Beyond Financialisation?

Transformative Strategies for More Sustainable Financial Markets in the European Union

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Abstract

The global financial crisis has led many regulators and lawmakers to a rethinking about current versus optimum financial market structures and activities that include a variety and even radical ideas about deleveraging and downsizing finance. This paper focuses on the flaws and shortcomings of regulatory reforms of finance and on the necessity of and scope for more radical transformative strategies. With 'crisis economics' back, the most developed countries, including the EU member states, are still on the edge of disaster and confronted with systemic risk. Changes in financial regulation adopted in the aftermath of the financial meltdown have not been radical enough to transform the overall system of finance-driven capitalism towards a more sustainable system with a more embedded finance. The paper discusses financialisation in order to understand the development trends in finance over the past decades and examines various theories to describe the typical trends and patterns in financial regulation. By focusing on a limited number of regulatory reforms in the European Union, the limitations of current reforms and the need for additional transformative strategies necessary to overcome the finance-driven accumulation regime are explored. Finally, the regulatory space for such transformative strategies and for taming finance in times of crisis, austerity, and increased public protest potential is analysed.

Keywords: financialisation, financial market integration, financial reform, financial innovation, financial crisis.

A Introduction

Since the outbreak of the global financial crisis in 2007, conventional wisdom about modern financial markets changed dramatically. The various stages of the crises, aftershocks, and the return of 'crisis economics'[1] revealed multiple market, state and regulatory failures and how problematic the overall role of finance as well as particular structures, activities, and products has become. As the crisis started in the centre of global finance and quickly threatened very large financial

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1 N. Roubini & S. Mihm, *Crisis Economics: A Crash Course in the Future of Finance*, London, Allen Lane 2010.

institutions that were regarded by their regulators as top performers in risk management and as systemically relevant or too-big-to-fail (TBTF), bold and swift emergency action followed by a fundamental overhaul of the regulatory regimes seemed the only acceptable response. This led in the USA to the most significant financial reform since the 1930s with the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that promises in its subtitle among other things to increase financial stability by improving accountability and transparency, to end TBTF, and to protect taxpayers from paying for bailouts. With the same intentions, in the European Union (EU) a number of existing regulations and directives were modified, and entirely new ones have been adopted with additional proposals in the decision-making process. In the overall context of a systemic crisis, questions about necessary lessons for states and markets as well as whether a smarter and better regulatory regime could ever help to avoid major crises or to make at least a significant difference have become parts of a highly contentious discourse about the future of finance, capitalism, globalisation, regional integration, and regulation. For the EU, these questions are moreover linked to lessons from financial integration before the crisis since excesses and significant resource misallocations as well as regulatory shortcomings related to the pre-crisis integration regime have become clearly visible. Regulators and lawmakers focused on rapidly cleaning up and recapitalising banks and on law reforms. Additionally, debates emerged about the optimum design for regulating finance and the optimum financial market structures that include even radical proposals for downsizing and deleveraging finance that would lead to a fundamentally different balance between finance and society. The reforms in the USA, EU, and other jurisdictions have been designed to contribute to a more sustainable, more resilient, more preventive, and more precautionary regime, and regulators have begun trying to 'tame finance' after decades of excesses. For the EU, where the crisis exposed numerous fault lines and recapitalising banks and cleaning up their balance sheets has been more complex and slower than in the USA, the debate also includes questions about short- to long-term effects on (less or more) economic and financial integration that have (with the currency union crisis escalating quickly) culminated in proposals for deeper integration – of at least the Eurozone countries – by establishing a banking union. While the latter will ultimately require a lengthy process to change the Treaty, key EU actors claimed that the EU would not only push for stricter regulation for financial markets at the G20 level but also take over a pioneer role in adopting such regulation in line with G20 commitments while keeping the goal of an ever more integrated financial market and avoiding further market fragmentation that had resulted from the crisis. The Obama Administration also claimed a pioneer role in driving regulatory change. Both jurisdictions are major economic powers whose regulations can have extra-territorial policy impacts. However, both jurisdictions have remained careful about any issues that could arise from regulatory competition between them or with other existing or emerging financial centres, and in key areas convergence emerged via transatlantic dialogue and regulatory cooperation between competent authorities.

Despite major regulatory reforms, it remains unclear in this period of high uncertainty what the consequences with regard to transforming the existing financial system will be, if the reforms already adopted are only cosmetic or go into the right direction without creating bad unintended consequences, and what sort of regulatory reform could tame finance within an overall framework that is more preventive and precautionary. Besides concerns about negative impacts on recovery, there are moreover worries because the most developed countries, including the EU member states, are still on the edge to disaster and confronted with systemic risk that could only too easily result in significant aftershocks or open a new phase of the crisis. As the crisis transformed the states' capacities fundamentally, it may have led to the 'depleted state' which lacks legitimacy as well as organisational and financial resources and is therefore no longer able to achieve the necessary outputs or outcomes.[2] In short, when the next crisis hits too early, warnings that financial institutions are now not only TBTF but also 'too big to save'[3] might become reality. Getting the system right is therefore of utter importance. To address at least some of the uncertainties, lawmakers on both sides of the Atlantic left major decisions to regulators who have to adopt detailed rules and implementation standards or were put in charge to study certain areas in more detail as a basis for any further reforms. This might lead to various problems, given traditionally strong business influence on regulators, but might also result in gradual changes that help overcoming any shortcomings, flaws, and loopholes from recent reforms.

This paper focuses on the question whether the pre-crisis system understood as financialisation will prevail or can be transformed beyond its problematic characteristics. Firstly, it will discuss in part B the concept of financialisation, how this accumulation regime led to financial instability and a particular mode of regulation, and a number of theories explaining regulatory change. The main part C will first describe the general features and trends in the European version of financialisation, before looking at a limited number of key reforms that will affect this accumulation regime. It will be argued that regulatory changes adopted in the aftermath of the financial meltdown in the EU have not been radical enough to transform the overall system of finance-driven capitalism towards a more sustainable system with a more embedded finance and that new transformative strategies are necessary to achieve system transformation. Although quite significant reformulations within financialisation are observable, reforms resulted in a number of loopholes, flaws, and possible unintended consequences that altogether do not put into question the overall dominance of finance and contribute to continued financial instability. As the European reform debates are embedded in global debates and as they are especially reflecting any intended or unintended consequences for the future of the European financial sector in global competition, especially with Wall Street, G20 commitments and US reform debates are

2 M. Lodge, 'Crisis, Resources and the State: Executive Politics in the Age of the Depleted State', *Political Studies Review*, Vol. 11, No. 3, 2013, p. 378.

