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Macartney, Huw; Jones, Erik

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TTIP and the 'Finance Exception': venue-shopping and the breakdown of financial regulatory coordination

Erik Jones and Huw Macartney

Abstract

This paper asks why financial market regulatory coordination did not form a major part of the US and EU negotiations on the Transatlantic Trade and Investment Partnership (TTIP). Given the highly interconnected nature of transatlantic financial services, common experiences of insufficient regulation exposed by the global financial crisis, the G20 commitments made by both blocs, and the awareness that uncoordinated re-regulation could threaten global financial stability, the US and the EU arguably had every incentive to make financial services a central pillar of the TTIP. Yet financial services coordination is conspicuous by its absence. We argue that the breakdown in financial coordination was driven by the fact that US authorities' moved more quickly and in ways less appreciated by major actors in the financial sector than their EU counterparts in implementing the G20 agenda. This has given rise to 'venue-shopping' on the part of the largest financial firms. Rather than try to tackle US regulatory agencies head-on, they hope to gain traction on the US regulatory process by influencing how European partners approach contentious issues. We conclude that where we used to worry that firms would shop the lightest regulatory environment, now there is concern that they will shop the most porous lobbying arena.

Erik Jones is Professor of European Studies and International Political Economy, and Director of European and Eurasian Studies at the Paul H. Nitze School of Advanced International Studies (SAIS) of the Johns Hopkins University. He is also a Senior Research Fellow at Nuffield College in Oxford, United Kingdom. Professor Jones is author of *The Politics of Economic and Monetary Union* (2002), *Economic Adjustment and Political Transformation in Small States* (2008), and, together with Dana Allin, *Weary Policeman: American Power in an Age of Austerity* (2012). His most recent volume is a collection of short essays called *The Year the European Crisis Ended* (2014). He is editor or co-editor of more than twenty books or special issues of journals on topics related to European politics and political economy including reference works such as *The Oxford Handbook of the European Union* (2012) and *The Oxford Handbook of Italian Politics* (forthcoming 2015), and teaching works such as *Developments in European Politics 2* (2011) and *Europe Today: A Twenty-First Century Introduction* (2014). Professor Jones is a contributing editor for *Survival* and will be co-editor of *Government and Opposition* from May 2015.

Huw Macartney is Lecturer in Political Economy at the University of Birmingham. He was previously Hallsworth Research Fellow in Political Economy at the University of

Manchester. He is the author of *European Democratic Legitimacy and the Debt Crisis* (2013) and *Variegated Neoliberalism: European Varieties of Capitalism and International Political Economy* (2010). His research has also been published in *Review of International Political Economy, Review of International Studies, The Political Quarterly, British Journal of Politics and International Relations, Competition and Change,* and *Politics* amongst others.

Introduction

This paper asks why further financial integration did not form part of US and EU negotiations on the Transatlantic Trade and Investment Partnership (TTIP) that opened in 2013. Financial integration is deeper between the United States and Europe than between any two other regions of the world. The principal firms have dominant roles in both markets. US and EU firms make up the majority of the world's largest banks by market capitalization (see Table 1). The euro-dollar exchange rate is the world's most traded base pair and almost all currency transactions move into or out of either the dollar or the euro. Moreover, much of this activity is in the service of integration in the areas of transatlantic trade and investment; US and European banks are more exposed to each other than to other parts of the world (see Table 2). Hence financial integration would seem a natural area for transatlantic regulatory partnership — particularly if the goal is to eliminate non-tariff barriers through the promotion of new global standards. Nevertheless, finance seems likely to remain outside the TTIP conversation.

Table 1: Origins of world's largest banks (by total assets US$ tn)

Rank	Bank	Home Country	Total assets ($ tn)
1	Industrial and Commerce Bank of China	China	3.18
2	*HSBC Holdings*	*UK*	*2.76*
3	China Construction Bank Corporation	China	2.60
4	*BNP Paribas*	*France*	*2.59*
5	Mitsubishi UFJ Financial Group	Japan	2.51
6	*JP Morgan Chase & Company*	*US*	*2.48*
7	Agricultural Bank of China	China	2.47
8	Bank of China	China	2.44
9	*Credit Agricole Group*	*France*	*2.35*
10	*Barclays PLC*	*UK*	*2.67*
11	*Deutsche Bank*	*Germany*	*2.25*
12	*Bank of America*	*US*	*2.15*
13	Japan Post Bank	Japan	1.97
14	*Citigroup Inc.*	*US*	*1.89*
15	*Societe Generale*	*France*	*1.74*
16	Misuho Financial Group	Japan	1.71
17	*Royal Bank of Scotland Group*	*UK*	*1.70*

18	*Banco Santander*	*Spain*	*1.61*
19	Sumitomo Mitsui Financial Group	Japan	1.57
20	*Groupe BPCE*	*France*	*1.57*
21	*Wells Fargo*	*US*	*1.55*
22	*Lloyds Banking Group*	*UK*	*1.40*
23	China Development Bank	China	1.32
24	*UniCredit S.p.A.*	*Italy*	*1.16*
25	*UBS AG*	*Switzerland*	*1.11*
Source: http://www.relbanks.com/worlds-top-banks/assets			

Table 2: Foreign Exposure of US and European Banks

Percentages	European Banks	United States
Total Foreign Exposure	100	100
Developed Europe	47	42
Developing Europe	7	3
United States	20	0
Japan	2	9
China	2	3
Offshore Centers	8	17
ROW	15	26

There are three potential explanations for the conspicuous absence of financial integration in TTIP: the first is that post-crisis financial coordination was simply taking place in alternative fora, meaning that its insertion into TTIP would have been surplus to requirements; a second explanation places the emphasis instead on rival firms and protectionism. Here the argument would be that large financial institutions on both sides of the Atlantic lobbied their domestic (US) or regional (EU) authorities to demand that further integration remain outside of the TTIP conversation as a mechanism for protecting their market share and interests. A third explanation however, highlights the competition between regulatory authorities. Such competition could play out in many ways, through a mutual attempt to preserve independence or some effort by one regulatory authority to gain influence over the other.

