Financial Industry Lobbying and the UK Banking Reform Process

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UK banking reform:
Preliminary findings

Part 1. How did industry lobby?

Part 2. How can we explain banking reform?

Part 1.
Explaining the lobbying network

Effective lobbying requires organisations to engage in **collective action**

Organisational ties established to inform, persuade or **collaborate** with others in pursuit of policy goals

Networks serve as a conduit for the targeted **transfer of valuable resources** (information)

Relational environment shapes opportunities and constraints for political action

Power not just an attribute of agency but a function of **structural relationships** (Knoke *et al* 1996)

Methodology

Analysis of the inter-organisational lobbying network surrounding the Independent Commission on Banking (2010-2011)

Social Network Analysis used to map organisational ties

Survey questionnaire and interviews with 26 most prominent organisations

- Information transfer (directed ties)
- Reputational leadership (1-5 scale)
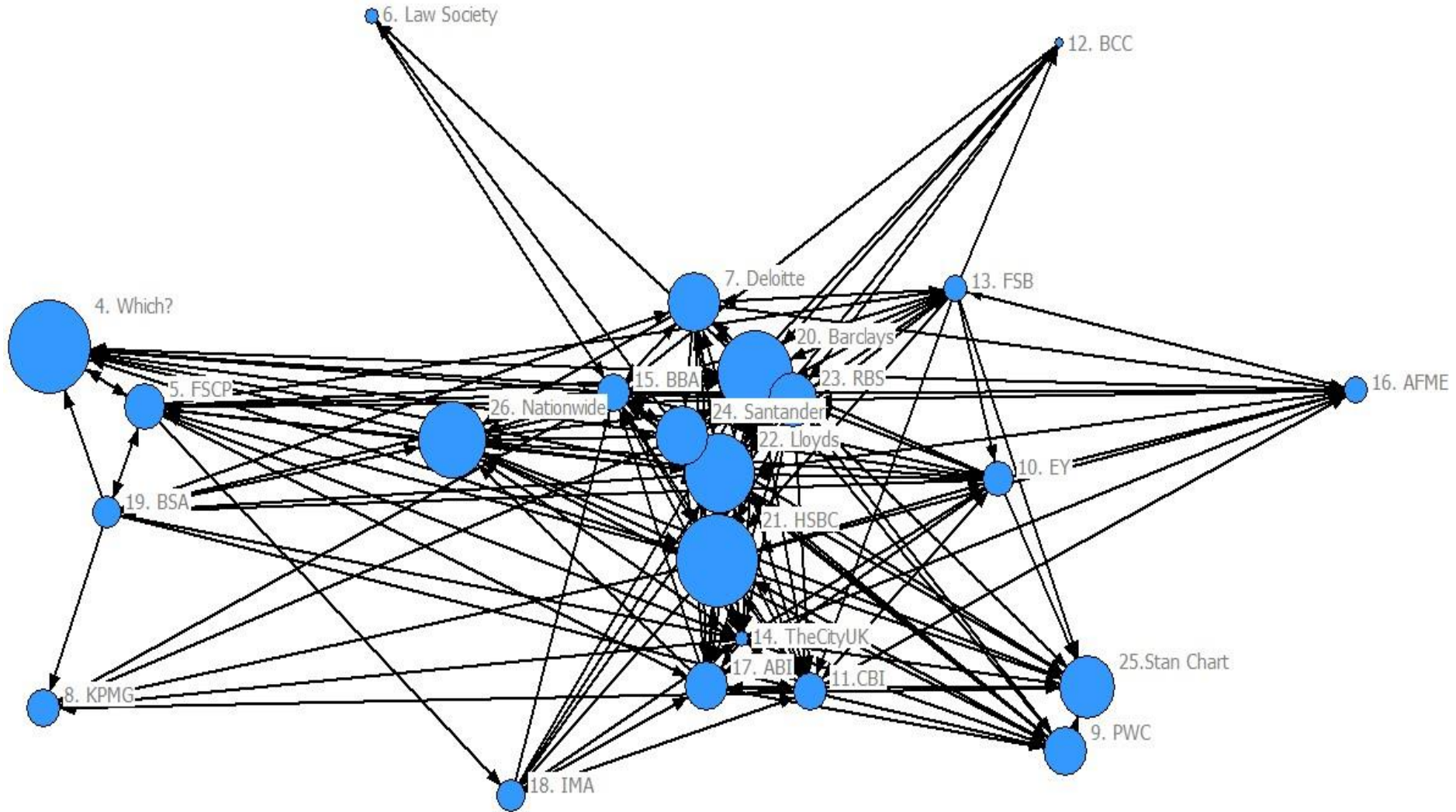- Preferences on banking reform (1-5 scale)