3 R. Pozen, *Too Big to Save? How to Fix the U.S. Financial System*, Hoboken, NJ, John Wiley & Sons 2010.

taken into account. Part D concludes and discusses how a more embedded and more sustainable financial sector could be created via gradual institutional reforms and new transformative strategies.

B Financialisation, Crises, Regulation, and the Future of Finance

Contrary to pre-crisis mainstream claims that modern finance with its highly sophisticated risk management practices would have made the financial system safer, the evidence is clear that the liberalisation and deregulation of global financial markets since the 1970s did not result in stability but in an overall system that has frequently generated all sorts of financial crises; and moreover that systemic crises have become ever more severe and costly.[4] Accelerated by financial innovation that was designed to maximise profits by exploiting regulatory loopholes and flaws and often also unfair market advantages, financial markets underwent significant transformations that led to an extremely leveraged system with overly complex and opaque structures, activities, and products. Ignoring numerous warnings by critics about these developments, the mainstream actors had shared a dominant paradigm based on the belief that liberalised and deregulated financial markets would be efficient and that finance as new main organising principle would be beneficial for the entire society, all social groups, and every individual who could participate in better, widely accessible, and therefore more democratic, new financial products. Critics on the other hand had portrayed deregulation as dangerous and the dominance of finance negatively by describing the system as a casino and a zero-sum game based on purely negative forms of speculation in which the financial sector extracts resources from other sectors and moreover undermines democracy by markets outgrowing states. The overall result would be a general 'retreat of the state'.[5] Now in the aftermaths of the financial meltdown, even key regulators concluded that there are strong 'facts' that "lead to the inescapable conclusion that, beyond a certain point, financial development is bad for an economy. Instead of supplying the oxygen that the real economy needs for healthy growth, it sucks the air out of the system and starts to slowly suffocate it".[6] Obviously the system had already passed that point

4 *See*, for example, the IMF database on crises between 1970 and 2007 identifying 124 systemic banking crises in that period: L. Laeven & F. Valencia, 'Systemic Banking Crises: A New Database', IMF Working Paper WP/08/224, Washington, IMF 2008.

5 S. Strange, *Casino Capitalism*, Oxford, Blackwell 1986; S. Strange, *Mad Money: When Markets Outgrow Governments*, Ann Arbor, University of Michigan Press 1998.

6 S. Cecchetti, 'Is Globalisation Great?', *in* Bank for International Settlements (BIS), *The Future of Financial Globalisation*, 11th BIS Annual Conference 21-22 June 2012, BIS Papers No. 69, December 2012, p. 4.

before the crisis,[7] when finance transformed from a serving role as an 'intermediary' to society to its master and 'deceiver'.[8]

Financialisation is a term that has been introduced to describe a 'finance-led accumulation regime',[9] *i.e.* a system in which the growing weight of finance in relation to other parts of the economy such as industrial or agricultural production is transforming the entire society. In its broadest meaning, the term covers "the increasing role of financial motives, financial markets, financial players and financial institutions in the operation of the domestic and international economies".[10] Krippner defined "financialization as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production".[11] The result of these 'financial expansions' is an increasing importance of speculation over productive investments also for non-financial firms.[12] Arrighi also put financialisation in the broader context of earlier phases of financial expansions and reminded of the necessary terminal crisis of a dominant regime of accumulation. Another important aspect in the financialisation literature is the clear identification of moderate growth and stagnation tendencies inherent to this accumulation regime.[13] This links the debate to contemporary discussions about the limits of growth and the need for degrowth that have shown that growth in its current form becomes increasingly costly and how the 'growth obsession' of contemporary societies could be overcome.[14]

If financialisation is understood as a particular mode of political regulation and capitalist accumulation, the crisis of this finance-led regime eventually opens the way for an alternative accumulation regime. This obviously leads to the question how recent regulatory changes affect financialisation in its reproduction and could help to transform the overall system into one that is not just more resilient

7 Adair Turner, then chair of the British Financial Services Authority, concluded more carefully: "There is no clear evidence that the growth in the scale and complexity of the financial system in the rich developed world over the last twenty to thirty years has driven increased growth or stability, and it is possible for financial activity to contract rents from the real economy rather than to deliver economic value." A. Turner, 'What Do Banks Do? Why Do Credit Booms and Busts Occur? What Can Public Policy Do About It?', *in* A. Turner *et al*. (Eds.), *The Future of Finance: The LSE Report*, London School of Economics 2010.

8 P.H. Dembinski, *Finance: Servant or Deceiver? Financialization at the Crossroads*, Basingstoke Palgrave Macmillan 2009.

9 M. Aglietta, 'Capitalism at the Turn of the Century: Regulation Theory and the Challenge of Social Change', *New Left Review*, No. 232, 1998, p. 41.

10 G.A. Epstein, 'Introduction', *in* G.A. Epstein (Ed.), *Financialization and the World Economy*, Cheltenham, Edward Elgar Publishing 2005.

11 G.R. Krippner, 'The Financialization of the American Economy', *Socio-Economic Review*, Vol. 3, No. 2, 2005, pp. 173-208, at 174.

12 G. Arrighi, *The Long Twentieth Century: Money, Power and the Origins of Our Times*, London, Verso 1994.

13 J.B. Foster & R.W. McChesney, *The Endless Crisis: How Monopoly-Finance Capital Produces Stagnation and Upheaval from the USA to China*, New York, Monthly Review Press 2012.

14 E. Altvater, 'The Growth Obsession', *in* L. Panitch *et al.* (Eds.), *The Globalization Decade: A Critical Reader*, London, The Merlin Press 2004, p. 275; W. Bello, *Deglobalization: Ideas for a New World Economy*, London, Zed Books 2004; R. Heinberg, *The End of Growth: Adapting to Our New Economic Reality*, Gabriola Island, New Society Publishers 2011; S. Latouche, *Farewell to Growth*, Cambridge, Polity Press 2009.

but one that goes beyond financialisation. As such, a change faces strong resistance from the currently dominant market forces, and their political supporters, political action, and transformative strategies are required that can become hegemonic.