This paper follows this third explanation. Specifically, we argue that US financial regulators – the US Treasury in particular – refused to allow finance to become part of the TTIP negotiations because they worried that any movement toward regulatory convergence would come at the expense of their independence and could result in the lowering of their standards. Importantly though, US fears were informed by the

impression that the European regulatory process was more susceptible to interference from large financial institutions.

This argument is not pieced together by forensic deduction. Indeed, Treasury officials make the point explicitly in conversation.[1] So do representatives of U.S. business interests in Europe who support including financial services in the TTIP conversation.[2] The same business representatives also insist that a chapter on financial services could be slipped into any agreement at the last minute – which is how they expect the negotiations to unfold. Hence the importance of the argument is not so much what it tells us about the latest round of trans-Atlantic negotiations but rather what is says about attempts to promote global (financial) governance (see also Germain, *this issue*).

Within the wider context of market integration, this case study reveals an interesting aspect in venue shopping – which is the attempt by firms to choose the regulator who will treat them in the most advantageous manner. Where we used to worry that firms would shop the least restrictive regulatory environment, now there is concern that they will shop the most porous lobbying arena – meaning, the one where they can have the greatest influence over the regulatory process. It also reveals the different dimensions of trust that are required – both in market institutions and in political institutions. In other words, the treatment of finance in the TTIP stands in stark contrast to the treatment of trade and investment: negotiations over trade and investment have been characterized by an almost unprecedented level of trust and willingness for regulatory engagement and cooperation; meanwhile, the absence of finance from the conversation smacks of mistrust and independence on the part of the US authorities. Simply, financial stability concerns continue to dominate the post-crisis transatlantic financial regulatory process, with all the corresponding costs to market access and integration.

Our argument unfolds in four stages. First, we map the TTIP negotiations to show how finance was systematically excluded. In the second section we then briefly consider the two potential alternative explanations, that financial coordination was being dealt with in alternative fora and that rival firms had demanded the financial exclusion. In the third and main section of the paper we then provide evidence to support our claim that competing regulatory regimes and US opposition was the main explanation for the finance exception. We do this by (i) process-tracing US opposition, and by (ii) mapping post-crisis regulatory reforms to explain that the US moved more quickly and in ways less attractive to large banks than the EU. In the fourth section we then examine the evidence of venue-shopping by the largest firms.

The finance exception?

This first section maps the TTIP negotiations to support the claim of a finance exception in TTIP. At the Transatlantic Economic Council (28 November 2011), Senior EU and US leaders agreed to strengthen their cooperation on customs procedures, electric vehicles,

and new technologies in cloud computing. It was also agreed to strengthen cooperation aimed at supporting small and medium sized enterprises international trade; and increased cooperation in the field of investment, particularly with regards to barriers in third countries. The Council noted though that the premise for increased cooperation in trade and investment sprung from the fact that the EU and the US enjoyed the most integrated economic relationship in the world: for both goods and services the two regions were each other's biggest trading partners.[3]

This summit resulted in the establishment of the EU-US High Level Working Group on Jobs and Growth. The purpose of the group was to look for opportunities for the elimination of non-tariff barriers and the promotion of compatible or common regulatory standards in order not only to stimulate economic performance but also to address issues of 'common concern' and to promote the achievement of 'shared economic goals'. This working group quickly came to the conclusion that the best way forward would be a comprehensive transatlantic agreement to facilitate the trade in goods and services, to foster investment, and to promote regulatory convergence. Acting on this recommendation, U.S President Barrack Obama announced his intention to open talks on a 'transatlantic trade and investment partnership' in his 12 February 2013 'state of the union' address.

The first round of TTIP negotiations was then held in Washington (8th-12th July 2013). According to official sources the aim was to 'liberalize as much as possible trade and investment between the two blocs'.[4] Of particular interest for the purpose of this article however, was the fact that even at this early stage both sets of authorities recognized that the goal was more than just removing barriers. They acknowledged that the main hurdles lay 'behind the border' in regulations, nontariff barriers, and red tape. The conclusion was the need to reinforce regulatory cooperation, 'so as to create converging regulations'.[5] In other words, the strategic importance to both sides of access to each other's markets manifested in a mutual agreement for regulatory convergence; and this level of agreement would fundamentally shape the unfolding TTIP negotiations. Strangely though, financial services were already conspicuously absent from the range of issues on the table at this July 2013 Summit.

To understand why the absence of finance is so glaring, it is necessary to back up a bit in the chronology. The High Level Working Group was always vague in its reports about what sectors would be included under the headings 'goods' and 'services'. Ultimately, different stakeholders would have to nominate (or self-nominate) different sectors for inclusion in the talks. In autumn 2012 EU and US authorities issued a call for input on regulatory issues to be considered part of the possible future trade agreement. Of the 52 respondents on either side of the Atlantic, only one submission represented financial institutions (the Bundesverband Deutscher Banken, the German Banking Federation). The BdB expressed its unqualified support for including financial regulation issues in any negotiations on a comprehensive EU/US agreement to further liberalized transatlantic

trade and investment.[6] They also noted that the US remains the most important financial market outside of the EU and hence, for German banks, US rules were highly important. In particular, they emphasized the need to apply principles of national treatment (i.e. competitive equality) and recognition of comparable home country standards when regulating US operations of EU banks (and vice versa). The German association also noted though that emerging US financial regulations had raised concerns, particularly because of the way in which they had been independently pursued.[7] We will return to this theme in our third section on the US post-crisis reform process.

