became one of the most powerful financial departments of any of established democracy in the World*” (Davis and Walsh 2016, p4). After the crisis, the Treasury has been very involved in financial policy-making process. Starting in 2008, the Treasury wanted to be ready to play a central part in the reform and they hired more people to refine their expertise in financial matters (interview Senior Treasury Official 07132016a). As a Lord observes: “*the lead regulators are now entirely the BoE, the FCA and the Treasury. The position of the Treasury has changed. In conferences, there are now always a Treasury official*” (Member of the House of Lords, interview 06022016).

Traditionally, Treasury staff has been biased in favor of the UK financial industry. Davis and Walsh (2016) stress that the original function of the public finances. Until the 1970s, the Treasury was an inward-looking institution. Its main outside links were with City institutions and the Bank of England. Its staff dealt with these institutions on a daily basis and also moved in similar social circles (Ingham 1984; Theakston 1995). Consequently, Treasury staff shared an economic view of the world that had much in common with the Bank of England and City. This ‘Treasury view’ remains until today. It was summed up by Sir Nicholas Macpherson, Treasury Permanent Secretary in 2014: a ‘belief in free trade’, ‘better functioning international markets’, ‘well functioning capital markets’, ‘price stability’, a ‘strong currency’, ‘limits to what the state can do’, and ‘spending control’ (Davies and Walsh, 2016).

Above the Treasury staff, the Chancellor is also a powerful actor. As a British politician told me: “*The Chancellor is the most influential person in the Cabinet after the PM*” (Treasury Senior official 07132016a). Before the crisis, and in agreement with the

general shared orthodoxy among its staff, the Chancellor Alistair Darling (2007-2010) was in favor of a “light-touch” stance towards financial regulation. Mostly, they had adopted a stance of trust and deference towards bankers. Osborne, who became Chancellor in 2010, is knowledgably personally attentive to bankers’ interests. Despite his personal feebleness, many important banking regulations, including the banking structural reform, was passed under him.

After the crisis, the Treasury was caught between different streams of pressure. British bankers have direct access to Treasury staff: *“Most of the time, we meet with banks’ senior people directly. There are only four of them: HSBC, Lloyds, Barclays, RBS, and also Santander UK”* (Treasury Senior official 06102016a). UK banks have dedicated teams to lobby the Treasury (Senior banker, interview 07142016b). In general, British actors agree to say that the Treasury has often been reluctant to regulate banks. For example, a member of the Parliamentary Committee on Banking Standards (CBS) accused Chancellor Osborne of *“pushing regulators to find excuses to bankers when they said that they didn’t know about their banks’ wrongdoings”* (06092016). The Treasury was sensitive to the argument of bankers that politicians would undermine British growth by undermining banks. Treasury officials felt that other actors didn’t mind about the growth objective: *“The regulators are focused on stability, while we have a requirement of stability and competitiveness”* (Treasury Senior official 07132016a).

On the other side, regulators and members of the Parliament have been active in keeping pressure on the Treasury too. These latter threatened to stir public anger against the Chancellor. A member of the Committee on Banking Standards recalls a revealing anecdote, regarding the law on consumer credit protection: *“The government was resisting. It didn’t want more regulation. The debate was due on Monday. (...) I called Osborne, and told him: on Monday, either I say: “you support the banks against the poor”, or I say “you support the Poor against the banks”. He changed his mind on Sunday. So we agreed that there will be regulation. Osborne had to find out what is the most important: the banks or the electorate. The electorate!”* (interview CBS 07122016).

Although the Treasury was prone to water down reform for fear to penalize British banks, it was neutralized by the pressure put upon him by other public actors, most notably the members of the Parliamentary Commission on Banking Standards.

The strong regulators: The Bank of England and the Financial Conduct Authority

In 2010, the government put an end to the previous “tripartite” system of sharing regulatory responsibility between the Bank of England, the Financial Services Authority, and the Treasury. The 2010 reform was designed to “*empower the regulators*” (CBS, interview 07132016). The BoE has now responsibility for monitoring the UK financial system as a whole through the Prudential Regulation Authority (PRA) and the Financial Policy Committee (FPC)—composed of BoE members and outside experts. The FPC has influence on the prudential requirements that may be imposed on the banking system through its powers of direction and recommendation.

The BoE and, within it, the Prudential Regulation Authority (PRA) are independent from the government. An interview anecdote illustrates the attachment of the BoE officials to their independence from the government. The interviewee gave me the address of another person to contact at the BoE: “a***.***e@bankofengland.co.uk [and added]: *note the symbolic “co”. It is not “gov”* (interview senior manager BoE 06102016).

Mervyn King, the BoE governor between 2003 and 2013 is described by former Chancellor Darling as a “bookish and an academic economist” (Darling 2011, p14). He has been professor in multiple top-notch universities around the world. It is significant because regulators who don’t come from finance arguably don’t have the networks and professional experience that make them more sensitive to the industry’s arguments¹¹⁶. The academic profile of the regulators was mentioned by several interviewees: “*The governor of the BoE, the key link between the government and the banks happened to be an academic, not a banker!*” a British politician exclaimed (interview House of Lords, 06022016). King was outraged by moral hazard, a topic on which he had worked a lot as an economist. After the government had to intervene, he was obsessed with tackling the TBTF problem, which goes against all according to him goes against all sound principles of economic governance.

¹¹⁶ Norman Lamont, a former British Chancellor quoted in Davis and Walsh, perfectly states how having policy-makers coming from the industry that they regulate may affect the substance of policy-making: “I worked as an investment manager and I could see the problems that were building up, and the harm that was being done, and the distortions that were being created by policies. So I suppose, in that sense, my time in Rothschild’s did have a big impact” (Davis and Walsh, p6)

Regulators were under pressure to act after the crisis because they were to a large extent held responsible for it by the public: “*Regulators were on a hot seat just as much as the industry*” (senior banker, 07140216b). The Bank of England lobbied publicly and privately to hold the government’s ‘feet to the fire’ on banking reform (cited in Howarth and James, forthcoming). For example, it regularly provided advice to the members of the Independent Commission on Banking. Before the report was published, King launched a stinging criticism of bank lobbying tactics as a warning to the government not to cave in to industry pressure. Similarly, following the publication of the ICB Final Report, the Bank’s new Financial Policy Committee issued interim recommendations urging the government to implement the Vickers recommendations in full. King was successful in anchoring expectations and preventing the center of political gravity to shift away from reform.

Arguably, the dynamism of Mervyn King may to a certain extent be explained by the “near-death experience” followed by massive bailouts and monetary intervention that he witnessed and operated during the 2008 crisis. Yet, his successor Mark Carney, although less flamboyant, remains on the same line: “*Perhaps the most severe blow to public trust was the revelation that there were scores of too-big-to-fail institutions operating at the heart of finance. Bankers made enormous sums in the run-up to the crisis and were often well compensated after it hit. In turn, taxpayers picked up the tab for their failures. That unjust sharing of risk and reward contributed directly to inequality but – more importantly – has had a corrosive effect on the broader social fabric of which finance is part and on which it relies*”¹¹⁷.

Although the Bank of England has responsibility for the maintenance of financial stability, commercial banks and other financial services organizations in the UK are supervised by the FCA. The authority is an independent, non-governmental body established in 2013 to replace the Financial Services Authority (FSA). The FCA aims to protect consumers, ensure the industry remains stable, and promote healthy competition between financial services providers. The FCA is accountable to the Treasury. The head of the FCA until 2015, Martin Wheatley prove very aggressive towards banks. He famously claimed: “*we shoot first, we ask questions later*”. The non-renewal of Wheatley at the head of the FCA in 2013 has been considered as a sign of

¹¹⁷ Mark Carney, Governor of the Bank of England and Chairman of the G20's Financial Stability Board - 27 May 2014.

appeasement from Osborne to the bankers, who demanded the departure of hostile Wheatley.

After the crisis, British regulators were actively promoting and enforcing stringent banking regulation. British banks have been aware of this: *“Both the PRA and the FCA have continued to develop and apply a more assertive approach to supervision and the application of existing standards. This may include application of standards that either anticipate or go beyond requirements established by global or EU standards, whether in relation to capital, leverage and liquidity, resolvability and resolution or matters of conduct”* (Barclays, AR, 2016, p229).

4.3.3. The Parliamentary Commission on Banking Standards

Parliament has had a very significant role in post-crisis financial reform in the UK: *“If there is a strong sentiment in Parliament, it is very difficult to override it”* (House of Lords, interview 07120216c). More specifically, the Committee on Banking Standards was key in establishing all the major banking regulations after the crisis. It was appointed by both Houses of Parliament. Its members were picked up from the two houses’ financial committees by consensus between the majority and the opposition. The committee disposed of a lot of time and resources, and was, as table 12 shows, composed of politically heavy weighted, competent members.

Table 12: Composition of the Committee on Banking Standards

Member	Affiliation	Noteworthy previous position(s)
Andrew Tyrie MP (chairman)	Conservative	Special advisor at HM Treasury, described by the Independent as “the most powerful backbencher in the House of Commons” ¹¹⁸
The Archbishop of Canterbury	Non-affiliated	Senior bishop and principal leader of the Church of England
Mark Garnier MP	Conservative	Former banker

¹¹⁸ The Independent, 04/02/2013: “Andrew Tyrie: the most powerful backbencher in the House of Commons”

Baroness Kramer	Liberal Democrat	Figure of the LibDem, former candidate for London mayor
Lord Lawson of Blaby	Conservative	Former Chancellor of the Exchequer (1983-1989) under Thatcher
Andrew Love MP	Labour	
Pat McFadden MP	Labour	Minister of State in the Department of business; interim leader of shadow cabinet (2010)
Lord McFall of Alcluith	Labour	Chairman of the House of Commons Treasury Committee
John Thurso MP	Liberal Democrat	First hereditary peer to be elected in the House of Commons
Lord Turnbull	Crossbench	Cabinet Secretary (most senior civil servant in the UK, senior policy adviser to PM)

The Committee conducted hundreds of “*Watergate type of hearings*”, according to a CBS member interview 07132016b). I have met with four members of the CBS, both from the Commons and the Lords, Conservatives, Labour and Liberal Democrats. All interviewees agreed that, despite very different general politics and backgrounds, there was a significant consensus within the different members of the committee on the issue of banking regulation, although they stressed different priorities.

Why did the CBS matter so much?

- The Commission had a lot of resources and expertise: “*We had a lot of resources for the CBS. More than usual. Much more. That is why we produced so much. (...) There was a significant expertise in the committee*” (CBS member, interview 06092016).
- Its members enjoyed a relative independence from party politics. Many CBS members were senators. They are not dependent on their fellow party members for their political career. They don’t fear to alienate them by openly taking position against powerful actors like banks (Massoc 2017a). CBS members were ready to take on the regulators and the Treasury when they would find “excuses” for the

banks (CBS member, 06092016). Also, *“There were only strong and rather aggressive individuals in the CBS. It was clear that this would have a strong outcome. It was an angry committee and it became angrier”* (CBS member, 07130216b).

The involvement of these actors, who are outside of the typical relationship between the Treasury and the banks, created a new ideational mediation of banks’ structural power (Bell and Hindmoor 2015). For example, CBS members had pretty clear opinions on HSBC’s threats to relocate: *“I don’t believe HSBC when it says they’ll leave”* (CBS member, 06092016). A second said: *“HSBC reviews every other year where to put its headquarter. The question is: they want to leave but who else is going to take them? It is a massive bank to house. You need a huge fiscal and legal base”* (CBS member, interview 071312016a). Another clearly stated his lack of deference: *“Bankers were against it. But bankers have always been wrong”* (CBS member interview 07182016). This contrasts with the Treasury officials who recognized that they were afraid to see HSBC leave, and recognizes that *“the whole tax policy was designed in order to keep HSBC here”* (Senior Treasury official, interview 06102016).

4.4.4 Involvement of other stakeholders

The naughty press and the angry public

Several politicians mentioned their conflictual relation with the press. It was not good in the years after the crisis to be seen on the side of bankers, because tabloids would come after you and seek to wreck your career. A Lord told me: *“You may not be aware of the importance of press campaigns. Of the popular newspapers”* (Interview 06222016). Another member of Parliament agreed: *“They [the press] are crazy. They attack politicians very harshly”* (Commons, interview 06092016). A CBS member told the following funny story: *“The only thing the public cared about was how to put bankers behind bars! We published 5000 pages of report, and the only question the journalists asked us was: are they going to go to jail? Prison!”*. The popular press media kept public pressure high on bankers, regulators and elected officials.

Involvement of other interest groups

Finally, non-financial groups played an important agenda setting role. In particular, the consumer group “Which?” convened its own Future of Banking Commission in 2009 which brought together a

number of experienced politicians to propose reforms to the industry, enabling it to accumulate a wealth of expertise and credibility on the subject¹¹⁹. Its proposal that the core lending and deposit functions of UK banks should be ‘ringfenced’ placed the policy option firmly on the agenda and was influential in framing the thinking of the ICB. Small Business UK also led campaigns in favor of the promotion of challenger banks (Small Business UK, interview 071502016; Lady Cohen of Pimlico, House of Lords’ SMEs Committee interview 07172016), and regulation of UK banks¹²⁰.

4.4.5. UK confrontational state-banks mode of coordination

The institutions described above are fostering the typically *confrontational* mode of state-bank coordination during policy-making processes.

The main locus of decision-making is unstable. It really depends on the mobilization of power resources by actors. Venue shifting has promoted actors’ participation in the policy-making process beyond the narrow range of participants that normally occupy a policy subsystem. The ICB and the CBS were the center for the emergence of “new ideas”: obligating the banks to separate their retail from their market activities is not detrimental to the British economy, quite the opposite actually. In agreement with the ideational mediation of structural power described by Bell and Hindmoor (2015), members of the CBS (no matter their partisan affiliation) explicitly stated that they did not believe HSBC’s threat to relocate. Aggressive press campaigns, relatively more active interest groups, and more importantly, the permanent activation of conflict by the regulators and the members of the CBS kept the public pressure on the Treasury high. Preserving the political salience of banking reform was a conscious strategy: “*We feared that public pressure was going to dilute*” (CBS member, interview 06092016).