In the immediate aftermaths of the financial meltdown, many experts and observers thought that after a period of 'neoliberalism' with less strict regulation and too much deregulation and liberalisation, the 'regulatory pendulum' would swing back, and after being 'slapped by the invisible hand'[15] the solution could only be a much stronger 'visible hand'[16] of state intervention. The liberalised and deregulated markets would need to be re-embedded, and moreover fast action would be required as long as there is an open policy window with even the most powerful financial institutions and especially the hegemonic pro-market/anti-state-intervention set of ideas weakened. However, this countermovement remained rather weak, and pro-market, anti-regulation advocates have started to argue with some success that the crisis is foremost a result of bad regulation and state failure and that more liberalisation and deregulation would be in order, or if there is regulation, then it should not emerge in populist response to public pressures but delayed until after economic recovery.[17] Moreover, the better regulation practices assure that only measures with moderate economic costs and low uncertainties about their impacts are adopted. It has become a major requirement that proposals and decisions are based on comprehensive regulatory impact assessments, and a common practice is to largely ignore or underestimate the long-term costs of the current financial system.[18] In the USA, industry frequently threatens to take legal action against 'overambitious' regulators and in the EU, Britain was at the forefront of requiring passing a 'competitiveness test' before any measures could be adopted. In areas where the Commission presented more ambitious proposals, industry representatives and some member states criticised the quality of impact assessments and threatened with legal action.[19] In short, fears about possible 'overregulation' in a situation of high economic uncertainty became widespread, and regulatory proposals were frequently watered down, delayed, or abandoned by using better regulation tools but without stopping a clear trend towards more and stricter regulation, raising the question about the overall direction of regulatory change.

15 G.B. Gorton, *Slapped by the Invisible Hand: The Panic of 2007*, Oxford, Oxford University Press 2010.

16 S. Griffith-Jones, J.A. Ocampo & J.E. Stiglitz (Eds.), *Time for a Visible Hand: Lessons from the 2008 World Financial Crisis*, Oxford, Oxford University Press 2010.

17 D. Pesendorfer, 'Goodbye Neo-liberalism? Contested Policy Responses to Uncertain Consequences of the 2007-09 Financial Crisis', *in* K. Alexander & R. Dhumale (Eds.), *Research Handbook on International Financial Regulation*, Cheltenham, Edward Elgar 2012, p. 414.

18 S. Johnson, 'The Impact of Higher Capital Requirements on Banks', *New York Times Economix*, New York, 18 April 2013.

19 The most important example would be the proposal for enhanced cooperation in the area of Financial Transaction Tax. *See* D. Pesendorfer, 'Financial Taxes and the Sand in the Wheels of Financialization: Legal Challenges for the EU Directive Implementing Enhanced Cooperation in the Area of Financial Transaction Tax', *European Review of Public Law*, Vol. 25, No. 2, 2013, pp. 619-653.

All in all, the regulatory response to the global financial crisis follows a typical pattern of adopting new regulations in response to a financial crisis, promising better disclosure, prudential controls, and risk management and hoping that a similar disaster would never repeat, despite the general trend of deregulation and liberalisation following in the typical manner at a later stage to re-establish some business practices again.[20] Lessons from financial regulation also include that financial institutions are highly creative in circumventing existing and new regulation and regulators, lacking resources to catch up with industry developments and innovations, frequently loose in this 'catch me if you can' game. Moreover, massive business lobbying includes strategies to make regulations overly complex in order to create and exploit numerous loopholes.[21] Further classical explanations for moderate reforms with regulatory flaws followed by weakening of regulatory standards are regulatory competition between jurisdictions to keep or attract capital, which led in the era of globalisation to the well-known debates about races to the top or bottom, and regulatory capture describing the repeated regulation in the interest of the regulated industry instead of the public interest. Both theories have been widely applied to financial regulation, especially with how they explain regulatory failures, flaws, and loopholes as well as unintended consequences. The literature on regulatory competition also shows under what conditions regulatory cooperation can be successful, namely, when economically important jurisdictions become drivers of change and use their extra-territorial policy impacts to drive change in other jurisdictions.[22] Among the broad literature on regulatory capture, the most recent one is especially significant as it focuses on how particular institutional designs can help to avoid or minimise capture.[23]

C Financialisation, Regulatory Reforms, and the Future of Finance in the European Union

Within the EU, official debates shifted dramatically over recent years from early deceptive claims that the crisis would be one of Anglo-American capitalism with little effects on (continental) Europe to embarrassment that experts and stress tests did not foresee the bailouts and that member states in fiscal distress could not be rescued without support by the International Monetary Fund and realisation that the EU or at least the Eurozone countries were suddenly centre stage of global concern about instability, with the very survival of the EU and its currency union becoming topics of controversies and political struggles. In the years before the crisis, the internal market project had some particular features reflecting the

20 A. Persaud, 'The Inappropriateness of Financial Regulation', *in* A. Felton & C. Reinhart (Eds.), *The First Global Financial Crisis of the 21st Century*, London, CEPR 2008.

21 L. Zingales, *A Capitalism for the People: Recapturing the Lost Genius of American Prosperity*, New York, Basic Books 2012, p. 203.

22 D. Vogel & J.F.M. Swinnen (Eds.), *Transatlantic Regulatory Cooperation: The Shifting Roles of the EU, the US and California*, Cheltenham, Edward Elgar 2011.

23 D. Carpenter & D.A. Moss (Eds.), *Preventing Regulatory Capture: Special Interest Influence and How to Limit It*, Cambridge, Cambridge University Press 2014; S. Pagliari (Ed.), *Making Good Financial Regulation: Towards a Policy Response to Regulatory Capture*, Guildford, Grosvenor House 2012.

high degree of fragmentation and diversity in the Union's financial sector that demonstrated it was still an incomplete single market. It was not just the British 'Big Bang' financial revolution of 1986 and a decade later the light-touch regulatory approach introduced by New Labour for the City of London as one of the world's financial centres back then in deregulatory competition with Wall Street that had transformed the role of Europe's finance significantly. Other member states' financial sectors too underwent substantial transformations outside regulatory frameworks or were supported by regulatory change and contributed to the emergence of financialisation. Ireland, France, and the Netherlands, for example, became important locations for shadow banking; Italian, Swedish, and especially Austrian banks gained a dominant role in Eastern European countries, where also French and Belgian banks were considerably engaged, while Cyprus attracted significant capital from Russia and Greek banks that had only started to engage more in neighbouring countries. Several countries including Luxemburg, the UK, and Austria have, as 'tax havens', offered incentives for investors. Across all member states' banks, off-balance sheet and shadow banking activities became highly important, increasing speculation and driving a boom in securitisation. Significantly, capital markets and financial integration policies drove Europe into a direction that made finance extracting value continuously from the 'real economy' and increasing the sector's overall power. Finance was a key area identified within policies aiming at finishing the internal market and improving the EU's competitiveness based on economic theory that highlighted the advantages of international capital mobility and high liquidity (nowadays interpreted as excessive liquidity) that would work in the advantage of European convergence.