These firm-level responses fed into the Final Report of the High Level Working Group on Jobs and Growth (HLWG) (11th February 2013). Yet again however, financial integration and cooperation remained conspicuously absent from the official text. The final report noted that the EU and US would seek to reach bilateral agreement in the following areas: customs and trade facilitation; competition policy; state-owned enterprises; local barriers to trade; raw materials and energy; small and medium sized enterprises; and transparency.[8] Indeed, as the first round of TTIP negotiations took shape, finance remained – at best – peripheral. For example, of the 162 organizations that registered for the debriefing meeting after the first round of EU-US negotiations, only one organization (the European Banking Federation) represented financial services. Yet from the minutes of this debriefing it became apparent that finance had indeed been discussed in the context of regulatory issues.[9]

Following the second round of negotiations (11th-15th November 2013), a separate meeting on financial services regulation was organized.[10] Part of the reason was that a large number of stakeholders had raised questions about the status and progress of discussions related to financial services.[11] Then, in January 2014, the EU Commission revisited financial services integration under the broad preamble of cooperation on regulatory issues. This was a key turning point for Europe, as EU authorities became more determined. In a position paper they emphasized the global nature of financial services and the need for cooperation to reduce systemic risk.[12] The position paper highlighted that although regulatory dialogue had indeed taken place in a variety of fora, these principles had not been applied consistently in the two related jurisdictions. Some of this inconsistency was attributable to different EU and US market structures. But the position paper also noted that 'in too many instances, international standards have been implemented in a way that does not allow regulatory systems and the relevant regulators and supervisors to work together'.[13]

Indeed as the negotiations continued in 2014, financial services continued to be a theme for discussion in the EU Commission's TTIP Stakeholder Advisory Group.[14] At the January meeting for example the advisory group raised the question of how cooperation in this area could be addressed. Nevertheless, by the May meeting, the Chair – Commissioner Ignacio Garcia-Bercero noted that 'the EU and the US still [had] different views on inclusion of financial services' in TTIP[15] – even though the EU Commission

began ‘lobbying hard for such services to be included in the TTIP negotiations’.[16] Put simply, while financial services remained a consistent theme amongst European stakeholders and – as we will later show – European and US banks, it gained little traction in the EU-US negotiations.

These stakeholders have a good reason for focusing attention on trans-Atlantic finance. The North Atlantic is the most integrated part of the global financial marketplace. Successive surveys of cross-border capital flows by the McKinsey Global Institute show both the extent and the longevity of this predominance.[17] They also show the potential volatility that the trans-Atlantic financial marketplace can introduce into the global economy. The recent financial crisis reduced cross border capital movements ‘from $10.9 trillion in 2007 to just $1.9 trillion in 2008 and to $1.6 trillion in 2009’ (see Table 3).[18]

Table 3: Change in European and US Foreign Exposure from 2009 to 2014.

	2009		2014		Change (2014-2009)	
US Dollar Trillions	European Banks	United States	European Banks	United States	European Banks	United States
Total Foreign Exposure	20.33	2.71	17.12	3.20	-3.21	0.48
Developed Europe	10.92	1.37	7.97	1.36	-2.95	-0.02
Developing Europe	1.30	0.06	1.14	0.10	-0.17	0.04
United States	3.87	0.00	3.42	0.00	-0.45	0.00
Japan	0.54	0.28	0.35	0.29	-0.19	0.00
China	0.12	0.05	0.37	0.08	0.25	0.03
Offshore Centers	1.24	0.27	1.33	0.55	0.09	0.27
ROW	2.34	0.68	2.55	0.83	0.21	0.15

This collapse in cross-border capital flows was largely a result of heightened perceptions of counter-party risk in inter-bank markets. Such perceptions tend to be self-fulfilling. Banks that depend upon inter-bank lending to meet their funding requirements quickly come up short once inter-bank markets run dry. Hence there is a strong incentive for regulators on both sides of the Atlantic not only to strengthen their supervision of systemically important financial institutions but also to create the impression that their supervision is effective.[19]

The problem is that U.S. and European regulators have responded to the crisis in an uncoordinated fashion and by strengthening differences across the Atlantic.[20] We explore the substantive disagreements below. For this stage of the argument, the important issue is the extent to which regulatory differences have impacted on the trans-Atlantic trade in financial services. The evidence is mixed and distorted in many ways by the ongoing crisis in the euro area. Nevertheless, industry analysts – both at McKinsey and elsewhere – argue that divergence in regulatory responses to the crisis could hinder recovery in cross-border capital markets. Worse, there is concern that 'diversity [will lead to] arbitrage, severely reduced liquidity, new and unintended risk distributions caused purely by regulation and subsequent additional regulation'.[21] Our aim in this article is not to determine whether the US or the EU's regulatory response was substantively 'better'. Instead, our aim is to highlight that the divergence in response has created openings for potentially highly damaging regulatory arbitrage driven by financial firm venue shopping.

Competing explanations

This second section of the paper examines two alternative explanations for the finance exception: that financial coordination was being negotiated elsewhere; or that its absence was motivated by bank lobbying, seeking to protect their home markets.

Alternative fora?