The preferences of actors are shaped relatively autonomously from each other. They are also quite close to their material interests as they can be defined deductively.

¹¹⁹The Future of Banking Commission’s report is available at https://i.telegraph.co.uk/telegraph/multimedia/archive/01656/Bankpdf_1656684a.pdf

¹²⁰ See Financial Times, 03/13/2011, “Tell the banks they work for us”

- Banks want to be able to expand globally and at home. British bankers complained about the fact that the UK government did not consider them as national champions:
“If you look at France and Germany, they have their national champions. For example, concerning the capital ratio requirements: French and German banks are huge! And still they have been put in the tier 2. HSBC and UK based banks were put in the tier 1!! It is because their governments defended them. We are big banks, but we do not have domestic protection in the UK” (Senior British banker 06072016)
- Regulators have sought to promote financial stability.
- The priority of parliamentarians has depended on their partisan affiliation. But be it on behalf of stability and protection of taxpayer, or growth or SMEs’ funding, they have all agreed that the largest British banks had to shrink.
- The Treasury has been caught between its will to promote economic growth and its will to ensure financial stability. Defining how the two interact has been the object of lobbying from the banks and the regulators.

On the other side, there is an across the board consensus to promote the City in the UK. All politicians and regulators in interviews agree that this is not a controversial preference among mainstream parties. The expansion of the City is seen as win-win: it brings jobs and growth, but the foreign banks operating in it are not under the responsibility, should they be bailed out. Also, a Treasury official stressed that political salience concerns mostly UK banks: *“The fact that Goldman Sachs is doing a lot of things, lots of people don’t understand that. 95% of them don’t have an idea. They focus on the elements that affect them directly. For all the international stuff, it is all win-win: it brings tax, jobs, spending..Bankers are vaguely unpopular concerning the fact that they make a lot of money, that they don’t behave morally... But it’s far away. The problem for most lawmakers is thus with domestic banks” (Treasury official, interview 07120216b).*

During policy-making processes, actors actively deployed the power resources available to them. On the side of state: *“We use the threat of legislative activity” (PRA, interview 06102016).* Banks deployed a strong arsenal of lobbying activities too. They used many traditional channels of lobbying such as appointments requests, invitation to informative meetings, and sending of ‘reports on

unintended consequences of the regulation’ to the regulators (Senior British Banker, interview 07142016b). They played their instrumental power card. Banks launched a very intensive program of poaching among the regulators and the Treasury. A National Audit Office in the PRA the FCA reported in 2015 that “current levels of staff turnover result in the consistent departure of skilled and experienced staff”. In 2013, Mr. Bailey told MPs: “*If you are supervising a major institution, you see them [regularly] and, of course, the institutions know who the good [employees] are and who the less good ones are, and they do bid for them.*”¹²¹ It is materially difficult for regulators to retain the best elements in front of banks’ generous offers. Finally, they made a strategical use of their structural power resources (Culpepper and Reinke, 2014). HSBC has repeatedly threatened to relocate. It was reported in the press that Barclays was also planning to move parts of its operations offshore¹²².

Banks have been successful at influencing policymaking on several important points. The former Bank of England governor, Mervyn King, warned that certain elements of the Independent Commission on Banking reforms have already been watered down due to lobbying (Treanor 2012). In particular, ring-fenced banks have successfully argued that they should be allowed to engage in certain derivatives trades such as interest rate and currency swaps. Other examples of successful lobbying include the limitation of the bank levy to UK balance sheet, the giving up of the reversal of the burden of proof, and the non-renewal of the FCA’s head Wheatley... In 2014, the CBS former members jointly published a statement to worry about the effects of this lower pressure on the enforcement of banking regulation¹²³. Yet, at the time of writing, the core of the UK banking reform seems to hold.

¹²¹ The Telegraph, 12/05/2015 ”Fears of brain drain at Bank of England's PRA as staff leave”; Financial Times, 01/31/2012, “Treasury beset by exodus of top staff”

¹²² Financial Times, 04/10/2011, Banks Hope their Lobbying Pays Off

¹²³ statement available at <https://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/statement/>

4.5 Conclusion

This chapter has examined the different modes of state-banks coordination that led to shaping different state priorities towards finance in France, Germany and the UK. It has presented a detailed analysis of these meso-level institutions and empirically illustrates how actors have relied on them to coordinate and shape policymaking toward finance after the crisis. In France, group identity and trust between large banks' top managers and state officials foster a *symbiotic* mode of state-bank coordination: actors tend to make compromises on their initial preferences to accommodate each other and to avoid using power resources. The typical locus of decision lies in this narrow state-bank elites' nexus. This French *symbiotic* mode of state-bank coordination has led to the shaping of state's priorities consisting of promoting large banks' expansion globally and at home. In the UK, a pluralistic and fragmented organization within the banking and state agencies fosters an *adversarial* mode of state-bank coordination: actors tend to be reluctant to make compromises and they tend to use power resources available to them in order to influence each other. The typical locus of decision in the UK is unstable because it depends more on fluctuating power resources. Under post-crisis conditions of high salience, it has often lied with the anti-large banks regulatory agencies and the parliamentary and independent commissions. Those actors have managed to impose their priorities consisting of shrinking UK banks at home and globally. In Germany, privileged access of Deutsche Bank' top managers to the very top state officials coupled with strong local public-private coalitions foster a *dual* mode of state-bank coordination: preferences of top officials tend to be captured by larger banks, but the implementation of these preferences is limited by the structural strength of local coalitions. The typical locus of decision in Germany lies with these local coalitions when their interests are at stake; when they are not, the typical locus of decision lies with Deutsche Bank's top management. State's priorities have thus consisted of permitting the expansion of large banks, but in the limits of the protection of German local public banks.

CHAPTER 5

The post-crisis banking structural reform (BSR) in France, Germany and the UK

5.1 Introduction

After the crisis, governments in each country came under political pressure to crack down on their large banks. In France, all the systematically important banks benefited from state aids during the crisis. In Germany, one out of two benefited from state aids (Commerzbank). Germany also bailed out one regional bank, West LB. In the UK, two out of four benefited from state aids (Lloyds and RBS). Taxpayers had to be protected from these Too Big to Fail banks. In France, President Hollande was elected in 2012 following an “anti-finance”¹²⁴ campaign that included a pledge to implement a full split between retail and investment banks. In Germany, Chancellor Merkel promised the introduction her own ringfencing rules. In the UK, Prime Minister Cameron promised to curtail banks’ trading activities.

However, the three countries ended up adopting different banking structural reform (BSR). The French and German governments sought deliberately to pre-empt tougher EU rules by implementing much weaker measures which would force banks to ringfence only a narrow set of proprietary trading activities. In the UK, the Conservative-Liberal Democrat coalition government acted unilaterally to ringfence banks’ retail activities in legally separate entities, prohibiting them from trading in a range of financial instruments, and imposing capital requirements significantly in excess of international or EU standards.

The important overall issue of functional separation for the banks lies in the extent to which the deposit-taking bank is prevented from supporting the trading bank during its operations. A lack of support from the deposit-taking segment of the bank may increase the financing costs of the trading bank, limiting its profitability and obliging it to scaling back its trading operations. The banking structural reform is a very significant piece of post-crisis reform regarding the evolution of large European banks. The potential disruption that structural reform may bring to these banks’ business model is important. It is thus relevant to examine closely the policymaking processes that led to different reforms across Europe. This chapter provides a detailed case study of this reform.

¹²⁴ François Hollande was marked by his speech at the Bourget in January 2012, where he famously claimed: “Mon ennemie, c’est la finance”.

5.2 International and European commitments in favor of BSR

BSR's advocates argue that regulatory measures focusing on the stability and health of individual institutions, while positive, are not enough to protect taxpayers because they have a micro-prudential focus (they make individual institutions more robust). BSR has more of a macro-prudential focus and concentrates on the systemic risks posed by large trading-oriented banks. It builds on the fact that while under the Glass-Steagall Act¹²⁵ which separated investment from retail banking between the 1930s and the 1990s, the USA has known a long period of banking stability.

Banking structural reform consists of separating market-related activities (investment banking) from the traditional lending activities (deposits, loans and payment system) of the largest European banks. It comes from the idea that public support for deposit banks is used to feed banks' trading activities. Market activities, more profitable, but riskier and more volatile, are backed by the retail banking activities (in particular deposit-taking). Because deposit taking is publicly guaranteed, banks' market activities are *de facto* in the end backed by taxpayers' money. If these banks fail because they took too much risks in the markets, they'll be bail out by the state to safeguard their mission of public interest (i.e. keep people's money safe). One solution is a law that prohibits the full integration of investment/market activities and retail banking services. This is the primary objective of a banking structural reform. Breaking up banks would avoid a situation where the short-term oriented, deal-based, investment banking culture can negatively influence the long-term, relationship-based culture of commercial banking.

The need to limit the exposure of the real economy to trading activities was a central theme of the G20 Pittsburgh summit (G20 2009). What followed was a host of ring-fencing reforms and

¹²⁵ The Glass Steagall Act was passed in 1933 in the USA. It prevented securities firms and investment banks from taking deposits, and commercial Federal Reserve member banks from dealing in non-governmental securities for customers, investing in non-investment grade securities for themselves, underwriting or distributing non-governmental securities and affiliating (or sharing employees) with companies involved in such activities. After year of congressional efforts to repeal the act, the 1999 Gramm–Leach–Bliley Act repealed the provisions restricting affiliations between banks and securities firms.

recommendations: the Volcker rule in the US; the Vickers Commission proposals in the UK (Vickers 2011); and then the EU's Liikanen Report (Liikanen 2013) and EU Commission proposals in 2014.

The Commission 2014 proposals' objectives were to grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitization operations) into separate legal trading entities within the group ("subsidiarization"). While introducing the proposal, Michel Barnier, former Commissioner for internal market and services, said: "*This legislation deals with the small number of very large banks which otherwise might still be too-big-to-fail, too-costly-to save, too-complex-to-resolve. The proposed measures will further strengthen financial stability and ensure taxpayers don't end up paying for the mistakes of banks*". Yet, between this date and 2017, there has been a slow burial of the proposals based on the Liikanen report (Hardie and Maccartney 2016). As developed in the next section, each country eventually adopted its own reform.

5.3 Different outcomes of BSR in France, Germany and the UK

The French Law on the Separation and Regulation of Banking Activities (*la loi de séparation et de régulation des activités bancaires*) separated out banks' proprietary 'speculative' activities -that is market operations operated in the account of the bank itself (AMF 2013). The law thus sought to distinguish these proprietary trading activities 'from those activities that are considered useful to financing the economy', by incorporating a series of exemptions focused on market-making activities. This meant that the proposals were not focused on market-based trading activities in general, as Liikanen and the Commission proposals were, but rather on a minor part of these activities. As a matter of fact, it is extremely difficult to distinguish proprietary trading from other market operations (done in the account of the bank's clients). At the end of the day, the law concerns only 'three to five' percent of banks' investment activities, and less than 1% of their revenues¹²⁶. After the hearings of the heads of three of the French

¹²⁶ Interrogated by the Finance Committee of the French lower chamber on the 30 January 2013, the Head of Société Générale, Frédéric Oudéa, confessed that the law would concern only "between 3 and 5% of our investment banking activities". Assemblée Nationale's Frédéric Oudéa, Compte-rendu 60, commission des finances

largest banks before the Parliament on 30 June 2013, the rapporteur of the bill was herself surprised by its weak impact: “*We understand from your three presentations that the bill does not bother you. I am both surprised and pleased to hear it*”¹²⁷. In the words of Hardie and Macartney: “*the law was deliberately intended to protect the domestic banking system, clearly weaker than the EU proposals, and involved minimal threat to the strengths of French universal banks*”. Fitch, the rating agency, said the reform would not affect the degree of state support for France's banks – although this was the explicit objective of the reform. “*The key aim of policy makers is to preserve banking stability, and the willingness to provide state support remains high,*” the agency said¹²⁸.

The German draft bill (*Entwurf eines Gesetzes zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen*), deviated from the Liikanen recommendations almost as much as the French version of it. The German government established thresholds above which proprietary speculative trading made would have to be separated out. First, this is consistent with the German aim of shielding its smaller banks from change, as this meant that only 10–12 German banks would be affected by the reform. However, this protection of smaller banks did not conflict with EU proposals, which were also focused on the larger banks. Even for the largest banks, though, the German proposals were more benign than the Liikanen report and Commission’s proposals. Similar to the French case, only the blurry domain of ‘proprietary trading’ shall be separated out.

By contrast, the UK adopted a much more stringent version of banking structural reform (Bell and Hindmoor 2015). The Banking Reform Act of 2013 largely built on the ambitious report produced by the Independent Commission on Banking, presided by Sir John Vickers. It prevents any bank housing over £25bn in domestic, personal, or small business retail deposits from trading in financial instruments and commodities. This encompassed six banks in total, but its most punitive effects stood to be felt by the four largest banks with

de l’Assemblée Nationale, 30 January 2013, available at <http://www.assemblee-nationale.fr/14/cr-cfiab/12-13/index.asp>.