Deregulation has been widely understood as the triumph of markets over governments, and European integration was frequently presented as an attempt to regain political power based on a significantly large internal market and a strong European currency that should reduce globalisation pressures internally and offer the Union externally a strong position to drive regulatory harmonisation where this was thought necessary. When the first 10 years of the euro were celebrated, there was wide agreement among experts and the political elite that the currency union had been a success in terms of generating economic stability and increasing cross-border activities, that it had successfully survived a number of tests, especially during the South-East Asian financial crisis, and that the euro proved to be a hard currency. Financial integration was also seen as necessary to direct capital from the slower growing richer countries to the less developed fast growers, resulting in convergence. However, the various policies of the EU to generate deep and highly liquid capital markets, to support cross-border activities, mergers, and acquisitions, and the emergence of large European financial conglomerates that would become major global players were the regional version of a finance-led accumulation regime that has become highly unstable and unsustainable. Especially the European Commission, the European Central Bank (ECB), and transnational financial corporations were described as strong promoters of a "transition toward the Anglo-Saxon model of capitalism" and pushed for deepening "the overall financialization of the European economy" with the Economic and Monetary Union, the Financial Services Action Plan, and the Basel II Accord.

The Markets in Financial Instruments Directive liberalised the trading environment to which markets responded with increasing algorithmic trading, including high-frequency trading. However, the overall effects of financialisation have been modified by what Ryner called 'compensatory neoliberalism'[24] resulting from the high degree of diversity and fragmentation with many small and medium-sized enterprises and small-scale and public banks. Critics expected that with the overall direction in European financial integration, the continental models of capitalism would get successively weakened.[25]

Among the many reforms that came on the agenda since the crisis, this section takes a closer look at key areas affecting the future of financialisation by addressing extreme leverage, overly complex and problematic structures, and highly speculative activities: capital requirements, structures of banks, orderly resolution, and shadow banking (alternative investment funds and derivatives).

I Stricter Capital Requirements

Among the many reforms of recent years, the main approach to deal with extreme and short-term leverage is the reform of the Basel Accord aiming at reducing systemic risk by deleveraging financial institutions via requiring higher capital buffers, limiting off-balance sheet activities, generally requiring more risk-sensitive capital adequacy ratios, and providing more transparency to stakeholders about banks' risk profiles. Stricter requirements with regard to the quantity and quality of bank capital, to be implemented gradually until 2019, lie at the heart of the Basel III reforms, which also include the idea of countercyclical capital buffers and of additional loss-absorbency requirements for the largest banks. The G20 member states' leaders committed to a timely, full, and consistent implementation of Basel III to avoid regulatory competition, and the Basel Committee adopted a Regulatory Consistency Assessment Programme to monitor implementation and enforcement. Compared to the USA where reforms were delayed and only after JPMorgan's 'London Whale loss' reform pressure increased to implement Basel III fully, the EU implemented the Basel reforms a bit faster via the Capital Requirements Directive amendments (CRD II-IV and) and the adoption of a Capital Requirements Regulation (CRR). The stricter capital requirements are generally seen as necessary requirement for financial stability, although not as a sufficient condition. Most actors see them as a step in the right direction if consistently implemented, with some arguing that the capital requirements are still not strict enough, while others regard them as unnecessarily strict. From the point of view that leverage has become too extreme and deleveraging is necessary, stricter capital requirements are not only an absolutely necessary measure but also one that would allow adjustments towards further deleveraging in a post-recovery environment. However, this would require deleveraging to

24 M. Ryner, *Capitalist Restructuring, Globalisation and the Third Way: Lessons from the Swedish Model*, London, Routledge 2002.

25 H.-J. Bieling & J. Jäger, 'Global Finance and the European Economy: The Struggle over Banking Regulation', *in* B. Van Apeldoorn, J. Drahokoupil & L. Horn (Eds.), *Contradictions and Limits of Neoliberal European Governance: From Lisbon to Lisbon*, Basingstoke, Palgrave Macmillan 2009, p. 88.

become a stronger goal within transformative strategies and continuous pressure from supportive actors that can resist industry pressures to return to higher leverage which can certainly be expected again. Currently, Basel III and CRD IV/CRR foresee that a stricter implementation of the leverage ratio needs further research and an 'extended observation period', with a report to be prepared by the end of 2015 and introducing the leverage ratio as a binding measure as of 2018.

II Reforming the Structures of Banks via Direct Regulation

Some of the most controversial questions are about the optimum size and number of banks, what roles banks with deposit insurance should fulfil, how size and activities affect interconnectedness of financial institutions, and how overall interconnectedness could be decreased to improve the system's resilience. Structures of financial institutions are generally influenced by a number of factors including various economic and market conditions such as the level of competition (domestically and international) and the firms' funding (short-term/long-term) as well as by the regulatory environment (competition laws and policies, market abuse rules, direct and indirect regulation affecting the structure of financial institutions).

With regard to direct regulation, a variety of reform proposals have emerged with a general agreement on more competitive and more transparent structures while not necessary with regard to the optimum level of complexity. Especially in the USA, demands for breaking up megabanks and to split commercial from investment banking were brought forward by a number of actors from the left and right wing of the political spectrum, while in Europe the largest banks successfully defended their claim that they were less affected by the crisis, that the European model of 'universal banks' would be superior, and that not size but only the quality of an institution's risk management quality would allow conclusions about impacts on financial stability. As a result, both jurisdictions went into different directions: while the USA incorporated the Volcker Rule[26] into Dodd-Frank, the EU has so far not adopted any measures, and only proposals for ring-fencing[27] exist,[28] but the UK[29] and Germany[30] will implement ring-fencing in some variation. However, more importantly at both sides of the Atlantic, more

26 The Volcker Rule, named after the former Federal Reserve chair Paul A. Volcker, or 'proprietary trading provision' in the Dodd-Frank Act, s. 619, prohibits banks from owning, investing in, or sponsoring hedge funds or private equity funds and from engaging in proprietary trading. The rule became more and more complex in the implementation negotiations between agencies and industry.

27 Compared to the USA, the EU member states have no history of a separation between retail and investment banking. The universal banking model led to the ring-fencing proposals that require a less strict separation but higher capital requirements to protect retail banking from the investment banking divisions.

28 E. Liikanen *et al.*, *High-level Expert Group on Reforming the Structure of the EU Banking Sector: Final Report*, Brussels, 2 October 2012.

29 Proposals came from the Independent Commission on Banking and the Parliamentary Commission on Banking Standards and should be implemented by 2019.

30 The German Banking Separation Act of 2013 follows the reform proposal by the EU High-level Expert Group, and the changes have to be implemented by mid-2015.

radical proposals were opposed by the key actors, and all jurisdictions have brought forward complex reform proposals with significant flaws and loopholes.[31]

III Resolution

Ending bailouts requires not only more resilient banking structures but also that an orderly resolution regime is in place that enhances financial stability by allowing banks to fail without infecting important parts of the system. Such a regime should also reduce moral hazard and protect depositors. The G20 Pittsburgh Summit called for "addressing cross-border resolutions and systemically important financial institutions by end-2010",[32] and the G20 Financial Stability Board was given the task to develop "Key Attributes of Effective Resolution Regimes for Financial Institutions".