There is some truth to the claim that financial market integration had been a topic for discussion between the US and EU in alternative fora. Ironically, this was the result of a U-turn by U.S. regulators in the early 2000s over issues related to corporate governance, accounting standards, and securities markets regulations. As Eliot Posner (2007, 2009) has argued, U.S. regulators were reluctant to make any concessions to support transatlantic financial regulatory cooperation until both the growth of transatlantic financial firms and the centralization of European regulatory authority made it attractive to do so.[22] Once that happened during the Lamfalussy process, however, U.S. regulators were more than willing to make concessions to their European counterparts in order to foster greater coordination (see also Howarth and Quaglia, *this issue*). Indeed, US authorities repeatedly used this recent history of transatlantic institution-building as a primary rationale for the exclusion of financial services regulatory cooperation from TTIP. As we will show below though, this was not the primary reason for its absence from the TTIP negotiations. Instead, what we witness with TTIP is also apparent in other multilateral fora: that is, the absence or paucity of transatlantic regulatory coordination on financial market integration following the global financial crisis.[23]

In broad terms, global financial cooperation between the EU and US had been discussed within the G 20, the Financial Stability Board, and the Basel Committee on Banking

Supervision. More specifically, a US-EU Financial Markets Regulatory Dialogue (FMRD) had been established in 2003 to promote financial market policy cooperation. Yet the post-crisis period has been characterized by 'extraterritorial, duplicative or discriminatory', unilateral policymaking on both sides of the Atlantic.[24] Indeed, even the Financial Markets Regulatory Dialogue was only designed to be an informal dialogue. And although US trade negotiators contended that this was sufficient, as we will argue below both EU authorities and EU-US financial firms contended that informal dialogue did not equal regulatory cooperation.[25] As Edward Bowles, regional head of Standard Chartered Bank (Europe) and member of the EU Commission's TTIP advisory group claimed, 'the Financial Markets Regulatory Dialogue [had] failed'.[26]

What was apparent was that the FMRD had been relegated to merely a talking shop, a forum for the exchange of ideas.[27] In part, this reflected concern in the United States that the EU was incapable of resolving its multiple (banking, sovereign debt, and growth) crises. As Michael Froman, the US trade representative, put it, 'if TTIP is seen as a way for Europe to export its way out of its problems, it won't have support…It's got to be part of an overall effort to promote reform and get their economies moving again'.[28]

Rival firms?

A second alternative explanation for the absence of financial regulation from TTIP is that rival firms on either side of the Atlantic lobbied their respective authorities to ensure its exclusion from negotiations. There are two reasons why this was not the case however. First, US trade negotiators were explicit from early on in the negotiations that they agreed that financial market access should indeed be discussed as part of the TTIP agreement.[29] What they rejected was a formal agreement on mutual recognition and common regulations, as we will explain below. Secondly though, insurmountable evidence from financial firms and trade associations on both sides of the Atlantic points to their desire for financial regulatory coordination to be included in TTIP. For example, in March 2014, fifteen US and EU financial trade associations and representative bodies signed an official statement in support of the inclusion of financial regulatory coordination, emphasizing that 'the opposite approach – diverging and conflicting regulation – risks damaging global growth, job creation, and investment and may hinder the important advances in the effectiveness and strengthening of the new regulatory environment'.[30] Put simply, neither alternative fora nor rival firms is a sufficiently robust explanation for the exemption of financial services regulatory coordination from the TTIP negotiations.

Competing regulatory regimes

Having briefly discussed the two alternative explanations outlined above, we now turn to the third section of the paper. Our argument unfolds in two parts. We begin by (i) substantiating the claim that the finance exception arose from US opposition, before (ii)

explaining the source of this opposition, namely the tougher approach of US authorities since the financial crisis and their perception that the EU was more susceptible to lobbying from large financial firms. Then in our fourth and final section of the paper we present the evidence of 'venue-shopping' which regulatory divergence between the US and the EU has given rise to. We conclude by suggesting that the *faster* and *harder*, yet isolationist, response by the US might result in regulatory arbitrage. This is not to deny that U.S. financial firms are unwilling to lobby the U.S. Congress or that they will have only limited success in their attempts to water down Dodd-Frank. Rather our point is simply that promoting trans-Atlantic regulatory cooperation is part of a wider strategy to influence the financial regulatory environment that includes venue shopping in Europe. Or at least that is what the US Treasury is concerned about. Hence we argue that finance was left out of the TTIP conversation from an early stage because of the staunch unwillingness of the US SEC and Treasury to play ball. Put simply, there was 'stiff opposition from the US Treasury [in particular]…[fuelled by a] fear that the US might lose its sovereignty over regulation'.[31] The result was that 'protectionist sentiment and economic nationalism [certainly in the area of financial services integration] were fast replacing the wave of enthusiasm' that characterized other areas of the TTIP negotiations.[32]

Process-tracing US opposition

As the first section of this paper showed, there were early attempts by the EU Commission and stakeholders involved in shaping the EU's position papers to include coordination on financial services regulation. Showing the US authorities' opposition is therefore relatively straightforward. A 'leaked document' from the EU Trade Policy Committee in May 2014 stipulated that in view of 'the firm US opposition to include regulatory cooperation on financial services in TTIP' the EU itself had withdrawn any commitments on financial services in the EU's market access offer.[33]

Though US authorities had been reluctant to discuss financial services cooperation from an early stage in the TTIP negotiations, their explicit rejection of any such inclusion came to a head following the 10-14th March 2014 meetings. It was at this round of negotiations that the European Commission tabled its specific services and investments proposals, to be included in Section VI. It raised a series of concerns for US authorities including explicit forms of *mutual recognition* and *mutual reliance*. With regards to mutual recognition, it stipulated that either party would commit to examine any measures which were seen to have a negative impact on the ability of market operators to provide financial services within the territory of both parties. With regards to mutual reliance, amongst other things, the text stipulated that both parties would commit towards convergence of their respective regulatory and supervisory frameworks.[34] In other words, both mutual recognition and mutual reliance would have constituted a much stronger form of coordination on financial regulatory policy.