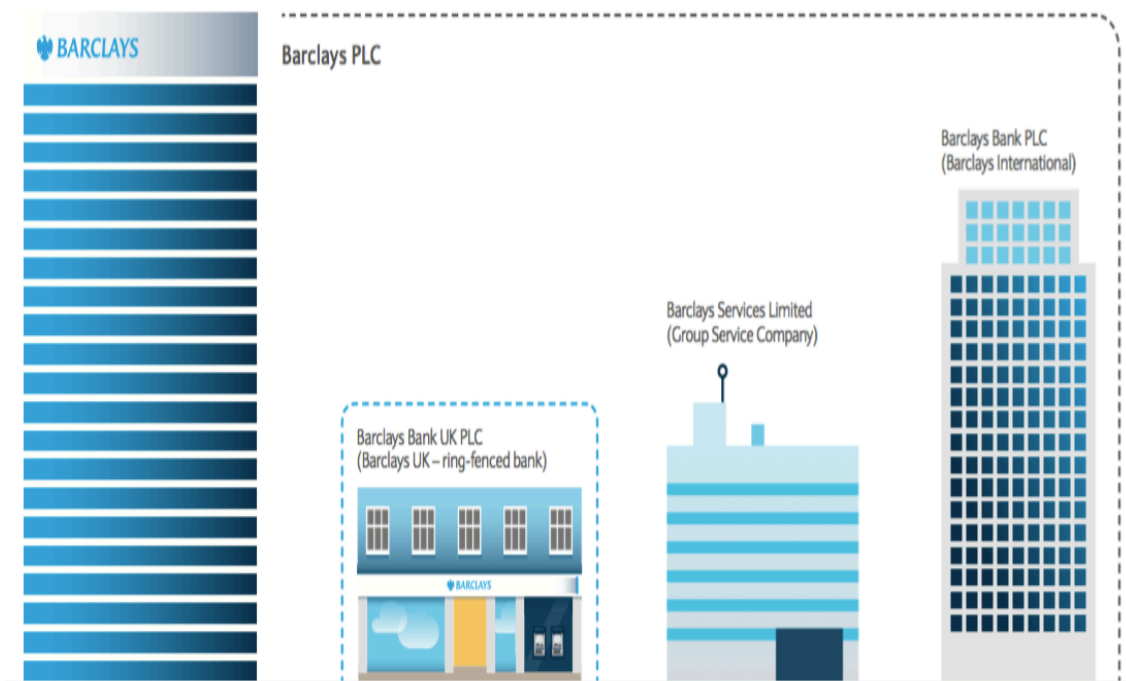
¹²⁷ Karine Berger, Compte-rendu 60, commission des finances de l’Assemblée Nationale, 30 January 2013, available at <http://www.assemblee-nationale.fr/14/cr-cfiab/12-13/index.asp>

¹²⁸ Cited in the Financial Times, 19 December 2012, ‘France unveils banking Reform’

substantial trading and retail operations (HSBC, Barclays, Lloyds and RBS). It calls for banks retail activities to be placed in a legally distinct, operationally separate and economically independent entity, which is no longer permitted to trade most derivatives and securities (ICB 2011). In addition, UK ring-fenced banks will be required to hold CET1 capital in excess of that required under CRD IV from 2019.

One can already observe the important consequences of the law on UK banks. Consider Barclays (See Figure 11). It has reorganized into two clearly defined divisions, Barclays Bank UK (the ring-fenced bank) and Barclays Bank PLC. Both are now independent subsidiaries of the Barclays Group. The Group Service Company, Barclays Services Limited, has been set up to deliver operational continuity.

Figure 11: Barclays’ representation of its two new ring-fenced subsidiaries



Source: Barclays, Annual Report 2017, p9

The law has changed the way of doing business of British banks. A British top banker complained to me about the law in interview: “Now, we can’t provide all services in one place to our clients. We are in the position of telling our clients that they should go to these banks [JP Morgan, Citigroup and other US banks] to find all the services they need. This is what British regulators have done” (British banker, interview 07192016)

5.4 Comparative study of policymaking processes

5.4.1 France: a symbiotic mode of state-bank coordination

In his “Bourget speech’ in January 2012, the then presidential candidate François Hollande said that “Controlling finance will start with a vote that will oblige banks to separate their credit activities from

their speculative market activities”.¹²⁹ According to a survey led by the IFOP in 2011, 84% of French were in favor of a banking structural reform. This could have been a good electoral wave for politicians to surf on. But this is not what happened.

The new majority enters the French bank-state elite nexus

During the presidential campaign, the candidate François Hollande presided over the ‘Committee on Vigilance and Economic Analysis’ (VIGI-ECO), set up by the Socialist Party and composed of economists and financial experts. A top recommendation of VIGI-ECO was to implement a ring-fence between the retail and the trading activity of French banks¹³⁰. Once elected, the president charged the new Minister of Finance, Pierre Moscovici to examine the feasibility of the VIGI-ECO recommendation. The Minister was advised in his tasks by the newly created Council of financial regulation and systemic risk (COREFRIS). COREFRIS is very different from the commissions put together in the UK. It is not composed of independent experts nor of members of parliament, but it is composed of officials from the Banque de France (BdF) and the French regulator Financial Markets Authority (AMF). But debates in the COREFRIS focused mostly on the effects that ring-fencing reforms in other countries, and at the EU level, would have on French universal banks’ competitive position, especially with regard to US investment banks¹³¹.

Consensus between the Treasury, the regulator and the banks: the national interest requires not to weaken the banking national champions

Following the line set up by COREFRIS, the Treasury, the regulators and the banks agreed that BSR would be bad for the French national interest because it would hinder French banks’ position on global markets and favor US banks. Bankers were very virulent in their defense of the French model of banking. French bankers presented the BSR as a way for ‘Anglo-saxon finance’ to impose their domination in the global financial markets:

“In plenty of domains, US banks are taking the leadership. They kick the European off and they are taking the market. A full separation [of

¹²⁹ François Hollande cited in Le Monde, 19 February 2013, “Que reste-t-il de la réforme bancaire de François Hollande”

¹³⁰ The declaration of VIGI-ECO in favor of the separation between retail and trade activities is available at <https://vigieco2012.wordpress.com/communiqu4/>

¹³¹ Financial Times, ‘France Unveils Bank Reforms’, 19 December 2012

activities] would allow them to continue do that. Better to tell us: “sell to the US”!” (French senior banker, interview 06022015)

All the public officials fell in line with the interpretation of the BSR being the Trojan Horse of Anglo-American banks. As Christian Noyer, Governor of the Bank of France, candidly admitted: *‘the French state would have found itself with only the big Wall Street banks to place its debt. Companies would have only found Wall Street banks to finance their operations’*. The Minister of Finance Pierre Moscovici said nothing else: A stricter separation was like *"giving a gift to the Anglo-Saxon banks"*, he said. *"[We must] protect the interests of Paris as a financial center."* He would later note in relation to the French reforms, *‘I did not want to weaken the French banking system. I want it to be strong’*. For both public and private actors, ring-fencing the retail banks from the investment bank, would have been *"against the national interest"*¹³².

A Socialist Member of Parliament involved in the discussion of the text in the lower chamber deplored: *“We understood that banks had started their lobbying as soon as May 7 [2012, the day after the election of François Hollande as president], and that techno-structure of the Treasury at Bercy shared their point of view more than ours”*¹³³. Actually, the harmony between French bankers and public officials that this member of parliament noticed during the discussion of the BSR builds on mechanisms that date back from way before May 2012.

When asked about who the Minister talked to in the process of crafting the BSR law project, a member of the Minister’s cabinet amusingly answered: *“the usual suspects [in English]”*. The usual suspects are the top executive managers of the four largest domestic banks, the Governor of the Banque de France and The Director of the Treasury.

¹³² Christian Noyer, cited in Ibid

¹³³ Cited in Le Monde, 31 January 2013, ‘Loi Bancaire : des élus PS espèrent muscler un texte inachevé’. Original text : « On a compris que les banques avaient commencé leur lobbying dès le 7 mai et que la technostructure du Trésor à Bercy partageait d’avantage leur point de vue que le nôtre ».

Table 13: Table presenting the education of the “usual suspects” during the French BSR policy-making

Francois Hollande	President of the Republic	ENA
Pierre Moscovici	Finance Minister	ENA
Rémy Rioux	Finance Minister’s cabinet Director	ENA
Ramon Fernandez	Treasury Director	ENA
Christian Noyer	Governor of the Banque de France	ENA
Gerard Rameix	President of the AMF	ENA
Frederic Oudea	Chairman and CEO of Societe Generale	ENA
Jean-Laurent Bonnafe	CEO of BNP-Paribas	Mines
Baudoin Prot	Chairman of BNP-Paribas	ENA
Yves Toublanc	Chairman of BPCE Supervisory Board	Economics and Management
Francois Perol	Chairman of BPCE management board	ENA

As table 13 shows, almost all of the “usual suspects” were at the time of the BSR alumni from the Ecole Nationale d’Administration (ENA). As it was developed in Chapter 4, ENA is more than a school. ENA Alumni share the same career path (although with nuances as to the weight between public and private positions), the “*same way of seeing things*” (interview top French banker, 04122009). When I asked him if the fact that the vast majority of people involved in policymaking in France are ENA alumni, a senior banker candidly answered: “*It helps us to understand each other*” (ibid). During interviews, it was difficult to have the interviewees talk about the details of decision-making over

time concerning the BSR. The answers provided had the flavor of the evidence: everybody understood what the problem with BSR was. There was actually not a lot of discussion between the banks and the public officials about the French version of the BSR, as they all started to agree very early on about the necessity not to break, or even ring-fence, banks. Because it is so easy to communicate, bankers presented their contribution as just calling back their colleagues to reason, which happened almost immediately after the election: “*There is a lot of heat during political campaigns. I understand that. And then you have to be called back to reason. They [the newly elected government] are smart people. They got that*” (Banker, interview 04172014).

Banks’ smooth cooperation

In the UK, Lloyds broke the ranks of banks’ unity because it made the strategical choice to accept ring-fencing in order to obtain concessions in terms of protection of its domestic business lines that the regulator wanted to force it to sell. In France, the less market oriented banks (Credit Agricole and BPCE) could have pursued the same strategy to the detriment of their more market-oriented fellow banks (BNP-Paribas and Societe Generale). Yet, the four banks succeeded in maintaining a united front in defending their first-choice preference: having the government adopted a BSR avoid of substance. The French Banking Federation published a report untitled “Banking Reform: Myth or Reality” (*Réforme Bancaire: Mythe ou Réalité*), which challenged the need for any ring-fencing and emphasized the dangers of doing so to both the successful model of French mixed banking and to banking lending to the real economy¹³⁴.

A complacent Parliament

The members of parliament who would favor a strict version of the BSR were mostly socialists. They were constrained by party discipline. A former Socialist MP recalls: “*Of course, we were seeing that the mountain was about to give birth to a mouse. But in France it is difficult, politically, to go against your government. There are retaliations. So we thought: ‘at least we got something [a watered down version of the BSR]’*” (Former Socialist MP, interview 1321206)). The declarations of the representatives of the Socialist Party come to support the vision of the party discipline that the interviewee

¹³⁴ The FBF report is available at <http://www.fbf.fr/fr/files/94FKPM/Reforme-bancaire-mythes-ou-realites-janvier2013.pdf>

mentioned. Some Socialist MPs tried to introduce amendments to extend the definition of the “proprietary trading” activities to be separated out. But the speaker for the majoritarian Socialist Party said: *“We called for wisdom (...). Accepted amendments will remain cosmetic. We don’t want to make banks’ life more difficult”*¹³⁵.

On the other side, the mainstream right in opposition in the lower chamber (UMP, Union for a Presidential Majority), came out early and strongly in favor of the Socialist-led government’s draft. During a discussion on the law at the lower chamber, Gilles Carrez, president of the Finance Committee responded to a MP who wanted to push for a stricter version of the law :*“I would like, Madam, for this debate to be motivated in the first place by the general interest and the preoccupation to protect our banking industry”*¹³⁶.

The widespread bipartisan support ensured from the start of the legislative process the elimination of any significant politicization of the BSR issue in parliament. A lobbyist for consumers’ interests’ annoyingly recalls: *“I was going to the hearings... Jérôme Chartier (a socialist MP) came to me. I could see right away that in terms of banking separation, political French authorities, from the right and the left, think that we absolutely should not touch to BNP-Paribas or Societe Generale, that they are national champions... If we don’t have them, Goldman Sachs will rule... »* (interview, 04052015).

5.4.2 Germany: a dual mode of coordination

As far as the BSR is concerned, the local coalitions did not activate to circumscribe the capture of the German Treasury by Deutsche Bank. No significant challenge rose from other sectors of the political or social arena. Parliamentary commissions were, in contrast with the British case, poorly endowed and their mission more vaguely defined. Political salience around the BSR remained low in Germany. With no venue shifting, no independent shaping of preference by key policymakers and no open political conflict around the issue, the domination of Deutsche Bank in the policymaking process remained to

¹³⁵ Cited in Le Monde, 6 June 2013, ‘Ce qu’il reste de la réforme bancaire de François Hollande’. Original quote : « On a appelé à la sagesse (...). Les amendements acceptés resteront cosmétiques. On n’a pas la volonté de chargé la barque des banques ».

¹³⁶ Gilles Carrez, Debates Lower Chamber for the vote on the ‘loi de séparation bancaire’, 14 February 2013. Original quote : Je voudrais, madame, que ce débat soit d’abord mû par l’intérêt général et le souci de la protection de notre industrie bancaire.

a large extent unchallenged.

Dodging the EU Commission's proposal

The “Commission’s High-level Expert Group on Bank Structural Reform”, otherwise known as the Likaneen Commission, after the name of its chair, published a report in 2012 recommending a pan-European ring-fence and a Volcker-style ban on proprietary trading. The single market commissioner Michel Barnier then proposes a EU-wide BSR based on the Likaneen Reform. The proposed measures targeted the largest German universal banks. Deutsche Bank, in particular, stood to be badly affected by the legislation and voiced its clear opposition during EU consultations. The Bank describes the projected reform in dire terms for the future of European financial industry and economy:

*“The loss of competitiveness and market share for European banks would lead to reduction in wholesale lending and associated services to the real economy. As a result, it should be expected that the transition to such future scenarios would be associated with large scale contraction of activity, client attrition and market dislocation”.*¹³⁷

With the European threat overhanging, the German government moved to introduce a kind of ‘defensive measure’ in the hope of getting a derogation (Hardie and Macartney 2016). As an EU official involved in the crafting of the European proposal recalls: *“The EU was united behind this [BSR] approach. But Germany came and refused! Deutsche Bank was key to push for the refusal by Germany”* (interview 05282015b). Once secured that no reform will be pushed out too hard at the EU level by the EU Commission, domestic politics played out in the implementation of a specifically German version of the BSR.