In terms of adopting a resolution regime that allows ending TBTF, the EU is lacking behind the USA. Dodd-Frank requires the banks to produce 'living wills', which are divided into two parts, one public and one confidential for agency-eyes only. The experience with these resolution plans so far has been rather disappointing with regard to both parts. But there is generally scope for gradual institutional change leading to stricter implementation as well as scope for regulatory capture and continued weak implementation.

The UK also adopted measures with the Banking Act 2009 that introduced a special resolution regime (SRR) for banks. Further changes will come with the EU Recovery and Resolution Directive and reform proposals made by the UK Independent Commission on Banking and HM Treasury[33] to extend resolution to non-bank financial institutions. With regard to globally active SIFIs, the US Federal Deposit Insurance Corporation (FDIC) and the Bank of England worked together to develop resolution strategies.[34]

The European Commission released its proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) in June 2012,[35] requiring that member states "ensure that each institution draws up and maintains a recovery plan" that should be updated at least "annually or after change to the legal or organisational structure of the institution, its business or its financial situation". Competent authorities could also demand more frequent updates. The most important aspect of resolution is the so-called bail-in clause that sets out a hierarchy for financial contributions in case of solvency.[36] However, there is a limit for bail-ins beyond which the taxpayer would still have to contribute to bailouts.

31 For a more detailed discussion including various alternative proposals, *see* D. Pesendorfer. 'Beyond Financialisation? How Direct Regulation Will Transform the Future of Financial Market Structures', *Northern Ireland Legal Quarterly*, Vol. 64, No. 2, 2013, pp. 255-275.

32 G20 Leaders' Statement: The Pittsburgh Summit, 25 September 2009, p. 9.

33 HM Treasury, *Financial Sector Resolution: Broadening the Regime*, London, August 2012.

34 Federal Deposit Insurance Corporation and Bank of England, 'Resolving Globally Active, Systemically Important, Financial Institutions: A joint paper', 10 December 2012.

35 COM(2012) 280/3.

36 *See* Article 29 General principles governing resolution, Article 37 The bail-in tool and Article 38 Scope of bail-in tool.

Additional measures became part of the emerging banking union. The Commission proposed a Single Supervisory Mechanism (SSM) for banks led by the ECB in September 2012. In June 2013, the Commission published its proposals for a regulation establishing a Single Resolution Mechanism (SRM) and a Single Bank Resolution Fund.[37]

The plans for the banking union foresee the regulatory oversight of the 130 largest banks by the ECB. The design and operating mechanisms for the resolution authority are still unclear. However, creating a centralised bank resolution authority is controversial. Member states argue that emergency action needs to happen within hours, and that could not be achieved within a complex network of 18 finance ministers, 18 finance departments, and 18 national resolution authorities. Another issue is whether there should be a Eurozone-wide resolution fund or national resolution funds. Germany has strongly argued for national funds to avoid domestically the political debate about German banks paying for the rescue of foreign banks; especially regional banks have largely opposed that idea. Others have argued that it would not make any sense to use a good number of national funds to rescue a large bank that would usually be active in a greater number of countries.

Another key aspect with regard to the emerging regime is the requirement of sufficient funds, to be provided by the industry itself. Such a recovery fund still needs to be established over the coming years, funded by a tax that has frequently been used as an argument against introducing a financial transaction tax that would have a stronger impact on speculative activities.

IV Regulating Alternative Investment Funds

With the global financial crisis, it became clear that an increasing number of financial institutions have emerged that were largely unregulated and outside of regulatory oversight but can pose a threat to financial stability. The term introduced for such institutions is shadow banks. It includes conduits, structured investment vehicles, hedge funds, private equity, and money market funds. They are characterised by short-term borrowing in rollover debt markets, significant leverage, and investment in longer-term and illiquid assets. Shadow banking raises systemic concerns because of its size and its high level of interconnectedness to the regulated financial system. It is estimated that in terms of aggregated assets shadow banking has become "half the size of the regulated banking system" with a geographical concentration in the USA and the EU/UK.[38]

While the US Securities and Exchange Commission (SEC) adopted in 2010 a regulation of money market funds, they only came recently on the EU's agenda beyond their limited coverage by existing legislation, when the Commission released a Green Paper.[39] With regard to other important areas, both jurisdictions

37 COM(2013) 520 final.

38 European Commission, 'Communication from the Commission to the Council and the European Parliament – Shadow Banking – Addressing New Sources of Risk in the Financial Sector', COM(2013) 614 final, Brussels, 4.9.2013.

39 European Commission, 'Green Paper Shadow Banking', COM(2012) 102 final, Brussels, 19.3.2012.

adopted new regulations. The focus here was on managers of 'alternative investment funds' instead of regulating the institutions themselves.[40] The EU adopted the Alternative Investment Funds Managers Directive (AIFMD).[41] Additionally, the Commission adopted a Delegated Regulation regulating exemptions, operating conditions, depositaries, leverage, transparency, and supervision.[42] Member states had to transpose the Directive into national law by July 2013. The technical implementation standards were left to the Commission and finalised without any need for transposition.[43] Further technical guidelines were published by the European Securities and Markets Authority (ESMA).[44]

The regulatory approaches taken do not put into question the enormous growth of shadow banks over recent years and suggest those institutions are all necessary for the future. In its 2013 Communication on Shadow Banking, the Commission emphasises "the important role that it plays within the financial sector" as "an alternative financing channel that is essential to the real economy, particularly at a time when traditional actors in the banking system are reducing financial support".[45] Hedge funds, for example, have grown worldwide "from around 3,800 in early 2000 to over 10,000 in late 2007", around 2000 did not survive the crisis,[46] and many suffered significant losses but others profited from the crisis. In the meantime, the overall number is going up again. With the crisis, also the capital invested in the global hedge fund industry went down but is back to strong growth again.[47] During the crisis, hedge funds have been widely criticised for a long-term performance problem and that they would make their clients[48] less money than mainstream financial markets while fees are extremely high. Nevertheless, especially pension funds continue to invest in them "as a safer, low-

40 In a limited way, shadow banks are moreover monitored through their relationships with banks. Here, reforms of accounting rules became significant since the crisis revealed the significance of off-balance sheet activities. Additionally, some contagion and arbitrage risks have been addressed with the CRR and CRD IV.