From the US perspective, this effort to promote transatlantic financial regulatory convergence was a clear attempt by the EU to defend the interests of its financial sector and an attempt to undermine US regulation that was far in advance of similar EU rules.[35] Indeed, such concerns were also echoed by left-wing research units and politicians from continental Europe. The Corporate Europe Observatory for example suggested that this 'proposal [would] not only make it more difficult for the US authorities to regulate European banks, it could block needed reforms on both sides of the Atlantic'.[36] Indeed, one Social Democrat MEP noted that the proposal would 'give a competitive advantage to those [financial institutions] hailing from the side that applies the lightest touch to finance'.[37] This prompted a response from the EU Commissioner for financial services, Michel Barnier, as he spoke at the Peterson Institute for International Economics (June 13th 2014). He noted: 'I understand there are concerns here…that financial services regulation in the TTIP would lead to a kind of unraveling of the Dodd-Frank and a kind of deregulation of financial services'.[38] Yet he responded that his 'objective [was] exactly the opposite, better and high-quality interoperable regulations'.[39]

Nonetheless, whilst the US trade representatives acknowledged the need to 'lock in existing and create new market openings for [US] financial services suppliers', they stipulated that they would continue to 'ensure that [the US] government retains full discretion to regulate the financial sector'.[40] In other words, demonstrating that (i) US opposition to the inclusion of financial services was determinant is relatively straightforward. The remainder of this third part of the paper now focuses on outlining (ii) the 'big picture' of regulatory reforms in the EU and the US, before (iii) focusing specifically on the areas of derivatives and foreign access, and capital requirements.

US moved 'faster and harder'

The one, overarching concern that animated the US' position throughout the TTIP negotiations was therefore to maintain any improvements to the stability of its domestic financial system. This overarching concern had played out in two important ways prior to the TTIP negotiations: one was that efforts to shore up US financial stability framed efforts to reduce the liability to the US system of foreign-owned banks. This concern also animated the extra-territoriality clauses of various pieces of EU legislation. But the US went further in this area, as we will show in the case of third-country provisions and derivatives. The other way in which the aim of improving domestic financial stability played out was in the implementation of Basel III capital requirements. Unlike its more agnostic stance in relation to Basel II, the US aggressively applied a stringent version of Basel III. The fact that the EU was then widely recognized to have watered down its implementation of the new Basel accord in response to industry lobbying only fuelled the US' resolve not to allow regulatory coordination to be included in TTIP. Opposition from US authorities therefore stemmed primarily from a reticence to re-open the Dodd-Frank act to negotiation. "'Our view', indicated the US trade representative, 'is that there is

nothing that we should do, or are going to do through TTIP, that would weaken Dodd-Frank'".[41] Simply, the US authorities believed that the EU was a more porous regulatory environment, and that too firm a commitment to regulatory coordination would result in a weakening of new US standards (see Young, *this issue*).

Before we turn to these two examples though – third country provisions and Basel III – we begin by highlighting that it was not simply that the US had moved harder and faster in all areas that fuelled the finance exception. It was also the case that the US and EU had simply pursued uncoordinated approaches to post-crisis re-regulation. In these areas it was not that any one approach was tougher or 'superequivalent'. These approaches simply reflected important differences in regulatory culture and structure of the domestic banking systems within the two blocs. But, just as these divergent approaches prompted financial firms to lobby for greater coordination, so the very existence of this divergence further set US and EU authorities at odds in a way that fuelled mutual mistrust.

Throughout the negotiation process the EU Commission was at pains to emphasize that 'both the EU and the US are similarly advanced in overhauling financial regulation in response to the crisis and are implementing the same set of standards'.[42] At least at face value the claim appeared valid. Table 4 shows the G-20 follow-up legislation in the US and the EU. In essence, both blocs had strengthened their regulatory and supervisory frameworks in response to the financial crisis and had incorporated G20 recommendations into their respective federal legal regimes.

Table 4: Overview of US & EU implementation of G20 agenda

SUBJECT	Dodd-Frank (US)	EU
Credit-rating agencies	Upgrade of NRSRO regime	Credit Rating Agencies Regulation
Hedge Funds	Title IV, amending 1940 Investment Advisors Act	Alternative Investment Fund Managers Directive (AIFMD)
OTC Derivatives	Title VII mandates central clearing and exchange trading of most OTC derivatives	Similar rules in EU Market Infrstructure Regulation (EMIR)
Price transparency of bonds, derivatives, commodities	(Idem)	Rules in draft MiFID II and MiFIR
Short-selling	-	Short-selling regulation
Basel III	Consultation on implementation ongoing	Implemented in CRD II, III, IV

Bank structure	Volcker rules	Liikaanen report, Vickers, member state rules
Bank tax	(Initially proposed, but scrapped)	Financial transaction tax (FTT) in individual member states and through ‘enhanced cooperation’
Remuneration rules	(Enhanced disclosure)	CRD III and IV, AIFMD, CRA 1
Bank resolution	Broader powers for the FDIC through the Orderly Liquidation Authority	Recovery and Resolution Directive (RRD), Single Resolution Mechanism
Institutional aspects	Financial Services Oversight Council (FSOC), Enhanced powers for the Federal Reserve, Consumer Financial Protection Bureau (CFPB), Federal Insurance Office	European Systemic Risk Board (ESRB), European Supervisory Authorities (ESAs), Single Supervisory Mechanism (SSM)

(adapted from Lanoo 2013: 4)

Yet the way in which each bloc had pursued re-regulation was almost entirely uncoordinated. As noted above, both the US and the EU took their lead from the G20 agenda on financial regulatory and supervisory reform. The G20 set the target date of the end of 2012 for all members to have implemented their response to the global financial crisis. In the US, the response focused on one piece of legislation - the Dodd-Frank Act. In the EU, multiple pieces of supranational legislation and often competing national reforms slowly emerged. The divergent approaches pursued by the two blocs are particularly apparent in four main areas, related to bank taxation; bank structure; remuneration rules; and short-selling.[43]