Relatively unassuming and unproductive commissions

The expert commission led by Ottmar Issing contrasted greatly with the British Independent Commission on Banking. His members were *“less wild”* (interview 11142016a); they dedicated less resources to the Commission (Issing was sitting in a newly set up advisory board with EU Commission President José Manuel Barroso at the same time), and the explicit focus of the Commission was to discuss reforms

¹³⁷ Consultations are available at http://ec.europa.eu/finance/consultations/2013/banking-structural-reform/contributions_en.htm

endeavored at the international level, and specifically to make recommendations for the position that Germany should adopt regarding a new financial framework and systemic risk control set up at the G20 level¹³⁸. The Commission thus dedicated very little time and resources to the issue of bank structural reform (interview with a former committee member cited in Howarth and James, forthcoming). The Commission did not contribute in any direct way to the Merkel government's 2013 draft law on banking structural reform. Even less did it seek to mobilize the public opinion around the issue.

The Parliament remained mostly quiet on the BSR issue too. The Green party, a small opposition party, called for the creation of an independent commission similar to the British ICB in order to make recommendations on how to implement a BSR in Germany. This proposal was easily blocked by the governing Grand Coalition. During the discussions on structural reform, the financial committees of the lower and upper chambers passed no amendments to the project presented by the government. In both Houses, only the Green Party and the far-left *Die Linke* actively criticized the Grand Coalition's draft legislation and made suggestions to strengthen it. But as one of their colleagues said, "*they were completely alone*" (Bundestag interview 1112016b).

Thus, there was no political work endeavored by experts and/or parliamentarians to politicize the question of banking structural reform in Germany. The issue remained in the domain of quiet politics (Culpepper 2010). "*Yes, [the BSR] has to do with the general interest. But in the media, nobody felt concerned.*" (interview 11132016a).

The passivity of the local coalitions

Local coalitions, composed of local banks, business and governments, could have weighted in favor of a more stringent BSF for large banks. But as soon as they had secured the engagement that the reform would not apply to public banks (even to the largest of them like Dekabank and DZ Bank), they kept a neutral stance towards the BSR. They secured this engagement quite early in the process (interview Lander Finance Minister, interview 11122016c). The German Savings Banks Association (*Deutscher Sparkassen- und Giroverband*) and Association of German Public Sector Banks (*Bundesverband*

¹³⁸ The reports of the commission and an official government statement on German aims for a new framework structure are available at: <https://www.bundesregierung.de/Content/DE/StatischeSeiten/Breg/G7G20/G20-finanzzmarktarchitektur.html>

Öffentlicher Banken Deutschlands, VÖB) remained passive. To make sure that the largest public banks would not be worried, the wisest strategy was to remain silent and not push for the implementation of a reform for their private competitors (Hardie et al, 2013). Arguably, they were even to some extent opposed to principle of the BSR. Some were sensitive to the argument that a big political power like “*Germany should have a global financial player too*” (VOB, interview 11102016).

Because their banks were safe, the representative association of German SMEs *Mittlestand (Bundesverband mittelständische Wirtschaft (BVMW))*, did not get involved either. A representative explained to me that “[*they*] are part of the real economy. What they do up there [global markets] is none of our concern” (interview BVMW 11092016).

The domination of DB in the policymaking process

The Parliament, the regulators and the otherwise powerful coalitions kept quiet in the issue of the BSR. Given the multiple scandals in which Deutsche Bank has been involved since the crisis, the bank could have been an easy target for politicians willing to go (or be seen to go) tough on finance¹³⁹. Peer Steinbrück, the Finance Minister from 2005 to 2009, indeed published a report on behalf of the SPD group at the Parliament in 2012 untitled “*Vertrauen zurückgewinnen: Ein neuer Anlauf zur Bändigung der Finanzmärkte*”, (“Regaining confidence, a new attempt to taming the Financial Markets”), in which he proposed splitting retail and investment banking¹⁴⁰. Yet, when he got in the grand coalition, Steinbrück stopped voicing his concerns and was happy with the government’s bill. Howarth and James (forthcoming) suggest that his silent was part of the deal for the SPD’s participation to the Grand Coalition.

Consequently, the domination of Deutsche Bank in the policymaking process has been unchallenged. In particular, the Treasury aligned its position on the BSR on those of the financial national champion.

Shortly before the crafting of the bill, Deutsche Bank published a report accurately titled ‘Universal Banks: Optimal for clients and

¹³⁹ ‘A Reputation in Ruin: Deutsche Bank Slides into a Swamp of Scandal’, *Spiegel Online*, 19 December 2012; <http://www.spiegel.de/international/business/deutsche-bank-reputation-at-stake-amid-a-multitude-of-scandals-a-873544.html>

¹⁴⁰ The SPC report is available at https://www.spdfraktion.de/system/files/documents/konzept_aufsicht_und_regulierung_finanzmaerkte.pdf

financial stability - Why it would be wrong to split them up'¹⁴¹. Consistent with Deutsche Bank response to the EU consultation on the BSR, this public report argues that splitting large universal banks will hurt the competitiveness of European banks and ruin the economy, while failing to reach its objective of economic stability. Throughout the policymaking process, the CDU controlled the Finance Ministry and communicated directly and frequently with the private banks and their peak associations (Mitchell 2016). Politicians at the highest level shared Deutsche Bank's worries (BaFin Official interview 11152016).

Even more than the argument about "*client attrition and market dislocation*"¹⁴², it seems that German state officials did primarily feared for the position of Germany in the global markets. The idea that "*Germany should have a global financial player too*" (VOB, interview 11102016) has been pervasive in the highest spheres of political power:

"Germany also wants a national champion. It is Deutsche Bank. Deutsche Bank's shareholders contemplated asking the bank to separate some activities. To keep only market activities within Deutsche bank. They were ready for a clear-cut separation! The government opposed the suggestion. It is unbelievable. It comes to recognize that you need deposits to support market activities. Of course, Deutsche Bank thinks so. It is a scandalous position on the part of the public authorities" (EU official, interview 05282015b).

5.4.3 The UK: an adversarial mode of coordination

The UK's BSR sticks out as being the most ambitious and severe reform implemented across Europe. British banks were virulent in their opposition to BSR. The Treasury was sensitive to their argument, but it was neutralized, and even forced to move forward concerning the BSR, by a set political pressures coming from different sides. The Independent Committee on Banking (ICB) and the Parliamentary Committee on Banking Standards (CBS) had enough resources and expertise to shape their preferences about the BSR independently from the banking industry. The members of these committees

¹⁴¹ The report is available at https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000455298/Universal_banks%3A_Optimal_for_clients_and_financial.PDF

¹⁴² Consultations are available at http://ec.europa.eu/finance/consultations/2013/banking-structural-reform/contributions_en.htm

conscientiously work to keep the political salience of the BSR high among the public opinion, as well as the Governor of the BoE, Mervyn King. Banks vigorously sought to counter-act these attacks. They used all the power resources available to them to convince the government to stop the reform. HSCB in particular made its threat to move out of the country more pressing. Confronted to the pressures coming from public agencies and those coming from the banks, the Treasury eventually decided to play the card of “the electorate” (Lord Newby, House of Lords, interview 07122016d).

The Independent Commission on Banking (ICB)

The ICB, presided by Lord Vickers, put together the first version of the ‘ring-fence’ reform, the British version of the BSR (ICB 2011¹⁴³). The ICB is a British specificity. It was set up by the Chancellor of the Exchequer George Osborne, and granted with complete autonomy and considerable resources. Why did the British government decided to put together such a potentially dangerous entity? The establishment of the ICB was due to pressure from important political figures from the Liberal Democratic Party and the House of Lords.

In the UK, the workings of party politics allowed for the emergence of policy entrepreneurs interested in capitalizing on the public anger against banks¹⁴⁴. In 2010, the Liberal Democrats (libDem) accepted to form a coalition with the Conservatives. To reassure constituents worried about the alliance with conservatives, LibDems took the lead in putting pressure on Osborne to establish the ICB. Business Secretary, and former member of the banking Commission of the consumer organization Which? Vince Cable¹⁴⁵ was particularly proactive (interview CBS members 07120216c, 06022016).

The LibDems were joined by a major conservative figure: Lord Lawson of Blaby. Lord Lawson was Chancellor under Margaret

¹⁴³ The final report of the ICB made two sets of recommendation: a first set aimed at addressing the financial stability issues identified earlier; and a second set aimed at boosting competition in the UK financial sector. The ring-fence reform is part of the former set of recommendation. ICB final report available at <http://bankingcommission.s3.amazonaws.com/wp-content/uploads/2010/07/ICB-Final-Report.pdf>.

¹⁴⁴ For an account of the role of party politics in the emergence of political salience around a specific issue, see Massoc 2017a.

¹⁴⁵ *Financial Times* (2012) ‘MPs back forced separation of banks’, 26 December 2012.

Thatcher¹⁴⁶ and has since remained a major figure in the British political scene. He is sitting in the House of Lords (permanently) and is of quite an advanced age. Confronted with no electoral terms and with no great plans for the future of his political career, Lawson feared not to alienate fellow conservative politicians (Lord Lawson of Blaby, interview 07182016)¹⁴⁷. According to the Spokesperson HM Treasury at the House of Lord, “*Lawson persuaded Osborne to set up the Committee. He didn’t want to in the first place but he didn’t find a good argument to oppose it*” (interview 7122016d). The composition of the ICB was the outcome of political bargaining. George Osborne consulted Mervyn King, the governor of the BoE and an outspoken advocate of reform, for advice on suitable candidates. Vince Cable pushed hard for Martin Wolf, who had been a leading critical voice through the crisis (Ganderson forthcoming).

As table 13 shows, the ICB was well-endowed in terms of intellectual resources. It was composed of independent-minded, reputable commissioners.

Table 14: ICB members’ bio highlights

ICB members	Bio highlights
Sir John Vickers (chair)	Professor of economics at Oxford and had taught in prestigious universities around the world. Former economist at the BoE.
Martin Taylor	attracted the tag "wonderkid" after being appointed chief executive of Barclays at 41. Editor of the Lex column at the Financial Times.
Claire Spottiswoode	Business woman in the cotton and silk products’ import Consumers protection champion
Bill Winters	Investment bankers at JP Morgan. Was voted the most influential operator in the European capital markets in 2009.

¹⁴⁶ Under whom he was key in promoting... banking deregulation! From his own admission, he has made a U-turn on the issue of financial regulation.

¹⁴⁷ Lawson was also a leading pro-Brexit figure

Martin Wolf	Chief economics commentator at the <i>Financial Times</i>
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The ICB was also well-endowed in terms of material resources. The commissioners were supported by a dedicated secretariat of 14 members, who seconded them full-time. They helped to collect and collate exhaustive data, including thousands of submissions, including balance sheet data and testimony from banks, other businesses and consumer groups. The Commission also had a bounded horizon of 18 months within which to produce its findings. This timeline was carefully determined: long enough to produce a serious report but not so long as to represent a kick for the long grass, which was one of Cable’s concerns (Ganderson forthcoming).

ICB members thus had the capacity to shape their own independent opinion about the desirability and feasibility of the BSR. James (2017) describes how the ICB “*served as a highly effective screening mechanism of industry signals*”. The ICB represented a formidable set of intermediaries that were more than capable of calling out falsehoods and exaggerations of bankers. For example, banks’ claim that ringfencing would cost £12-15bn in increased bank funding costs. But the ICB led its own investigation and found out that the figure was closer to £4-5bn¹⁴⁸. ICB members had not internalized the notion that regulations were a drag on the UK’s competitiveness or might hurt investment. They came to the conclusion that the BSR could in fact strengthen London’s reputation as a leading financial center.

After the release of ICB’s final report, Vince Cable made it his mission to stir public attention around the Committee’s main recommendations, in particular ring-fencing. “*That’s why tomorrow the government is going to launch this initiative on the banks accepting in full the Vickers commission. We’re going to proceed with the separation of the banks, the casinos and the retail business lending parts of the bank,*” he said¹⁴⁹.

¹⁴⁸ *The Guardian*, ‘Banks put yearly bill for radical reforms at £15bn’, 20 March 2011.

¹⁴⁹ Cited in Reuters, 18 December 2011, UK to "accept in full" ICB bank reforms – Cable available at <https://uk.reuters.com/article/britain-banks-cable/uk-to-accept-in-full-icb-bank-reforms-cable-idUKWLA034120111218>

The Parliamentary Commission on Banking Standard (CBS)

The CBS pushed for the reform recommended by the ICB to be adopted and implemented.

As was developed in Chapter 4, the CBS was also very well-endowed in terms of material and intellectual resources.

Table 12 (reproduced from Chapter 4): Composition of the Committee on Banking Standards

Member	Affiliation	Noteworthy previous position(s)
Andrew Tyrie MP (chairman)	Conservative	Special advisor at HM Treasury, described by the Independent as “the most powerful backbencher in the House of Commons” ¹⁵⁰
The Archbishop of Canterbury	Non-affiliated	Senior bishop and principal leader of the Church of England
Mark Garnier MP	Conservative	Former banker
Baroness Kramer	Liberal Democrat	Figure of the LibDem, former candidate for London mayor
Lord Lawson of Blaby	Conservative	Former Chancellor of the Exchequer (1983-1989) under Thatcher
Andrew Love MP	Labour	
Pat McFadden MP	Labour	Minister of State in the Department of business; interim leader of shadow cabinet (2010)
Lord McFall of Alcluith	Labour	Chairman of the House of Commons Treasury Committee
John Thurso MP	Liberal Democrat	First hereditary peer to be elected in the House of Commons

¹⁵⁰ The Independent, 04/02/2013: “Andrew Tyrie: the most powerful backbencher in the House of Commons”

Lord Turnbull	Crossbench	Cabinet Secretary (most senior civil servant in the UK, senior policy adviser to PM)
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An interviewee recalls: *“The CBS was very powerful. The Banking bill resulted from it. It adopted most of the committee’s recommendations. There were Lawson, the archbishop of Cantesburry, McFall... It was a powerful lot”* (interview 07122016d).