41 Directive 2011/61/EU, OJ 2011 L 174/1.

42 Commission Delegated Regulation (EU) No 231/2013, OJ 2013 L83/1.

43 European Commission, AIFMD Level 2 Implementation Measures (19 December 2012); Commission Implementation Regulation (EU) No 447/2013 and Regulation (EU) No 448/2013 of 15 May 2013.

44 ESMA, Guidelines on sound remuneration policies under the AIFMD (11 February 2013); Draft regulatory technical standards on types of AIFMs (2 April 2013); Guidelines on key concepts of the AIFMD (13 August 2013).

45 COM(2013) 614 final, p. 14.

46 M. Aglietta, S. Khanniche & S. Rigot, 'Why Regulating Hedge Funds?', *La Lettre Du CEPII*, No. 296, 28 January 2010.

47 Hedge Fund Research, *Global Hedge Fund Industry Report*, 2013.

48 As Aglietta *et al.* highlight, the systemic risk and losses of hedge funds are a public concern "as hedge funds are not merely means of managing private wealth". Most investments come from "institutional investors (pension funds, insurance companies, government agencies and academic institutions)". According to the EU Commission, "the assets under management within AIF amount to 18% of the EU's GDP or more than the GDP of France or the United Kingdom in the year 2010. More than two thirds (68%) of the assets of AIF are held by institutional investors". *See* Commission Staff Working Document: Impact Assessment accompanying the document Commission Delegated Regulation, SWD (2012) 386 final, Brussels, 19.12.2012.

volatility option in a tough investment landscape". As a result, hedge funds "have more cash to manage than ever".[49]

Before the crisis, hedge funds faced in some countries, especially in Germany and France, heavy critique for their speculative activities. However, demands for strict regulation or even a ban, frequently raised in the critical globalisation 'another world is possible' movement, were not supported, and hedge funds were only moderately regulated, in the UK, for example, via their managers,[50] and with regard to their marketing. Now, Dodd-Frank as well as AIMFD extended the approach of regulating managers/advisors quite significantly. However, the thresholds for regulation are too high, offshore funds insufficiently regulated, and the approach of only regulating managers is problematic for hedge funds that already proved in the past to be highly flexible. However, industry had support strong enough to water down the original proposal further via impact assessments and lobbying. In the USA, regulators, which were criticised even from inside for lacking resources for effective implementation and enforcement, compensated the industry with lifting the ban on marketing funds to the public.[51] Having lost the battle to give up their secrecy, hedge funds opposed further regulations that would have affected them negatively. Their associations have continued to emphasise the need for high liquidity and have for that purpose defended (naked) short-selling and high-frequency trading,[52] two areas heavily criticised as harmful speculative activities with unfair competitive elements. With regard to the AIFMD, they remained highly concerned about various aspects such as lock-in/lock-out effects and lobbied massively for watering down draft regulations to take into account the existing 'diversity of funds' which invest in all kinds of asset classes and with all kinds of investment strategies.

In short, the regulatory approach in the area of shadow banks remains within financialisation by only aiming at improving the market by increasing transparency and capital requirements, improving liquidity management, requiring information for investors and regulators, etc. in the least burdensome way for the sector and without questioning the size and growth of the industry as such. Although 'extreme' leverage can become subject to imposing limits, intervention will largely depend on the regulators' strictness. However, debates are still going on at the global level and in the EU.[53] Recently, the Bank of England raised concerns about systemic risk from hedge funds and concluded that it needed to collect more information.[54] Regulators still have a focus on developments in the

49 L. Fletcher & T. Wilkes, 'Hedge funds enjoy post-crisis popularity with "safe" image', *Reuters*, 17 September 2013.

50 In the USA, the SEC adopted a rule requiring the registration of hedge fund managers in 2004, but the rule was struck down by a court ruling in 2006.

51 The ban, which had the purpose of protecting small investors from taking on potentially dangerous risks, was abolished with the Jumpstart Our Business Startups Act 2012 that empowered the SEC to adopt a corresponding rule.

52 M. Lynn, 'Hedge Funds Are Running Out of Reasons to Exist', *Bloomberg*, 20 September 2010.

53 *See* EU Commission COM(2013) 614 final.

54 FINalternatives, 'Bank of England Raises Systemic Concerns About Hedge Funds', 25 September 2013.

sector, and reforms might be extended gradually. However, a change from managers to funds and a linkage to downsizing strategies would require a broader debate about the role of shadow banking within and beyond financialisation that currently does not seem to be part of the expert discourse among regulators.

V Derivatives, the New Risk Management, and the Need to Regulate Products

Derivatives, such as futures, forwards, options, and swaps, are financial products whose values are derived from an 'underlying' value, be it an asset such as residential mortgages, commodities for credit derivatives, index, and weather conditions for agricultural products to name just a few. A typical definition is that they are "financial contracts that are designed to create market price exposure to changes in an underlying commodity, asset or event".[55] Derivatives fulfil three functions: hedge, arbitrage, and speculation. They have been traded on specialised derivatives exchanges or over-the-counter (OTC), usually by a few dealers. The growth in derivatives has by far outstripped the growth in the underlying commodity production and the need for derivatives to hedge risk. Especially OTC derivatives expanded rapidly since the 1980s. While regulators such as the BIS or the US Commodity Futures Trading Commission (CFTC) got increasingly concerned about the threat to financial stability from this growth and the diversity in products, attempts to regulate them beyond voluntary industry self-regulation failed, and regulatory change was moreover designed to increase the attractiveness of these products.[56] As a result, OTC derivatives became important elements of the shadow banking system. The OTC derivatives market is also characterised by the central role played by a very small number of globally active large financial institutions, which therefore pose a high potential for contagion. As the crisis and numerous examples before have shown, these mega-institutions have also the possibility to abuse their market position by using the lack of transparency to pass on toxic assets to other institutions.[57] Only recently, this led at least in the USA to settlements between banks and regulators, including a US$13 billion settlement with JPMorgan which is the largest settlement ever between government officials and a singly company. But in Europe too the largest banks set aside 60 billion euros for legal disputes, settlements, and fines.[58]

With regard to OTC derivatives, the regulatory approach supported by the G20 was the introduction of clearing through central counterparties (CCPs) and trade repositories for this market to increase transparency, to reduce counter-

55 R. Dodd, 'Derivatives Markets: Sources of Vulnerability in the US Financial Markets', *in* Epstein 2005, p. 149.

56 In the USA, the Commodity Futures Modernization Act of 2000 explicitly stopped CFTC and other regulators to intervene in the OTC derivatives markets. As a consequence, legal certainty of contracts increased. *See* G. Morgan, 'Constructing Financial Markets: Reforming Over-the-Counter Derivatives Markets in the Aftermath of the Financial Crisis', *in* W. Grant & G.K. Wilson (Eds.), *The Consequences of the Global Financial Crisis: The Rhetoric of Reform and Regulation*, Oxford, Oxford University Press 2012, p. 70 *et seq*. In the EU, the Financial Services Action Plan reduced national barriers; *see* Pesendorfer 2012.