In the area of *bank taxation*, the US proposed a bank balance sheet tax which was subsequently withdrawn during the drafting of Dodd-Frank. In the EU however, under the enhanced cooperation initiative 11 member states have agreed to implement a transaction tax of 0.1% on the value of secondary market equity and bond transactions, and 0.01% on derivatives. In the area of *bank structure* the Volcker rule, limiting proprietary trading, came into effect in July 2012. This was a particularly tough rule which effectively prohibited banks from engaging in an extensive list of activities that could be classified as trading on their own account and solely for profit. In Europe however, the EU Commission has struggled to introduce a separation of higher risk trading activities, in part because of the range of divergent or weaker national reforms introduced in the UK, France, and Germany.[44] In relation to remuneration, new rules have been established in the EU under the various Capital Requirements Directives. No

such rules have been introduced in the US though. Finally, in the area of *short-selling* the EU regulation was introduced to cover the range and diversity of practices within Europe. It prohibits uncovered short sales in shares and sovereign debt securities. The US is less strict on uncovered short sales, but gives more discretion to the Securities and Exchange Commission (SEC) in handling them. In sum, in these four areas the issue was not so much which approach was tougher, it was simply that they were different – and these differences were unattractive to many of the larger firms. The costs associated with this divergence were a cause of concern to the banking industry, just as the divergence prompted US and EU authorities to defend their respective arrangements at the expense of enhanced coordination.

These divergent approaches alone are not however sufficient explanation for the finance exception in TTIP. If they had been, it would seem rather odd that the EU had pressed so hard for financial services coordination to be included in the negotiations. Instead, what we need is an explanation for the US' fears that Dodd-Frank would be watered down and that the EU was a more porous lobbying venue. These two elements are best explained by looking at third country provisions and derivatives, and capital adequacy requirements.

Derivatives and foreign access

As noted above, the overarching aim of improving the stability of the domestic financial system led the US to reduce its potential liability to costs associated with foreign institutions. This approach influenced the US' regulation of derivatives. The September 2009 G20 summit made a commitment to improve the transparency and safety of derivatives markets. The Summit Declaration stated, 'all standardized OTC derivatives should be traded on exchanges…cleared through central counterparties…and reported to trade repositories'.[45] In the US, Title VII of the Dodd-Frank act and in the EU the European Markets Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Directive 2 (MiFID 2), sought to apply these principles. Though the EU was the first of the two blocs to announce its intention to regulate OTC derivatives in 2009 the US moved further and faster than EU authorities in this area.

There were clear difficulties for foreign firms simply by virtue of the inconsistent approaches employed by the two blocs. These differences are apparent in the target groups (in the US: all market participants, whilst in the EU: non-financial entities are only included above certain thresholds); the product categories covered by the rules; the applicable disclosure requirements; and the obligations incumbent on central trading platforms and counterparties.[46] Yet there was also evidence that the US pursued a particularly stringent approach in its treatment of non-domestic financial infrastructures. An especially noticeable example was that non-US banks trading with US counterparties are now required to register as swap dealers and operate according to rules set by the CTFC on capital requirements and risk management. This provoked an immediate response from non-US swap dealers who argued that the legal costs of such a requirement

would essentially act as a major disincentive to dealing with US counterparts.[47]

The US' approach to foreign firms in the area of derivatives was also reproduced in other post-crisis reforms. One of these areas related to the treatment of subsidiaries of foreign banks operating in the US. This is because, from a European perspective, 'draft US rules on Foreign Banking Organisations…do not recognise non-US prudential rules [and therefore] they discriminate against non-US banks'.[48] One notable example has been the capital and regulatory requirements applied to non-US banks. In February 2014, the US introduced particularly controversial additional requirements on foreign banks which, if conducting US-based non-branch banking operations with total assets of $50billion are required to set up an Intermediate Holding Company. The implication is that these holding companies would be forced to meet specific capital, regulatory and liquidity requirements that would involve restructuring their US operations. In effect these criteria could require much larger amounts of capital and liquidity to be held in the US than would otherwise be necessary to comply with global financial or regulatory rules.[49] In a sense this was an attempt to 'ring-fence' foreign banks' American operations, rather than allowing them to rely on their parent banks' buffers.[50] According to one senior banker though, this American rule 'lets loose the dogs of protectionism, of Balkanisation'.[51]

The banks that would be most exposed to the American rule would be Deutsche Bank, Credit Suisse, Barclays, UBS, HSBC, BNP Paribas, and RBS. The extent of their exposure largely depends on the percentage of their assets held in one of their American subsidiaries. This figure ranges from thirty-eight percent (Deutsche Bank) down to nine percent (RBS).[52] The Dodd-Frank Act had earlier required foreign-owned bank holding companies to meet the same capital requirements as their American-owned peers. In response to this earlier measure Barclays and Deutsche Bank had shifted their big American operations out of their holding companies and into more lightly regulated structures. The new Intermediate Holding Company rule was therefore the US authorities' attempt to close this kind of loophole.[53] Simply, due to 'efforts by a small number of very large foreign banks to evade the intent of Congress that capital standards apply to their U.S. Operations', the US authorities felt the need 'to create this structural requirement'.[54]

In sum, the new US requirements placed on foreign banks were motivated by a suspicion that foreign governments of large international firms would not necessarily be able to provide a sufficiently robust backstop to their banks' operations in the US. As Daniel Tarullo, Federal Reserve governor, suggested 'We have to recognize that notwithstanding all the international cooperation…we do retain the responsibility to maintain the U.S. financial system, as do our brethren in jurisdictions around the world maintain their responsibilities for their own'.[55] The result however, in keeping with the big theme of this article concerning the breakdown in trust and coordination between EU and US regulatory, was what EU authorities perceived to be 'discriminatory measures which would have the effect of treating European banks worse than U.S. Ones'.[56] As we will

show in the coming sections however, this was not simply a protectionist response targeted at foreign banks. The US authorities displayed an equally hostile approach to its own domestic banks in its bid to improve domestic financial stability. And it was the defense of this tougher approach that framed the US' suspicions about including financial regulatory coordination in TTIP.