CBS members very consciously stirred up public attention on the BSR. They publicly denounced lobbying by the banks. MP Tyrie especially was a vocal critic of banks’ attempts to weaken the ring-fence with lobbying (Walsh 2014). The CBS relied on formal publicly available select committee- style hearings in which senior bank executives were scrutinized by MPs. One CBS member describes them as *“Watergate hearings”* (interview 07162016b). CBS members were aware of the necessity for them to follow up on the political work needed to make the reform implemented. In 2015 (two years after the CBS stopped), Andrew Tyrie was still publicly stating that it is *“Parliament’s job now is to ensure that the regulators don’t inadvertently allow the reforms to be called off before they have been implemented”*¹⁵¹.

As importantly, the CBS was involved in an independent process of preference shaping regarding banking reform. A CBS member insisted that the position of all CBS members regarding BSR was not settled when the Commission was set up. Their engagement in favor of BSR got stronger as the hearings and research deployed:

“Lots of people started with thinking that banks should have a good excuse. And they became appalled. These institutions are so big, there is no way to know what is going on. We needed to force them shrink and get new players in” (CBS member, interview 07162016b)

They were also collectively convinced that the threat of large British banks (and more particularly of HSBC) to leave the UK was not credible. One interviewee bluntly stated: *“I don’t believe HSBC when it says they’ll leave”* (CBS member, interview 06092016). A second confirmed: *“HSBC reviews every other year where to put its headquarter. The question is: they want to leave but who else is going to take them? It is a massive bank to house. You need a huge fiscal and*

¹⁵¹ Andrew Tyrie cited in the Financial Times, 16 November 2015, “Regulators should not give in to bank lobbying, says Tyrie”.

legal base” (CBS member, interview 071312016a). This contrasts with the Treasury officials who recognized that they were afraid to see HSBC leave (Senior Treasury official, interview 06102016).

Involvement of other actors in the British BSR

The SME sector supported structural reform on the grounds that it would bring greater financial and economic stability (Interview with Small Business UK, 07152017). The consumer group *Which?* also convened its own Future of Banking Commission in 2009 which brought together a number of experienced politicians, including Vince Cable, to propose reforms to the industry, enabling it to accumulate a wealth of expertise and credibility on the subject (FBC 2009). Its proposal that the core lending and deposit functions of UK banks should be ‘ringfenced’ placed the policy option firmly on the agenda and was influential in framing the thinking of the ICB (Howarth and James forthcoming).

Banks’ lobbying and disunity

All British banks have been strongly opposed to the ring-fencing reform. They made their position clear, both through public and private channels. A CBS member recalls:

“HSBC was very unhappy with the ring fencing. They want their investment banking to support commercial banking. HSBC has been more vocal publicly. But privately the others were actively lobbying too” (CBS member interview 06092016).

British banks have seen the British ring-fencing as a treason from their politicians. A British banker analyzes that *“Ring-fencing applies to only five banks in the world... so they [British policymakers] have screwed only British banks”* (British Senior banker 07192016b). Another complained that *“France has its national champions. They would never treat their banks like the UK treated British banks”* (UK Senior banker, interview 07142016b).

Yet, as the reform threatened to impact on bank business models in different ways, banks’ ability to speak collectively was undermined and they faced incentives to lobby privately. In order to secure specific concessions for their bank, managers quietly stated their support to those aspects of the reform that would hurt them the less. Lloyds in particular took the decision to break ranks (Howarth and James,

forthcoming). This was largely a strategic move aimed at avoiding being forcibly broken up on competition grounds – at a time when the ICB was preconizing stricter a re-organization of the bank than the EU Commission. A British banker explained the divergences between banks that he had witnessed during the lobbying against the BSR: “*You see the difference of business model with the ring-fencing rule*” (UK Senior Banker 07112016b).

The Treasury under pressure

On the BSR matter, the Treasury and the Chancellor found themselves in the middle of two contradictory sets of pressure: the banks kept repeating that the reform was dangerous for their competitiveness and the British economy as a whole, and they threatened to leave the country. “*The Government was lobbied intensively by investment bankers. They told them they would go out*” (Lord Lawson, interview 07182016). On the other side, the Parliament kept pressuring the Treasury too. Because the Chancellor did not want to clash with the Parliament, and risk a political backlash in the electorate, he supported the reform, even when the Conservatives won the elections that the LibDems left the coalition in 2015:

“Look at ring-fencing. Banks hate ring-fencing. But the government didn’t change it because they knew the Parliament wouldn’t step back. Even at the BoE, many were not very keen on ring-fencing. But the Treasury cannot do what they want to” (Senior Treasury Official 06082916).

5.5 Conclusion

The important overall issue of functional separation between retail and trading activities for the banks lies in the extent to which the deposit-taking bank is prevented from supporting the trading bank during its operations. A lack of support from the deposit-taking bank would increase the financing costs of the trading bank, limiting its profitability. This might result in the larger universal banks scaling back their trading operations – opening the door to foreign trading institutions. This is why BSR has been a major regulatory stake for banks and policymakers after the crisis. The potential disruption that it may bring to domestic financial sector is important. This chapter has shown that different institutionalized state-banks modes of

coordination in these countries have led to different banking structural reforms in France, Germany and the UK.

The French Treasury, in close agreement with banks' top managers and the governor of the Banque de France (BdF), worked hard to implement a French version of the BSR that would not impact banks' business model. No independent commission was set up where policymakers could form an independent opinion about the legitimacy of the BSR. When voices existed in favor of the BSR, they did not have a venue to weight in the policymaking process.

Germany started implementing its own BSR in order to avoid the UE Commission's pressure to impose its own, stricter, version of the reform. Early on, Joseph Ackermann, Deutsche Bank's CEO, convinced Finance Minister Wolfgang Schaueble that the BSR could hurt the largest German bank. The Minister put his political weight in the defense of the national champion. On their side, small local public and cooperative banks were at first circumspect about the BSR project. Very easily and early on in the process, through the intervention of state governments, they secured the engagement that they would not be concerned by the reform, regardless of the specific content of the future BSR. Thus, they did not mobilize in favor nor against the reform. Feeling unconcerned, the Mittlestand association BVMW also remained neutral.

The UK's BSR sticks out as being the most ambitious and severe reform implemented across Europe. British banks were virulent in their opposition to BSR. The Treasury was sensitive to their argument, but it was neutralized, and even forced to move forward concerning the BSR, by a set political pressures coming from different sides. The Independent Committee on Banking (ICB) and the Parliamentary Committee on Banking Standards (CBS) had enough resources and expertise to shape their preferences about the BSR independently from the banking industry. The members of these committees conscientiously work to keep the political salience of the BSR high among the public opinion. Confronted to the pressures coming from public agencies and those coming from the banks, the Treasury eventually decided to play the card of "the electorate" (House of Lords, interview 07122016d).

CHAPTER 6

When do Banks do what Governments tell them to?

A comparative study of the Greek sovereign crisis management in France and Germany in 2010

6. Introduction

I have argued in the previous chapters of this dissertation that state-banks mode of coordination differed in France and in Germany. In Germany, state-banks mode of coordination is dual. The access of Deutsche Bank to the Treasury has been key in protecting large German commercial banks (See chapter 5). Policymakers from the executive branch has been led by their deference to commercial and their idea of the importance for Germany to have a national champion in global finance. But this capture is circumscribed by the power of local coalitions, led by local public banks, which interests sometimes diverge from the preferences of the federal government. In France, I have argued that the state-banks mode of coordination was not consistent with a story of sheer capture of the state by banks. The mode of coordination between bankers and state officials is more horizontal and based on early discussions and compromises: it is symbiotic. In terms of the outcome, the French state has adopted a sectoral policy more advantageous to the banks than Germany. Many would say that the French case is a case in point for capture. Nevertheless, I would like to follow the advice of Carpenter and Moss not to infer the degree of capture from the degree of conformity of the outcome with business preferences (Carpenter and Moss 2013).

This chapter's objective is to examine even more closely the difference between French and German state-bank coordination. If the French mode of coordination is symbiotic, and not captured, bankers should also be sensitive to the preferences of state officials. In other words, when state officials ask a favor from the banks, they should comply. We should also observe similar mechanisms, building on the same institutions, as in financial policymaking cases. By contrast, there is no reason for banks to comply with the request of a government that they capture. We should expect that they refuse and the government to use tools available to it to constrain them.

In 2010, at the beginning of the Greek sovereign debt crisis, the French government asked French banks not only to retain plummeting Greek bonds on their balance sheets but also to buy *more* Greek sovereign debt. French banks did just that. The German government asked German banks to do exactly the same. German banks sold

massively. This chapter shows that different state-banks modes of coordination explain this outcome.

Through a comparative case study of the management of Greek sovereign debt by French and German banks in 2010-2011, this paper argues that the key factor determining whether banks comply (or not) with government requests are the existence of specific institutionalized modes of state-banks coordination in these countries. When bank managers conceive of the government's request as embedded in a long-term cooperation from which they may also benefit in the future, and they are confident enough that other bankers in their domestic community share the same view, they will be more likely to comply, even when complying may lead to important financial losses.

In France, the concentrated and centralized character of the state and banks' organization, as well as sociological homogeneity between banking and government elites, foster informal institutional linkages between those elites through mechanisms of group identification and network relationships (Kwak 2009; Woll 2014). The persistence of elites' proximity in this country has repeatedly been underlined by French scholars, often to explore how banks have "captured" government's policies (Chavagneux and Philipponnat 2014). On the other side, the potential 'capture' of banks by the government has rarely been explored, yet it is plausible that some mechanisms of social capture may also work the other way around (Jabko and Massoc 2012). The French government first informally asked the banks to retain Greek bonds on their balance sheet in February 2010. Finance Ministry officials stressed the necessity for the banks to comply if France was to play a role in the management of the Greek crisis against its powerful German neighbor. Despite bankers' disagreement with the strategy, talks between top bank managers and Minister Lagarde and her team members quickly led them to collectively commit to retain Greek bonds. The agreement was barely publicized: nobody wanted not to attract too much attention to a deal that could weaken French banks. A year later, the banks had remained faithful to their commitment and had endured important financial losses due to their high exposure to Greek sovereign bonds. In order to try and minimize the losses, French banks didn't value their bonds at market prices as accounting standards would have required them to. In October 2011, European regulators blamed the French government and regulators for letting them do that.

In Germany, federal governments, whatever majority in charge, have always considered since the 1980s that it was crucial for an economic power like Germany to have its "own" national champions.

Deutsche Bank in particular is still considered as a jewel of the crown by German state officials. Access to Treasury officials, and even the Chancellor, by Deutsche Bank's top executives is so easy that observers have dubbed the bank "the state within the state". Yet, the decentralized and fragmented organization of the banks and government, as well as looser sociological proximity between federal government and commercial banks elites, do not foster the same informal government-banks institutional linkages as in France. This doesn't mean that government don't try (and sometimes manage) to influence banks' management, but only that different mechanisms are at work. They use resources identified by the power literature and deploy strategies of persuasion to influence each other. Whether banks comply with government's requests largely depends on the availability and mobilization of these resources. As early as February 2010, German bankers conceived of the German government's inquiries to retain Greek bonds on their balance sheets as a constraint that they would have to dodge. The German government made use of one traditional tool of pressure in its attempt to make the bankers to comply. The German Finance Ministry tried to constrain them by bringing public attention on them, publicly shaming the banks that did not comply, and praising those that did. The strategy worked at first. Finance Minister Schaeuble actively publicized the "Gentlemen's Agreement" of May 2011, in which some of the biggest German banks committed to retain Greek debt, as his own political victory. But German banks retained their Greek bonds only as long as the public pressure lasted and started selling quickly after committing to the Gentlemen's Agreement.

The 2010 case of Greek bonds management by French and German banks provides a good opportunity to explore informal institutional linkages between government and banks and how they impact important decisions made by banks. The story is striking in its simplicity: a) The government's preferences were clearly formulated and identical: both French and German governments wanted the banks to retain Greek bonds; b) Banks' interests were straightforward and identical: both French and German banks wanted to sell Greek bonds; c) and the outcome was yet very different: French banks retained their Greek bonds and German banks sold them.

6.2. An opportunistic design

6.2.1 Same request, different outcomes

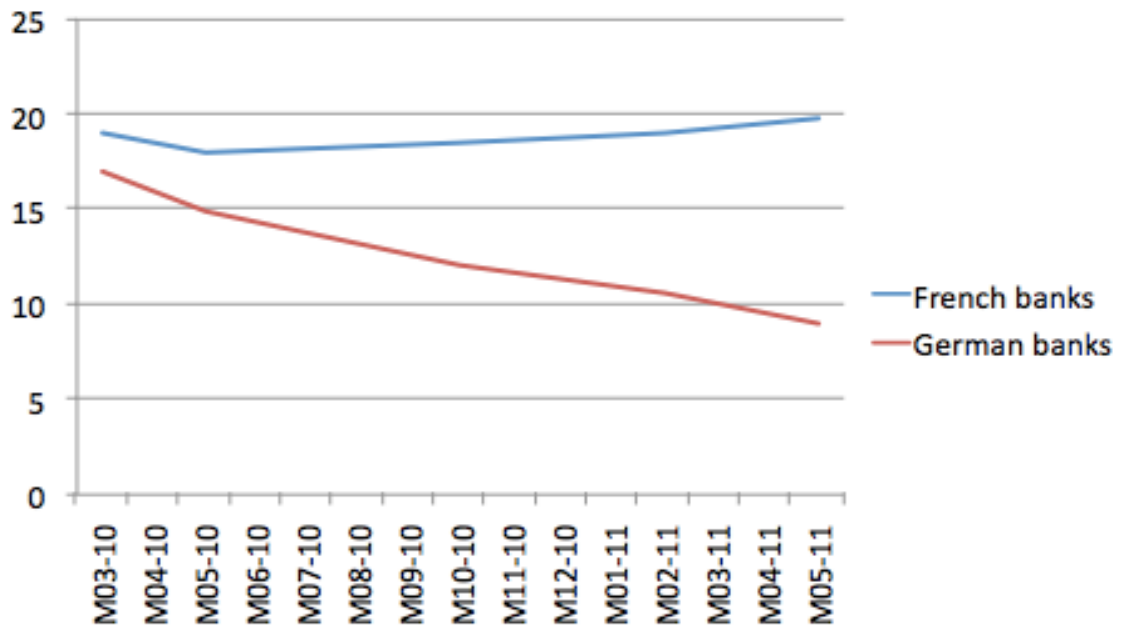
In February 2010, the interest rates on Greek bonds reached their highest level since Greece had entered the Eurozone in 2001. Credit agencies had just downgraded the Greek sovereign rating. The Greek parliament was passing the first austerity package as doubts were raising on the sustainability of the Greek debt and the capacity of the Greek government to prevent the country from defaulting and eventually leave the Eurozone. Aggressive speculative attacks from hedge funds were led against the Euro (Armingeon and Baccaro 2012, Johnston et. al., 2013).