57 S. Das, *Extreme Money: The Masters of the Universe & the Cult of Risk*, Harlow, FT Prentice Hall Pearson 2011.

58 *Der Standard*, 22 November 2013.

party risk, and to assure sufficient collateral for trades. The G20 Pittsburgh Summit in September 2009 set the goal and a time frame for reforms:

> All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.[59]

The idea of central clearing was already discussed before the crisis as it was well established in other areas. However, initiatives including incentives to extend the approach to derivatives voluntarily had failed. Now it seemed an adequate approach to shift away the attention from ideas to adopt strict product regulation for derivatives and to significantly downsize this US$700 trillion market or even more radically to completely ban OTC products and to allow only derivatives traded on regulated exchanges. Despite the lessons from the crisis, there was, as Morgan emphasised, still a powerful coalition of "financial institutions, the interdealer brokers, and some of the clients, together with the support of many economists and commentators for the idea that the OTC market was efficient"[60] who successfully blocked any radical change.

The EU implemented the G20 commitment with the European Market Infrastructure Regulation[61] (EMIR), adopted on 4 July 2012 and entering into force on 16 August 2012. EMIR introduced mandatory clearing for all standardised OTC derivative contracts by the end of 2012 and a reporting obligation to trade repositories. The European Securities and Markets Authority (ESMA) became responsible for drafting the regulatory and implementing technical standards and has now a central role in the authorisation and monitoring of CCPs and trade repositories. The European System of Central Banks (ESCB) is responsible for the oversight of CCPs. With regard to the adaptation of technical standards and guidelines, 'market participants' have to be consulted, and regulatory impact assessments are required. The overall implementation design, regulatory competition, and regulatory capture make it likely that the regulation becomes weaker.

But there are also possibilities for gradual institutional change that could result in stricter regulation. The G20 mandate provides powers to the Financial Stability Board and national regulators to take further measures if those taken would be "insufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse". EMIR gives the Commission the task "to monitor closely the evolution of the OTC derivatives market" and to intervene "where necessary", especially with regard to any "unintended competitive distortions of the OTC derivatives market" and "to prevent competitive distortions from occurring in the internal market with the aim of ensuring a

59 G20 Leaders' Statement: The Pittsburgh Summit, 25 September 2009, p. 9.
60 Morgan 2012.
61 Regulation (EU) No 648/2012, OJ 2012 L2001/1.

level playing field in the financial markets".[62] Additionally, some further aspects of the G20 commitments still need to be implemented via reform of the current Markets in Financial Instruments Directive (MiFID)[63] and the Market Abuse Directive.[64]

The introduction of CCPs to reduce counterparty risk is a fundamental change, given that up to now only a small percentage of OTC contracts are centrally cleared. Under EMIR, CCPs need to have all sorts of risk management in place, to establish a default fund, and to be able withstand the simultaneous default of the two largest clearing members. However, there are a number of problems with central clearing and trade repositories. Some authors have argued that the number of CCPs would need to remain small and clearing "sufficiently centralized"[65] for a functioning or even optimum system, but there are also risks with CCPs becoming too big or too interconnected and a general risk that the taxpayer ends up bailing out CCPs, if they take on too many risks and if their default fund would be insufficient. Given competition between CCPs for market shares, a race to the bottom between them could occur, especially when a new wave of deregulation and liberalisation would set in or when regulators become less concerned or captured. It is important to note that in the USA with Republicans trying to undermine Dodd-Frank, the regulator lacks resources for effective implementation.[66] Given global competition, this could easily lead to a similar approach in Europe (and Japan where CCPs have also been introduced). Another issue is that in order to address the counterparty credit risk, the new institutional and risk-management practices depend increasingly on 'time-critical liquidity', which has significant consequences on financial stability, given all kinds of interdependencies and interconnectivity in the emerging new system.[67] Moreover, it remains to be seen how many contracts will become standardised and centrally cleared and how many will remain uncleared transactions and whether the risk mitigation techniques for them will be sufficient.

The most significant problem with OTC derivatives remains that the market as such should not be radically downsized and that the overall regulatory framework has been designed in a way to assure that costs would not increase too much and are outweighed by higher legal certainty of contracts while liquidity and flexibility for market participants stay high. The OTC derivatives markets only shrunk

62 OJ 2012 L201/6.

63 The reform debate resulted in the 2011 proposals for a new Directive (MiFID2) and a new Regulation (MiFIR).

64 The Commission adopted proposals for a revised Directive (MAD) and a new Regulation (MAR) in October 2011.

65 D. Duffie, *How Big Banks Fail and What to Do about It*, Princeton, Princeton University Press 2011, p. 57. *See also* V.V. Acharya, O. Shachar & M.G. Subrahmanyam, 'Regulating OTC Derivatives', *in* V.V. Acharya *et al.* (Eds.), *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance*, Hoboken, NJ, John Wiley & Sons 2011, p. 399.

66 The key regulator, the CFTC, "is underfunded, understaffed and perennially under attack"; J. Eisinger, 'In Obama's Pick to Lead a Financial Regulator, an Enigma', *New York Times*, *DealBook* 20 November 2013.

67 D. Marshall & R. Steigerwald, 'The Role of Time-critical Liquidity in Financial Markets', *Economic Perspectives*, Federal Reserve of Chicago, 2Q/2013, pp. 30-46.

for a short period during the crisis in 2009 and 2010 and have returned to growth since then. The new system will bring more transparency into at least parts of the market and maybe lead to more stability via the higher capital and collateral requirements. In Europe, the possible introduction of a financial transaction tax might have an additional effect on the size of the market.[68] However, from the experience with OTC derivatives so far a stricter product regulation seems necessary to downsize the market and to keep new innovation under control.

Bringing new financial products on the market has in most jurisdictions become highly unregulated in the era of deregulated and liberalised financial markets. Countries that kept stricter product regulation in place were frequently criticised for losing out in competitiveness and wealth generation. However, the crisis showed clearly that countries with stricter product regulation such as Canada or India were less affected. This led to various calls for a stricter product regulation that also emphasised comparisons to food, drugs, or the European chemicals regulation[69] but which have not found their way into EMIR or Dodd-Frank.