Capital requirements & weakening of EU position

The fact that the US authorities adopted an equally tough approach to their own domestic banks is perhaps best demonstrated in the application of Basel III capital requirements. Further, it was the weaker implementation of Basel III by the EU that gave rise to the US' concerns about the EU being more susceptible to industry lobbying. The new Basel III capital rules have considerably raised the capital requirements applicable in both the EU and the US. Under the new requirements the loss- absorbing Tier 1 capital ratio must be raised from 4% to 6% and, below that, Core Tier 1 capital has to be increased from 2% to 4.5%.[57] All banks will also be required to hold a capital conservation buffer of common equity amounting to 2.5 percentage points as a countercyclical capital cushion. On top of that, a capital surcharge of between 1 and 3.5 percentage points is being introduced for global systemically important banks (G-SIBs).[58]

Yet there were important differences in the implementation of the Basel rules, particularly as a result of industry lobbying in the EU. In the US, the Basel III rules constitute the most comprehensive overhaul of US bank capital standards in over two decades. The final rule was approved in July 2013 by the three US banking regulators: the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC). Part of what was particularly controversial about the US' approach was that the Federal Reserve proposed to apply Basel III and other enhanced prudential standards to any intermediate holding company (IHC) that a large foreign banking organization would be required to establish for its US banking and non-banking subsidiaries. But the US Basel III rule also applies to the entire US banking sector, from community banks to regional banks, to the largest US SIFIs. Put simply, the Federal Reserve decided to implement capital requirements that were substantively stricter than under Basel norms.[59] What was equally important – for the purposes of our argument here – is that whilst the community and midsize banks won certain concessions through their lobbying efforts, the largest banks were largely unsuccessful in softening the proposal and, in fact, face additional requirements.[60] When delivering the reforms for example, Governor Dan Tarullo noted that whilst the Basel Rule would mark the end of major capital reforms for 'the vast majority of banks', the eight US Globally Systemically Important Banks would face additional capital initiatives. These would involve a supplemental leverage ratio above the Basel III minimum; another proposal concerning the amount of equity and long-term bail-in debt these firms should maintain; and a further potential rule to consider possible approaches to calculating

additional requirements for firms which rely heavily on wholesale funding. As the Fed explained, though the 'proposed rule [was] generally consistent with the Basel Committee's standard…it [was] more stringent in several areas'.[61]

In contrast, in the EU there was clear evidence that the Basel III rules had been diluted, and largely in response to the lobbying efforts of European banks (Howarth & Quaglia, *this issue*). When the Basel Committee published its reports on compliance of rules in December 2014 it stated that the EU was 'materially non-compliant with the minimum standards prescribed under the Basel framework' whereas the US was 'largely compliant' and all other jurisdictions reviewed were 'compliant'.[62] In other words, the EU was perceived to be a 'global laggard'.[63] In the EU's case, two areas were highlighted by the Basel Committee. The first was that the Capital Requirements Regulation allows for certain exemptions from capital requirements for credit valuation adjustment (CVA) risk and the second was the possibility to permanently exempt certain exposures from internal ratings based approaches .[64]

But the Basel report also flagged areas of deviation in the EU's 'definition of capital and calculation of minimum capital requirements' which revealed concessions made to French and German banking groups. In relation to large French banks, the treatment of insurance subsidiaries was flagged; whilst German banks had gained concessions in the area of capital for cooperative banks.[65] In relation to the earlier Basel III negotiation process French authorities had opposed the implementation of the rules with regard to banks with insurance companies, which would have particularly affected Societe Generale and Credit Agricole.[66] German authorities had also joined their French counterparts in pushing back the deadline to disclose leverage ratios and on efforts to phase out hybrid forms of capital that were important to German public banks.[67] A Franco-German statement argued that the stringency of Basel rules would harm lending capacity and harm the real economy.[68]

Essentially, private sector arguments that stringent capital requirements would slow economic recovery resonated with national and European authorities – particularly given the struggles the Eurozone was experiencing in restoring economic growth. The result was that in both the final Basel III rules and, more particularly, in the final EU Capital Requirements Directive and Regulation the continental European bank lobby succeeded in achieving certain concessions. Although the new Basel accord included an effective tier one capital requirement of 7 per cent of risk-weighted assets, its phase-in was pushed back to last until 2018.[69] Yet the precarious economic situation led European authorities to be especially accommodating to demands from their private sector actors, particularly in relation to the leverage ratio, which would only be 'tested' until 2017. This was clearly related to demands from the German and French banks, which were simply incapable of meeting more stringent requirements.[70]

In sum, the experience of the implementation of Basel III capital requirements was particularly important for US authorities. It fundamentally shaped their conclusion that

the EU was more porous and susceptible to private sector lobbying. This perception was supported by certain hard facts such as the reality that new capital requirements were substantively lower in the EU than in the US. Whereas a key minimum common equity capital or leverage ratio had been made binding in the US, this was not the case in the EU law; and the leverage ratios of large euro-area banks tended to be 1% lower than those of their US peers.[71] These considerations were an important factor shaping the lack of trust US authorities placed in including financial regulation in TTIP.