Since it was accepted in the Euro-zone, Greece has been the recipient of massive amounts of inward capital inflows, principally from French and German banks, that enabled the country to maintain high levels of consumption. French and German banks were thus the financial institutions that were the most exposed to Greek debt. German and French banks are also among the largest in the world in terms of both total financial assets and in relation to the domestic GDP of their own governments, as well as being an important source of employment in the domestic market (Goldstein and Véron 2011, Goyer and Valdivielso 2013). Given the volumes of lending, their own governments have been keenly aware of the need to protect them from their exposure to Greece, Ireland, Italy, Portugal and Spain (GIIPS) in order to avoid involving taxpayers in costly bailouts (Blyth 2013; Hall 2012, pp2363-2365). The management of the sovereign debt crisis had thus in general been highly favourable to the interests of French and German banks (Armingeon and Baccaro 2012; Hall 2012; Goyer and Real 2013). The burdens of adjustment associated with the bailout packages had been placed chiefly on the GIIPS economies in the form of austerity packages while protecting bondholders.

Yet, in Spring 2010, the French and the German governments asked their banks to keep Greek bonds on their balance sheets. This meant that banks were asked not sell the Greek bonds as well as to renew loans that were supposed to end by 2012. This was supposed to give the Greek government a little bit of slack and not neutralize the effects of the reforms implemented by the Greek government in its first austerity package. In May 2010, both German and French banks publicly accepted to keep their Greek bonds and renew loans to Greece. But soon after, it appeared that only French banks had respected the

deal. German banks started selling in the Summer 2010. In a year, they had sold about one third of their Greek bonds since May 2010¹⁵². The first sign of French banks starting to get rid of their Greek bonds is in June 2011, with Société générale reducing its exposure by 10%¹⁵³. But in general, French banks started to sell only in the Summer 2011.

Figure 12: Greek bonds holdings by French and German banks - Evolution between March 2010 and May 2011 (Data available for March 2010, May 2010, October 2010, February 2011 and May 2011)



Source: The Financial Times Deutschland; The Financial Times; Reuters

6.2.2 Controlled alternative potential factors

This special event provides us with a rare setting to study when banks do, or not, what governments tell them to. The setting of the story is strikingly simple and allows us –at least partially- to control for some

¹⁵² Mitteldeutsche Zeitung, “Deutsche Banken stossen Anleihen ab”, 9 June 2011 and Financial Times Deutschland “Banken lassen Athen doch Hangen”, 9 June 2011

¹⁵³ Reuters, “Greek Debt shadow looms over European banks”, 20 April 2011; La Tribune, “Quelles sont les banques françaises les plus exposées à la crise grecque?”; 05/06/2010; Bloomberg, “German Top French on \$23bn Greek Debt, BIS Says”, 06/06/2011; Forbes, “French Banks Hold \$93bn Greek Debt”, 27 June 2011.

potential alternative factors that could explain why French banks complied with their government's request and German banks did not.

The French and the German government had the same motivation to ask their banks to retain Greek bonds. Both governments wanted French and German banks to retain Greek bonds on their balance sheet in order to 1) Limit the pro-cyclicality of selling (big banks selling would incite other market actors to sell too), 2) Limit the borrowing cost of Greece, which could already hardly find affordable finance and had just announced that it needed to borrow an extra €50bn on the markets in 2010. It was important to buy Greece a little bit of time while the government was implementing its first austerity package. Politically, governments also wanted to send a signal to their constituents that they were asking the banks to participate to the costs of bailing Greece.

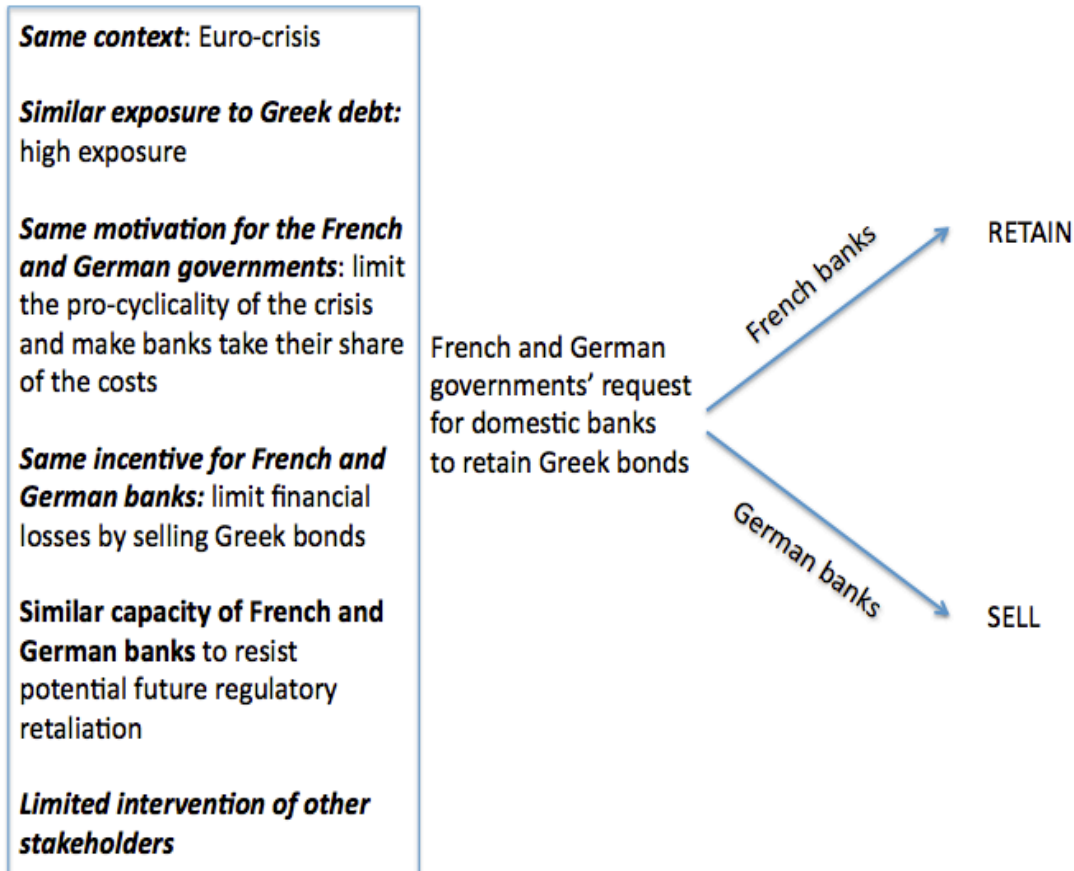
The French and the German banks had the same incentive to sell their Greek bonds. In 2010, the value of Greek bonds was plummeting, as risk of sovereign default was becoming more credible. Banks had a pressing incentive to get rid of their bonds as soon as possible. But this short-term incentive may be mitigated by the level of banks' exposure to Greek debt. A bank with a very high exposure to Greek debt may have interest to retain the bonds to decrease pro-cyclical effects and the probability of a Greek default, which would have dramatic consequences for its financial health. Because it was feared that a Greek default would trigger defaults in the GIIPS countries, banks exposed to these sovereigns may also have had interest in keeping their Greek bonds. Were French banks more exposed to Greek and/or peripheral sovereign than their German counterparts? In 2010, different analyses gave slightly different answers to this question, depending on the data and mode of calculation that they are using. But it transpires that both German and French banks were highly exposed, with German banks slightly more exposed to Greek public debt and French banks slightly more exposed to Greek private debt¹⁵⁴. Beyond Greece, France was slightly more exposed to Italy, while Germany was more exposed to Spain (Aneloni et. al. 2012). Based on these analyses, there is no evidence that German and French banks had interest to play radically different strategies regarding retaining or selling their Greek bonds.

¹⁵⁴ See AGEFI, "Les banques allemandes semblent le plus exposées au risque souverain grec", 3 April 2010 ; AGEFI, "L'Exposition des grandes banques françaises à la dette grecque semble gérable", 7 May 2010 ; Reuters 20 April 2010 ; Les Echos, "8 Milliards d'exposition à la dette grecque" 10 June 2010

There is not a significant different in the degree to which French and German banks were capable of resisting potential future regulatory retaliation from the government. In his study of 2008 banking bailouts, Culpepper (2015) argues that the decision of banks to accept or not to participate to a collective bailout was determined by the degree of structural power of the healthiest banks. He measures structural power by the proportion of profit realized abroad by the bank: the bigger proportion of profit is realized outside of home country, the more credible the threat to ‘exit’ (for example by relocating headquarters). In the UK, HSBC was the only healthy bank, but refused to submit to the bailout because it knew that it would have the capacity to block potential regulatory retaliation from the UK government. HSBC indeed makes most of its profit out of the UK and its threat of exiting is credible. In France, Crédit Mutuel was healthy too, but lacked similar structural power and ended up agreeing to participate to the collective bailout. But the structural power argument doesn’t work well in the case of the management of Greek debt by French and German banks. First, Culpepper’s argument is about the defection of the most powerful (healthy) bank. Here, we showed that all powerful and less powerful banks had the same preference (selling bonds), and yet some sold and others retained. For example, BNP-Paribas wanted to sell, just like Commerzbank. BNP-Paribas is more structurally powerful than Commerzbank, even if structural power is measured only by the proportion of profit realized abroad. Yet, BNP decided to retain, and Commerzbank decided to sell. Second, and more generally, the structural power of banks can be measured, beyond the proportion of profit made abroad, by the proportion of the domestic economy relying on them (in terms of Non-Financial Corporations’ financing and employment). From this point of view, German banks don’t benefit from a clear advantage over French ones (Goyer and Real, 2013).

As Figure 3 illustrates, this design thus allows us to rule out hypotheses proposing explanatory variables like the variation in preferences, the variation in resources, and the hypothesis of coalitional politics. The key differences explaining why French banks retained Greek bonds and German banks did not, must thus be sought in the decision-making processes that led to these outcomes.

Figure 13: Schematic description of the case study



6.2.3 *Different state-banks modes of coordination affecting the decision-making process*

This paper focuses on the decision-making processes that led the banks to sell or retain Greek bonds on their balance sheet. It argues that informal institutional linkages are key in determining whether banks complied with their state's request or not. The informal institutions identified here are: 1) the shared belief between bank managers and government officials that it is legitimate for the other party to ask for their help in achieving their own goal; 2) the shared expectation between bank managers and government officials that the other party will take their interest into account in the future. In this case, 1) French top bankers believed that Finance Minister Lagarde was legitimate asking them to help her alleviate pressure on Greece during the bailout

as well as secure a better position for France in the bailout negotiation process against Germany; 2) French top bankers were confident that government officials will be taking their own interest into account in the future. They were also confident that other bankers in their community shared the same belief and expectation. When informal institutional linkages between government officials and top bankers are tight, outcomes are relatively stable and we can predict that banks will comply with government's request, as was the case in 2010.

The shared beliefs and expectations between government officials and top bankers in Germany are radically different. 1) Bankers generally don't consider requests by the government as legitimate and the request of retaining Greek bonds on their balance sheet was not exception; 2) Top bankers conceive of the action of the German government toward their own interest as highly uncertain. They were not confident that their present sacrifice would be 'repaid' in the future. In this case, government officials mobilize other resources pertaining to tools of influence analyzed by the capture literature to influence bankers. When no informal institutional linkages exist between bankers and government officials, it is more difficult to predict an outcome because it largely depends on availability and mobilization of power resources. In this case, the tentative by Minister Schaeuble to constrain the banks through public shaming proved unsuccessful in the long-run.

6.3 The Greek debt management by French and German banks 2010-2011

As Figure 4 illustrates, we can identify three stages in the decision-making process that deployed from the moment governments made their first request to banks to the outcome itself (selling or retaining bonds).

Figure 14: Simplified chronology of events in the management of Greek bonds by French and German banks between February 2010 and Fall 2011



The point is to see if the multiple actions and statements of the actors at each stage of this process are consistent with the image of the world implied by the argument developed above and summarized in Figure 1 (Hall 2003).

6.3.1 The French and German informal requests to banks

The German government formalized and publicised its request for the banks to retain Greek bonds on their balance sheet in May 2010, but informal inquiries had already been made as early as February 2010. Unsurprisingly, there are very few mentions of these informal inquiries in the press. Reuters mentions that French and German banks had been approached by their governments, citing a banking source, but the article also states that governmental sources had denied it did¹⁵⁵. During interviews, both bankers and government officials confirmed that behind the scene, informal requests had already been made in February.