Products could be regulated in two ways: either their marketisation could be subject to approval by a regulator or only products that were explicitly allowed for in law could enter the market. While the first approach would be faster, there might be a higher risk that regulatory capture comes into play. Especially the second approach is seen as a major barrier to financial innovation that has led to many claims that any such product regulation would stop innovation without any further consideration of what kind of innovations would be stopped and what kind of innovations would still go ahead. Morgan identifies "a variety of disadvantages to the originators of such products" such as that "nobody would be able to accrue first-mover advantage and the possibility of rapidly establishing scale and reputation for these new products would be more difficult to achieve".[70] Epstein and Crotty argue for strict regulation of innovations "both before and after they get into circulation" as part of a 'Financial Precautionary Principle' and with a 'Financial Stability and Product Safety Administration' as regulator "that will test and approve (or deny) the marketing of new financial products".[71] With regard to OTC derivatives, Epstein and Crotty formulated important ideas such as 'sunset provisions' for the approval of all highly complex financial products and a clear rule:

> If the product is too complex to understand with a relatively high degree of certainty as to how it will function in normal times and especially in times of stress, then it should NOT be approved until it is well understood. In less extreme cases where the likely benefits are high, it should only be approved with very strict limitations and follow-up requirements, including possible

68 There is still uncertainty if and how the proposal will be implemented; *see* Pesendorfer 2013.

69 G. Epstein & J. Crotty, *Controlling Dangerous Financial Products through a Financial Pre-Cautionary Principle*, Amherst, Department of Economics and Political Economy Research Institute (PERI), University of Massachusetts 2009; Pesendorfer 2012; Roubini & Mihm 2010, p. 202.

70 Morgan 2012, p. 67.

71 J. Crotty & G. Epstein, *A Financial Precautionary Principle: New Rules for Financial Product Safety*, Wall Street Watch Working Paper, No. 1, Consumer Education Foundation, 2009, p. 5.

> high liquidity and/or capital reserve requirements. In other words, the rule should be that if the tests are insufficiently clear and the assumptions insufficiently sensible, and the results murky or negative, then the product should not be approved, unless it can be proven by the sponsor that the social benefits far outweigh the risks.[72]

'Shifting the burden of proof' is a key aspect of precautionary public policy.

For overcoming a major problem of financialisation, strict product regulation would be unavoidable. As a result, financial innovation would be significantly transformed, not by ending innovation as opponents have claimed, but by increasing the chances to stop toxic innovations before they can reach a level where they become too risky. Transformative strategies would need to supplement the proposals for strict product regulation with ideas to make the regulator capture-proof.

D The Regulatory Space for Transformative Strategies

With regard to reform outputs and outcomes, some scholars have argued that only the next crisis might show whether the reforms were sufficient or did not go far enough.[73] Nevertheless, evaluations of reforms have already shown quite significant shortcomings, flaws, and loopholes and identified possible (unintended) consequences. As the major decisions about the reform direction have already been taken, a lot depends on implementation and, further, now more gradual change resulting from the new regulatory environment. It has also been argued that problems will always occur in unexpected new areas[74] and this is certainly right for overly complex systems. In chemicals regulation, this insight has led to demands for dematerialisation, stricter product regulation, and a strict implementation of the precautionary principle. In financial regulation, calls for significant deleveraging and downsizing finance as well as for a financial precautionary principle are comparatively new especially with regard to their impacts on transforming financialisation. Indeed, the questions about optimum capital requirements and leverage, optimum banking structures, and optimum sizes of particular markets are difficult to answer. As the discussion on key European reform areas has shown, financial reform has not met the expectations of those that hoped to transform the finance-led accumulation regime, and there are still strong beliefs that megabanks, large financial conglomerates, rapidly growing alternative investment funds, and derivatives markets are positive and can be controlled. If we accept that such a system is extracting resources from the real economy and that the growth in finance has clear limits beyond which its contribution to wealth becomes negative, further and more ambitious reforms become unavoidable, also requiring new transformative strategies.

72 *Ibid*., p. 13.

73 V.V. Acharya, O. Shachar & M.G. Subrahmanyam, 'Regulating OTC Derivatives', *in* Acharya *et al.* 2011, p. 405.

74 *Ibid*.

In most areas discussed above, regulators and the Commission were given powers to closely observe developments and take further actions if necessary. Given the history of regulators as business-friendly and dependent on information provided by business, there are various strategies necessary to assure gradual institutional change for a more sustainable system. Firstly, a more strategic use of different business interests would be necessary. In major reform areas, different business interests have more been used for moderate reformulations within financialisation than for transforming the finance-led accumulation regime. In the derivatives reform, for example, exchanges became powerful actors in pushing for market shares as future clearing houses, without any interest in significantly downsizing this huge market.

Lawmakers and regulators are still captured. Making legislators and regulators capture-proof is a key lesson from the capture literature. An important strategy is "strengthening the plurality of voices and perspectives in the regulatory process [...] to reduce the risks that regulators find themselves exposed to one-sided evidence from the regulated financial sector".[75] Not surprisingly given the costs of regulatory change, concerns caused massive lobbying activities, in June 2010 even culminating in protests by members of the European Parliament (including conservatives, liberals, social democrats, greens, and united left MEPs) that they reached an unacceptable and unprecedented level that would endanger democracy.[76] To counterbalance this influence and following a call from EU officials and politicians, a new NGO – Finance Watch – was founded with financial support by the EU in 2011 to observe the regulatory debates and to intervene in law-making processes. This approach is not new and has been used in other areas such as environmental regulation, where NGOs frequently receive funding to contribute to reform debates. However, this practice has also been criticised for undermining the independence of NGOs. In the context of the newer regulatory capture literature, there would be many more ideas how to design institutions in a way to allow continued influences from outside the mainstream in regulatory oversight and throughout the policy cycle via requirements for using diverse and independent expertise or assuring adequate media coverage. This debate is well established in the USA but so far only insufficiently part of the regulatory practice and largely absent in the European discourse. Existing examples also show that more public pressure and action as well as leadership by key actors are important requirements for success.

Yet, austerity and crisis management have had limiting impacts on any attempts to assure high pressure during implementation and enforcement of already adopted measures. The regulatory space for transformative strategies and taming finance in times of crisis and austerity seems rather limited, but with increased public protest potential, the continued possibility of aftershocks, and further crises, actors interested in overcoming financialisation need to find new

75 S. Pagliari, 'How Can We Mitigate Capture in Financial Regulation', *in* S. Pagliari (Ed.), *Making Good Financial Regulation: Towards a Policy Response to Regulatory Capture*, Guildford, Grosvenor House 2012, p. 22.

76 *See* <http://blog.brusselssunshine.eu/2010/06/meps-ring-alarm-bells-over-financial.html>.

and broader coalitions and develop strategies using the insights from literature on regulatory capture, regulatory competition, financialisation, and limits to growth.