Venue-shopping

In this fourth and final section of the article we present evidence of venue-shopping by the largest financial firms. In short, the divergent approaches have raised three big issues: that of market access to the respective host bloc; that of the cost-burden of duplicative regulatory requirements; and that in the all-important details of many of these regulatory initiatives the US has pursued a different (and arguably tougher) approach than European regulators. The result has been that financial services firms have invested a lot of resources in lobbying to have finance included in the TTIP negotiations. According to data from the Corporate Europe Observatory, of the 32 sectors that lobbied the EU Commission up until July 2014, financial firms were the 7th most active.[72] More important however, is the evidence that EU negotiators' consistent pressure to have financial services included in TTIP stemmed in large part from the lobbying of *both* European *and* US banks at the European level. Put simply, EU firms have been particularly concerned about market access issues arising from tougher US requirements; whilst US firms have been primarily concerned about the cost-burden associated with duplicative regulatory requirements. Regulatory divergence however, of which the finance exception in TTIP is just one example, has therefore created openings for firm lobbying and regulatory arbitrage.

Evidence of the lobbying activity of European banks and financial trade associations to have regulatory cooperation and market access issues included in the scope of the TTIP negotiations is abundant.[73] From continental Europe the main proponents of this inclusion have been the largest banks with the highest exposure to the US market, and therefore the most to lose. Deutsche Bank is perhaps the most obvious example. Its higher leverage ratio, greater reliance on short-term borrowing for its US operations, and higher reliance on proprietary mathematical models to reduce risk-weighted assets were particularly susceptible to the changes in the US regulatory regime outlined in the second section of this paper.[74] There is also however, extensive evidence of British firms and the City of London lobbying both domestic and European authorities to have finance included in TTIP.[75]

Evidence of efforts by US firms to have financial services included in TTIP begins with their concerns with the expansive and stringent scope of their own new, domestic regulatory regime. In December 2013 for example, the International Swaps and

Derivatives Association (ISDA), the Securities Industry and Financial Markets Association (SIFMA), and the Institute of International Bankers launched a lawsuit against the US Commodity Futures and Trading Commision (CTFC).[76] The trade associations claimed that 'in the guise of "guidance,"…[the CTFC had promulgated] an expansive new body of regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") that seeks to extend the CFTC's authority and requirements across the globe'. As a result, the financial associations indicated that this 'flawed attempt' would 'harm investors, impair US and foreign businesses, impose inconsistent, duplicative requirements on firms that are regulated by other nations'.[77] In turn they claimed that the attempt 'exceeded the CTFC's lawful authority' (ibid.) and risked imposing 'a series of rules that are contrary to the spirit and the letter of international cooperation and may harm global markets'.[78] As noted above in relation to derivatives clauses included in Title VII of the Dodd-Frank Act, this was precisely the kind of expansive and stringent activity which industry had feared would occur as a result of new powers afforded US authorities in the text of Dodd-Frank. The extraterritorial effect of post-crisis US regulation was not simply an issue for foreign firms but also for domestic firms.[79]

For these financial trade associations the fact that policymakers appeared to have made a commitment to pursue commensurable regulatory changes in the area of OTC derivatives was sufficient grounds to challenge the isolationist stance taken by the CTFC. In their position paper they cited the CTFC—EC joint statement of July 11th 2013. They noted that in a document entitled 'Path Forward', the authorities had explicitly emphasized that since these markets were international, and not withstanding the high degree of similarity in emerging regulatory requirements on both sides of the Atlantic, 'without coordination, subjecting the global market to the simultaneous application of each other's requirements could lead to conflicts of law, inconsistencies, and legal uncertainty'.[80] Indeed, the EU Commission had stated that it was 'very surprised by the latest CTFC rules which seem…to go against both the letter and spirit of the path forward agreement'.[81]

Yet there is also clear evidence that US firms have massively increased the sums they spend on lobbying in Europe. Under new EU disclosure rules for example, Goldman Sachs revealed that it had spent between €700,000-€790,000 on lobbying in Brussels in 2014, compared to an estimated €50,000 in 2013.[82] This was the largest increase among the US firms. Yet other firms reported even larger amounts spent on lobbying in Brussels, the difference being that these amounts were more consistent with spending in previous years: JPMorgan Chase estimated that it had spent between €1.3-€1.5million in 2014; and the International Swaps and Derivatives Association estimated that Brussels lobbying activities had cost them €2.5-€3million in 2014.[83] Though these figures are still significantly less than the comparable amounts these same firms spend on lobbying their (domestic) US authorities, they point to the increased importance US firms are placing on representing their interest in the EU reform process.[84] In sum, our claim in this section is

that unpredictable and stringent behaviour of the US authorities, coupled with the more cooperative stance of the EU authorities, provided the necessary opening for US firms to (also) direct their lobbying efforts at the EU.[85]

Conclusions

This paper has argued that financial services had been systematically excluded from the TTIP negotiations due to US opposition. This US opposition stemmed from a belief that they had moved *faster* and *harder* in their post-crisis response than the EU authorities; and that US authorities feared that the EU was a more porous regulatory environment and thus more susceptible to large private sector lobbying. The US decision to move harder and faster was motivated by domestic financial stability concerns. It gave rise to both a tougher treatment of their respective domestic firms as well as a tightening of market access and tougher requirements placed on foreign firms.[86] In an odd way, however, this isolationist policy has unwound a pattern of regulatory convergence that was the hallmark of the 2000s without eliminating the large trans-Atlantic financial institutions that grew up in the same period.[87] The U.S. Treasury seeks to return to a more isolationist regulatory posture and yet the institutions it must regulate have a more global outlook. Now those financial institutions are looking to enlist support abroad in their efforts to restart trans-Atlantic coordination. And they are pushing on an open door in Europe. This is not to say that there is truth in the concern among Treasury officials that European regulators are more porous; it would be enough if European regulators and trans-Atlantic financial firms found a common interest in regulatory convergence. The Treasury and the SEC may hold out against the inclusion of finance in TTIP, but it will have a hard time reasserting the primacy of American financial regulation in the same way it could in the 1980s and 1990s.

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