It is important to investigate how those inquiries were made and how bankers first responded, because it can tell us a lot about how government officials and top bankers interact in situation of low political salience, and what their first reaction to a government inquiry is. If French banks' keeping the bonds is not due some subsequent random event, or to some pressure imposed by the government to the banks, but to the informal institutional linkages between banking and government elites, they must have accepted very quickly after the first inquiry was seriously made. If German bankers accepted the Gentlemen's agreement in May 2010 only because the German government put them under too much pressure, it must have been clear that they did not intend to comply when the request was made informally.

Both German and French bankers immediately expressed their disagreement with the idea of the government of having them retained plummeting Greek bonds. German bankers were harshly critical: "You don't need a PhD to realize that this was a bad idea" (German Senior Banker, 04092014). But French bankers did not depict their disagreement in much lighter terms. "It was completely stupid" (French Senior Banker, 04172014), a French banker bluntly told me, while another complained that the request was a good illustration of the fact that "the government tends to see us as public utilities, not companies"

¹⁵⁵ Reuters, 11 February 2010

(French Senior Banker 01192015). Both French and German bankers had a similarly well-oiled argument: retaining Greek bonds on their balance sheet would cause important financial losses, weaken their balance sheet, at the very moment when they subject to tougher capital ratio requirements. In order to maintain high level of capital and in order to reassure the markets that would certainly penalize them for retaining Greek debt, they would necessarily have to cut lending activities, which would make the whole economy suffer and would do nothing to improve the situation in Greece. These are the kinds of arguments to which government officials are known to be especially sensitive. Yet, both French and German governments were so desperate to limit the plummeting of the Greek sovereign that they maintained their request.

6.3.2 *In France: Gift, counter-gift... and “publicly-minded” banks?*

In France, the informal request and following discussions went through informal meetings involving top bank managers and the Finance Ministry team: Lagarde, the director of cabinet, Stéphane Richard. The president of the French banking Association (FBF), BNP-Paribas' CEO Baudoin Prot, was in the frontline, both in the discussions with the government and among the banks during the FBF's weekly meetings. It is not surprising that BNP's CEO played such an important role. BNP-Paribas had already played a lead role in facilitating the communication between government officials and bankers to put together a collective bailout in 2008 (Jabko and Massoc 2012). The experience of the bank's (now retired) historical president Michel Pébereau has contributed to put the bank in this position of leader in government-banks interaction over the last decades. All the banks collectively accepted to retain bonds. Meetings that led to the French banks' accepting the government's request are confidential and unfortunately forever closed to scholars interested in studying decision-making processes. To understand how bankers got to this decision, we need to rely on how actors describe this process *a posteriori* in interviews or in the media.

Are these statements consistent with our hypothesis? Can we have confidence that bankers accepted because they conceived of the request as embedded in a long-term cooperation between themselves and the government? Did they conceive this request as legitimate? Did they assume that they would be 'repaid' for complying?

In this case, we should see statements consistent with the idea that bankers accepted the request of the government because they expected the government to repay them in the future. This is a difficult but not impossible observation to make. In general, it is striking how much bankers are aware of the transactional nature of their long-term relationships with the state¹⁵⁶. Bankers, especially French bankers, are also aware of their market reputation that the state is backing them actively, and from which they may benefit. A British banker questioned on the differences of banks' market strategies across jurisdictions said "*The French [bankers] know very well that the they [French regulators and government] will always treat them well*" (British senior banker 07112016a). The French also present themselves as distinctive from their British counterparts: 'The Anglo-Americans have no other objective in mind than their own profit. We are more publicly minded' (French Senior banker, interview 04122009). Expected future benefits don't necessarily come in the next round of interactions and the point of informal institutions (shared beliefs and expectations) is that there is no explicit bargain so it can be difficult to link empirically a 'gift' to a counter 'gift' (Mauss, 1990/1924; Parry, 1986). As Jabko and Massoc (2012) stressed in their study of the French banking bailout in 2008, the bank support plan should be viewed as a 'gift' that members of the same elite group extended to each other in exchange for future, albeit still indeterminate, 'counter-gifts'.

In our case, there are signs that future benefits came shortly after banks accepted to comply with the government's request. In the October 2011, the International Accountability Standards Board (IASB) accused French banks of not valuing sovereign bonds present on their balance sheet at their market value, and blamed French regulators for letting them do so¹⁵⁷. French bankers always have a hard time with the IASB, but when asked about this specific allegation by the IASB, one banker bluntly responded "*After what we had done, it would have been crazy to get on our ass*" (French banker, interview 0712024). The IASB allegation came in a context where French bankers kept reminding governments' officials publicly and privately that they had complied to the government's request. "*We conformed*

¹⁵⁶ Callaghan and Lagneau-Ymonet (2012) finds that one reason why the French government didn't intervene to stop NYSE to take over Euronext was the questionable patriotic credentials of those demanding intervention. Bankers may have learned from the bad consequences resulting from public actors' resentment that French banks had sold their shares (p396).

¹⁵⁷ The Financial Times, "French banks to take bigger losses on Greek Debt", 22 October 2011.

*ourselves to our commitment to Christine Lagarde not to sell, which is not the case of the German banks like Deutsche Bank or Commerzbank who yet received the same injunctions! We are the only ones to assume such a high cost for Greece” a banker cited in the French newspaper Le Monde*¹⁵⁸.

Not only are there signs that French bankers expected to be “repaid” for complying, there are also signs that French payers assumed that it was legitimate in the first place for the government to ask them for some help. It is probable that French bankers envision a more political role for banking than their German counterparts. In general, French bankers often talk about their sense of “general interest”. “Lemierre has the sense of general interest deeply rooted in him”¹⁵⁹, a friend from ENA said about Jean Lemierre, new Chairman of BNP-Paribas. In the same article, *Lemierre* himself is quoted: “The globalized elite, it doesn’t exist. We come from somewhere. I am from France, and Europe. In order to bargain well, one needs to know where one comes from”¹⁶⁰. In interviews with French bankers, the theme of the general interest pops up regularly. This quote is particularly illustrative of French bankers’ awareness of playing a role for the public good: “*To be a good banker, let’s be honest, you need to have a sense of the general interest*” (French Senior Banker, interview 01182009). These quotes come in striking contrast with German commercial bankers, who are less prone to praise their role in the public good. It is thus plausible that it is one specificity of French bankers to consider that “general” or “public” interest is one of their motivations. When the Finance Ministry made the informal request in February 2010, the Minister Lagarde made the strong argument that it was important for the banks to comply in order for France not to lose face in front of the Germans and be able to have weight in the coming negotiations relative to the Greek crisis management, especially against Germany.

It is of course difficult –not to say impossible - to determine with certainty whether French bankers really believe in their role to defend the public interest and to what extent this belief impact their decision-making. It is very probable that some do believe in it while others have a more opportunistic approach. In any case, French bankers’ regular references to the public interest may well work as repeated signals to communicate to government officials that about their shared

¹⁵⁸ Le Monde, “Les banques se délestent de leurs dettes souveraines”, 9 November 2011

¹⁵⁹ Libération. “Jean Lemierre, un banquier qui change”, 1 March 2015.

¹⁶⁰ Libération, “Jean Lemierre, un banquier qui change”, 1 March 2015.

expectation and beliefs. If French bankers are explicitly so concerned about the public interest, it is because they want to maintain their participation to the mutually benefiting cooperation with government officials.

6.3.3 In Germany: banks' refusal and politicization of the request made by the government

In February 2010, when formal inquiries were first made, bankers immediately saw the request as a constraint to avoid. A member of the German financial cabinet said: *"They were very reluctant. We knew we would have a hard time with them"* (1112024). Minister Schäuble especially lobbied Deutsche Bank CEO Joseph Ackermann to get his support. Yet, the response was not very encouraging. Most German banks –including HRE, Postbank, Deutsche Bank, publicly stated in 2010 that they would not renew their lines of credit to Greece. This was even before the request was made formally by the German government¹⁶¹.

In France, the deal was settled down since February, so there would have been no need for making the request formally. On the French side, there were only a few mentions of the formal acceptance of the banks to retain Greek bonds¹⁶². In Germany, the Minister of Finance got actively involved in publicizing the request and the response of the banks to it.

The political context was very tense in Germany. The Parliament and public opinion were upset that banks were not more involved in the Greek crisis, especially after they had to be bailed out by taxpayer's money a couple of years before. In April, the German lower Chamber adopted a public statement requesting German banks to be involved in the management of the Greek sovereign crisis¹⁶³. An opinion poll published in the press at the same time showed that an overwhelming

¹⁶¹ Deutsche Welle, "Deutsche Banken meiden griechische Anleihen", 26 February 2010.

¹⁶² Société Générale's CEO Oudea said that they would "maintain a level of commitment to Greece, so that the private sector accompanies the public sector" (cited in Financial Times, "SocGen has £bn Greek bond exposure", 5 May 2010). Baudoin Prot, BNP CEO was quoted: "Bercy asked us to maintain our credit to the Greek economy, both public and private" (cited in Le Figaro, "La France et l'Allemagne demandent un effort à leurs banques", 5 May 2010).

¹⁶³ Mitteldeutsche Zeitung, "Deutsche Banken stossen Anleihen ab", 9 June 2010 ; Les Echos, "Allemagne: des députés veulent une participation bancaire au sauvetage grec", 29 April 2010;.

majority of German thought that banks had to play a bigger part to solve the Greek crisis¹⁶⁴. Having the banks publicly agree was an important political stake for Schäuble.

While the French government was reluctant to make the request publicly because could damage the image of the French banks, the popular German Finance Minister himself, Professor Schäuble, made several public statements in this sense¹⁶⁵. Both English and German speaking newspapers reported news about the German governmental request and its progress. In a research on Factiva, I have found 23 articles mentioning the German government's request and banks' response contra only 2 mentions of the agreement on the French side. Governments can use public shaming and involvement of important and popular elected officials to pressure banks. Studies have shown that banks care about their image in the general public (Bloemer and De Ruyter 1998). After the financial crisis, banks were especially eager to improve their damaged reputation (Bravo et al 2010). One reason why banks care about image and reputation is that deposits and retail banking are important parts of their business model (especially since we're talking about universal commercial banks like in France and Germany): they need to retain their customers.

On May 4 2010, a much-publicized meeting gathering Wolfgang Schäuble, Deutsche Bank CEO Josef Ackermann, DZ CEO Wolfgang Kirsch, Commerzbank CEO Martin Blessing, representatives of insurance companies Allianz and Münchener Rück and representatives of several regional banks led to so-called a "Gentlemen's agreement" regarding the Greek debt crisis. Ackermann and Kirsch, speaking on behalf of all German banks, publicly agreed to maintain their existing Greek bonds "with all means possible" for at least 3 years to prevent collapse of the Euro. No official agreement was signed but Kirsch calls it "a very strict and strong gentleman's agreement"¹⁶⁶. Ackermann poetically justified: "When a house is burning, and that fire threatens to spread out, it is not a good time to argue about the fragile construction of the House¹⁶⁷". Schäuble himself made the announcement during a press conference on 4 May 2010.

¹⁶⁴ Les Echos, "Allemagne: des deputes veulent une participation bancaire au sauvetage grec", 29 April 2010; FT, 4 May 2010

¹⁶⁵ AFP, "Grèce: Berlin veut des engagement des banques allemandes", 30 April 2010.

¹⁶⁶ Wirtschafts Woche, "Banken helfen Griechen: Die Jo-Ackermann-Show", 5 May 2010; Zeit, "Eine gut verzinste Athen-Spende", 4/10/2010.

¹⁶⁷ Reuters, "Les Banques allemandes contribueront à l'aide à la Grèce", 4 May 2010

But the Gentlemen Agreement did not overcome the reluctance of all German banks. The very same day the Gentlemen Agreement was published, the President of Sparkassen published in *Der Spiegel* that they didn't feel concerned by the Agreement: "Only those who helped Greece with inventive accountability and unusual credit are to feel concerned. And those who wanted to earn money speculating on Greece's solvability"¹⁶⁸. Soon after the agreement, Josef Ackermann gave an interview on popular journalist Maybrit Illner's political talk show and publicly states that he doubts that Greece would ever be able to repay its loans.

Political salience on the "Gentlemen Agreement" soon faded away. German banks started selling their bonds almost immediately after the Agreement, and selling accelerated during the Summer 2010. In contrast, French banks had retained the same level of Greek debt in May 2011 than in March 2010. In the fall 2011, French banks came under serious market attacks. Moody's, the famous credit agency, downgraded Société Générale and Credit Agricole, and put BNP Paribas on a negative prospect in September 2011. The decision was driven by "concerns about their exposure to Greek debt"¹⁶⁹. In October 2011, in coherence with the idea that French banks would at some point in the future be 'repaid' for complying with their government's request, the International Accounting Standard Board accused French banks of not valuing their Greek bonds at their market value and blamed French regulators and government for letting them do so.

6.4 Conclusion

The general management of the Greek sovereign debt crisis has arguably been highly favourable to the interests of the creditors, of which French and German banks figured in the frontline. More generally, the burdens of adjustment associated with the bailout packages passed between 2010 and 2015 have been placed chiefly on the GIIPS economies in the form of austerity packages while protecting bondholders. The fact that German banks massively reduced their exposure to Greek debt even though the German government had asked them not to, while French banks retained their exposure in agreement with their government's request didn't impact this fact.

¹⁶⁸ Cited in *Les Echos*, "Les banques allemandes s'engagent à soutenir la Grèce", 5 May 2010.

¹⁶⁹ *Financial Times*, "French banks on the front line", 14 September 2011.

The objective of this chapter was not to explain the politics of the Greek sovereign crisis, but to take advantage of a particular event that provides us with an exceptional window to take a detailed look at the different modes of interaction between government officials and bankers in two of the biggest European economies and how these modes of coordination may affect decision-making of major market actors in Europe. The theoretical contribution of this paper goes beyond than just explaining why French banks retained Greek bonds while German banks did not. This episode is not an isolated case. Governments try to influence banks' market decisions more often than it is often realized. Collective participation to bailouts, SMEs lending, restriction on fungibility of groups' capital across borders, are just examples among others of cases where governments have tried to influence their banks' market strategy. It is unfortunately more difficult to identify cases of governments seeking to influence banks than the other way around. This is yet an important area of study that should be further developed if we want to have a full understanding of the relationships between state and finance.

CHAPTER 7

Conclusion: States as Fortuitous Strategists and Incoherent Varieties of Capitalism

This chapter summarizes and discusses the findings of this dissertation.

7.1 Summary of the dissertation

Many conventional theories in Economics and Political Science stress that the liberalization and globalization of finance have homogenized the behavior of state and market actors. Some even go so far as to assume that states have become irrelevant actors. However, these theories cannot account for empirical observations laid out in my dissertation research: that responses to the financial crisis in Europe have largely been crafted at the national level.

First, I have shown that there have been divergent trajectories of finance across Europe after the crisis. In France, market-based banking and traditional finance feed each other in the heart of the French universal banks. Because the developments of French banks' position in the global and in the domestic markets go hands in hands, the trajectory of French finance is universalist. The French trajectory of finance may appear, at first sight, to unite the best of the two worlds. French banks are competitive in the global markets. At home, proximity banking remains the rule and French banks have preserved their expertise in SME relationship lending. Yet, French banks are, today more than ever, too big to fail. They will remain a threat as long as there is no credible single European resolution fund up and running.

Because global market-based banking and domestic retail banking are operated by two different sets of actors, the German trajectory of finance has been bifurcated. Given the structural weaknesses of Deutsche Banks, there are doubts about the future of market-based banking in Germany. On the other side, although local public and cooperative banks need to address chronically low levels of profitability, German traditional relationship bank-based finance seems to be back on track – to the satisfaction of domestic SMEs.

British banks have shrunk in size and scaled back their global market operations. At home, they have had difficulties to develop traditional banking activities to which they are not used and for which the structures of the British political economy are not necessarily friendly. On the other side, the City of London continues to provide effective market infrastructures for global players. British banks have arguably become smaller, simpler and safer, but at home, they have

kept investing in niche markets such as credit cards and consumer lending. British small business thus remains confronted to a chronic lack of finance. The UK economy to this day remains over-reliant on foreign financial institutions and investors. Brexit raises a lot of uncertainty concerning the sustainability of the British trajectory of finance.

Second, I have shown that states have all been proactive in shaping their domestic trajectories of finance, but that their action reveals different state priorities – especially towards systematically important banks. They have passed different banking regulation and enforced regulation adopted at the international and European levels in different ways. I have led a comparison of 12 financial regulation policies and cases of regulation enforcement in France, Germany and the UK since 2008. I have analyzed each national version of a financial policy according to whether it may tend to hinder/permit/enhance the expansion of these banks, globally and at home. Chapter 3 has demonstrated that the substance of the policies was quite consistent across all of the 12 cases, revealing national patterns in the influence of the state towards finance. The French state has sought to protect, even promote, its banks globally and at home. In Germany, the state has sought to protect the global market activities of its financial champion. On the other side, it has protected the traditional turf of local public and cooperative banks. British policies reveal an attempt by the state to hinder large banks' expansion, regarding activities operated both globally and at home.

Finally, I have shown that state priorities have been determined by different state-bank modes of coordination building on historically rooted institutions. Although they are structurally and instrumentally powerful, large banks' preferences have not always prevailed. Different institutionalized routine modes of coordination between public and private actors systematically determine which actors systematically occupy key position in the decision-making process, which preference finds political expression and the forms of conflicts that ensue. In France, symbiotic mechanisms of interaction between domestic bankers and government officials have led to the crafting of mutually benefiting compromises in response to the crisis. French state officials have thus to a large extent abided by banks' preferences, which has led to the universalist French trajectory of finance. Yet, this outcome is to understand in mirror of the reciprocal character of the relationship: in important cases, banks also complied with state's preferences. In Germany, local governments have systematically opposed policies that

may have been detrimental to "their" local public banks. On the other side, the urge to promote one German champion in the global financial markets and the deference of state officials towards the expertise of banks' top managers, have led the federal government to abide by the preferences of German largest commercial bank, namely Deutsche Bank. This tension has led to a bifurcated trajectory of finance in Germany, where Deutsche Bank was able to expand globally, but not at home - a situation that has aggravated the structural difficulties of the bank. In the UK, adversarial mechanisms of interaction within and between domestic bankers and state officials have enabled identified public actors to exploit political leverage to the detriment of British domestic banks. British banks have shrunk quite dramatically, leaving room for foreign and non-bank financial actors to dominate both the global markets operated from London and the British domestic retail markets.

The findings of this dissertation have important implications for the discussions on the role of state and on the remaining varieties of capitalism in a Europeanized and globalized economy.

7.2 States as fortuitous strategists and incoherent varieties of capitalism

Can we talk of new varieties of capitalism? Can we say that the states have developed and implemented "industrial strategies" towards finance? Contrary to theories of neoliberalism, this dissertation shows that the attitude of states towards finance cannot be explained by the sheer capture of state actors by the financial community, be it conceived as national incumbents or global capitalist interests. Politics can get in the way of powerful capitalist (here banking) interests. Because power is institutionally mediated and that institutions vary across polities, diversities remain. Yet, I argue that states' attitude towards finance cannot either be explained by the pursuit of the institutional competitive advantage (Hall and Soskice 2001) or by national economic 'culture' (Zysman 1994; Dobbin 1994), be it fulfilled by a state conceived as a functionalist agent or an economic strategist (Breznitz and Zysman 2012)¹⁷⁰. This has important implications regarding the role of the state and the nature of varieties in the 21st century financialized capitalism.

¹⁷⁰ Breznitz and Zysman argued that states were key to designing "political settlements that at once resolve the technical tasks of growth (assuring the appropriate allocation of resources and the sustained reorganization of economic

To some extent, the divergent trajectories of finance described here could suggest the renewal of traditional post-war VoC models of capitalism. In the UK, the shrinkage of domestic TBTF banks and the preservation of London as a global financial center attractive to foreign investors and institutions may fit the traditional “market-based” model (Zysman 1983) or Liberal Market Economy (Hall and Soskice 2001). In Germany, the post-crisis trajectory of finance has included the conservation of local (public and cooperative) banks’ turf may fit the “bank’s credit-based” model of capitalism (Zysman 1983) or “Coordinated Market Economy” (Hall and Soskice 1983). The French post-crisis trajectory may correspond to “state credit based” (Zysman 1983) or a state-led variety of capitalism always prone to foster its national champions (Schmidt 2009; Clift 2012). In consistence with these theories, this dissertation also shows that these outcomes are caused by institutionally rooted institutions.

Yet, scholars in the comparative capitalism tradition have underlined the internal coherence of post-war capitalisms. Zysman wrote that “*the particular historical course of each nation's development creates a political economy with a distinctive institutional structure for governing the markets of labor, land, capital and goods*” (Zysman 1994). Hall and Soskice argued that economic actors coordinated on “*equilibrium strategies offering higher returns to all concerned*” (2001). They also determine a defined role for the state in the economy. This coherence built on encompassing institutions characteristic of their distinctive model of capitalism. By contrast, this dissertation argues that states, as sovereigns, can and do regulate and shape markets. But their economic priorities, and the ways to implement them are not determined by encompassing institutions characteristic of coherent national models of capitalism. They are determined through ad hoc policymaking processes, which build on non-encompassing institutions, and that imply no overarching coherence within each political economy.

In France, the logics of a “state-led” model of capitalism would imply that the French state has pursued a strategy of developing national champions in finance because of economic patriotism (Clift, 2012, Woll and Clift 2013) or state strength (Schmidt, 2009). Yet, the French state has shown multiple times that it had no longer the will or the capacity to promote national champions in other areas than banking. The sales of the big jewels of the French *dirigiste* period have made it

activities) as well as the political problem of allocating the gains and costs of development” (2012).

to newspapers' frontlines often since the 2000s (Culpepper 2010). Indeed, in other sectors, decision-making is not determined by the same symbiotic mode of coordination between public and private elites, like in banking. The logics of the typical German model of capitalism would mean that all the institutions (including but not limited to local banks) meant at preserving the distinctive competitiveness of the German Mittelstand have remained protected. Yet, Landesbanken, when they had the opportunities to turn their back to traditional finance in the early 2000s, did just so, thus turning away from the function they were attributed in the typical German Coordinated Market Economy (Hardie and Howarth 2009; Hardie et al 2013). More generally, other areas deemed as the warrants of the German institutional competitive advantage such as training or labor have undergone major changes (Streeck 2009). In these other areas, local governments did not oppose reform, like in banking, because local banks did not push them to do so. In the UK, the VoC framework doesn't explain why favoring market-based finance should necessarily translate into less UK banks – and more foreign - banks. Indeed, the British trajectory of finance doesn't indicate a return to direct market-based finance as much as a domination of market-based banking dominated by foreign banks. In addition, there are signs that the adversarial mode of coordination may lead to attacks on the City too, with the recent regulation of tax heavens by the UK in its own jurisdiction.

Consequently, the argument stressing the role of institutionalized modes of state-bank coordination in the emergence of divergent trajectories of finance also sheds light into the impression of 'bricolage' and 'incoherence' or 'directionlessness' that some authors have described in contemporary capitalisms (Engelen et al. 2009; Lane and Wood 2009; Levy 2013).

7.3 European Banking Union: the end of bank-state ties?

Is this lost coherence to be found in a potential European model of capitalism? The European Banking Union is arguably the most important and ambitious reform implemented in the EU since the EMU (Epstein and Rhodes 2016). This section discusses whether the banking union will undermine, in term, the validity of the argument presented in this dissertation. The EBU concerns only France and Germany, as the UK opted out in 2013 (and is now leaving the EU). The banking union seeks to deal with the vicious circle between banks and

sovereigns. When banks face difficulties, national governments bail them out, which in turn weakens their fiscal position. National banks thus accumulate national sovereign debt to support their government, which in turn weakens their balance sheets, and causes more difficulties for them. But, when banks face difficulties... The vicious cycle is triggered. The explicit objective of the European Banking Union is to “break the vicious links between states and banks”. With the Single Supervision mechanism, the ECB will ensure a “truly European supervision mechanism that is not prone to the protection of national interests”. The incentive for banks to buy their sovereign will thus lessen. With the Single Resolution mechanism, “banks will no longer be “European in life but national in death”, as any failure will also be managed by a truly European mechanism”. Banks’ difficulties will thus affect their sovereign less.

EBU attacks the bases of the structural interdependencies between states and banks. Structural interdependencies give an incentive to state and banking actors to foster routine modes of coordination. Without these structural interdependencies, the necessity of coordination may fade and the typical state-banks modes of coordination become obsolete. It is too soon to know the definitive answer to this question. Yet, the EBU may not undermine state-banks coordination and how domestic politics typically influence policy-making in finance.

First, the EBU, as it stands, is far from fulfilling its proclaimed missions; and it is probable that it will remain this way. The SSM has been in function since 2014. For the first time, a transnational supervisor got access to detailed data about the workings of large European banks, and banks saw a transnational supervisor sticking their nose in their balance sheet. Arguably, the different rounds of stress tests implemented by the ECB have been successful at spotting banks’ weaknesses and pressuring them to address those weaknesses (Petrella and Resti, 2016). Yet, it seems that domestic supervisory authorities continue to play an important role alongside the ECB. National regulators retain significant leeway. A lobbyist for the rights of the consumers of financial services in Brussels told me a revealing anecdote: he said that he was requesting the ECB to release certain data about European banks. The ECB staff refused to do so, and finally recognized that they were trying to get this data themselves, but until now had failed to have national regulators comply. They could only obtain partial and inaccurate data from them. National regulators sometimes seem to play the role of a shield to their domestic banks (interview 05212015).

Doubts about the capacity of the EBU to fulfill its missions are even more legitimate concerning the SRM. When asked about the effects of the SRM, interviewed market actors answered with cautious perplexity. Their reaction is consistent with Christophe Nijdam's, the president of Finance Watch: "*We're having problems to apply this principle to small Italian banks, how can we apply it to a financial giant such as Deutsche Bank?*"¹⁷¹. The resolution fund's target is to reach EUR55md, which may correspond to a middle bank's bailout, not a large bank's bailout. In agreement with these insiders' insights, it is revealing that there has been little change in the pricing of banking risk. In 2016, Bloomberg noted that BNP had access to the market (senior bonds) in similar conditions than in 2014, despite the implementation of the SMR. As a British regulator crudely put it: "*Nobody believes the bail-in rules. The only people with enough shoulders to bail banks are governments*" (interview 7132016). Concerning the third pillar of the EBU, the European Deposit Insurance Scheme has not been implemented yet. The beginning of the fiscal union that EDIS represents raises obvious reluctance from member states (especially from Germany), and it is not clear whether this will someday see the light. German public banks in particular are extremely opposed to the idea from a practical and legal point of view (VOEB, 2013, p15)¹⁷².

Second, the mechanisms of the EBU, even if they should come to work appropriately, may not put an end to state-banks institutionalized modes of coordination at the national level. Indeed, the EBU seeks to undermine structural interdependencies between banks and their sovereign, but it does not offer an alternative institutional framework to organize actors' interaction during policy-making processes. Offering such an alternative would necessitate a more ambitious political reform at the EU level that would go way beyond banking regulation and supervision: the creation of an actual EU polity. Until then, policy-making, or the enforcement of policies made out at the EU level, will certainly remain largely determined by state-banks institutionalized modes of coordination at the national level.

¹⁷¹ Christophe Nijdam, cited in EU Observer, 12 October 2016

¹⁷² They write : "We reject the full mutualisation of risks, given that this would separate the liability for risks from risk monitoring. We do not see a legal basis for the introduction of EDIS: The draft Regulation constitutes a breach of the subsidiarity principle; it is not in line with the principle of proportionality" (VOED, 2018, p15)

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