TABLE 1 *Centrality measures*

|	outdegree	indegree	Between
1. Bank of England	9	20	5.41535
2. Financial Services Authority (FSA)	20	20	34.69932
3. HM Treasury	25	24	70.4099
4. Which?	8	11	1.26369
5. Financial Services Consumer Panel (FSCP)	14	9	5.074405
6. The Law Society	4	4	0
7. Deloitte	13	9	4.50202
8. KPMG	0	7	0
9. Pricewaterhouse Coopers (PwC)	11	8	0.373449
10. Ernst and Young	16	9	2.72206
11.Confederation of British Industry (CBI)	17	16	12.39856
12. British Chambers of Commerce (BCC)	5	4	0
13. Federation of Small Businesses (FSB)	15	6	2.810191
14. TheCityUK	19	16	12.54165
15. British Bankers' Association (BBA)	20	22	34.41784
16. Association for Financial Markets in Europe (AFME)	11	12	2.859361
17. Association of British Insurers (ABI)	13	11	3.311021
18. Investment Management Association (IMA)	10	5	0.254762
19. Building Societies Association (BSA)	11	6	1.881151
20. Barclays	10	21	12.37173
21. HSBC	21	18	20.42578
22. Lloyds	18	20	26.0434
23. Royal Bank of Scotland (RBS)	15	20	12.69955
24. Santander UK	16	14	13.24273
25. Standard Chartered	4	15	1.456584
26. Nationwide	14	12	4.825505

UK banking reform network weighted by betweenness centrality
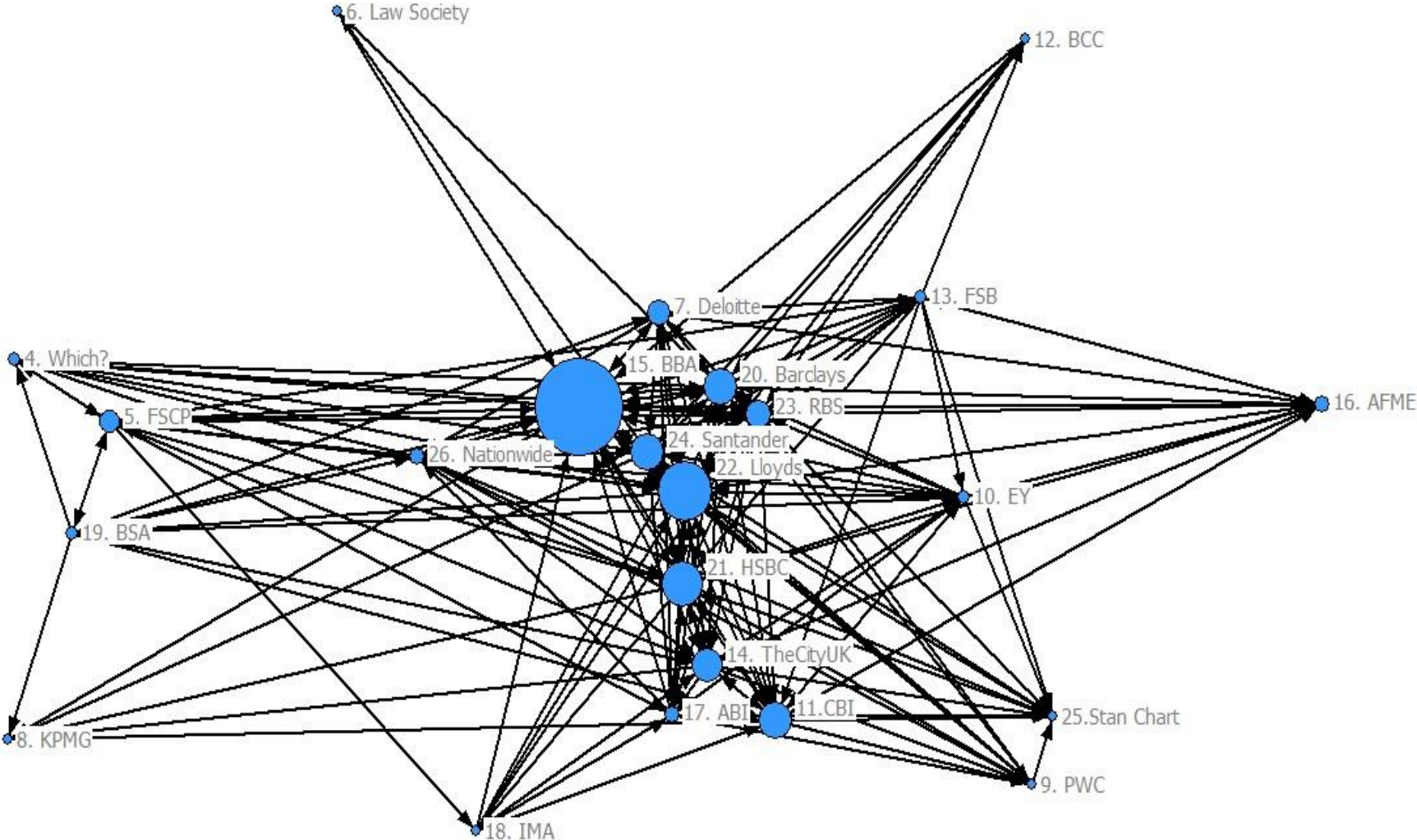
UK banking reform network weighted by reputational leadership

UK banking reform network weighted by regulatory preferences
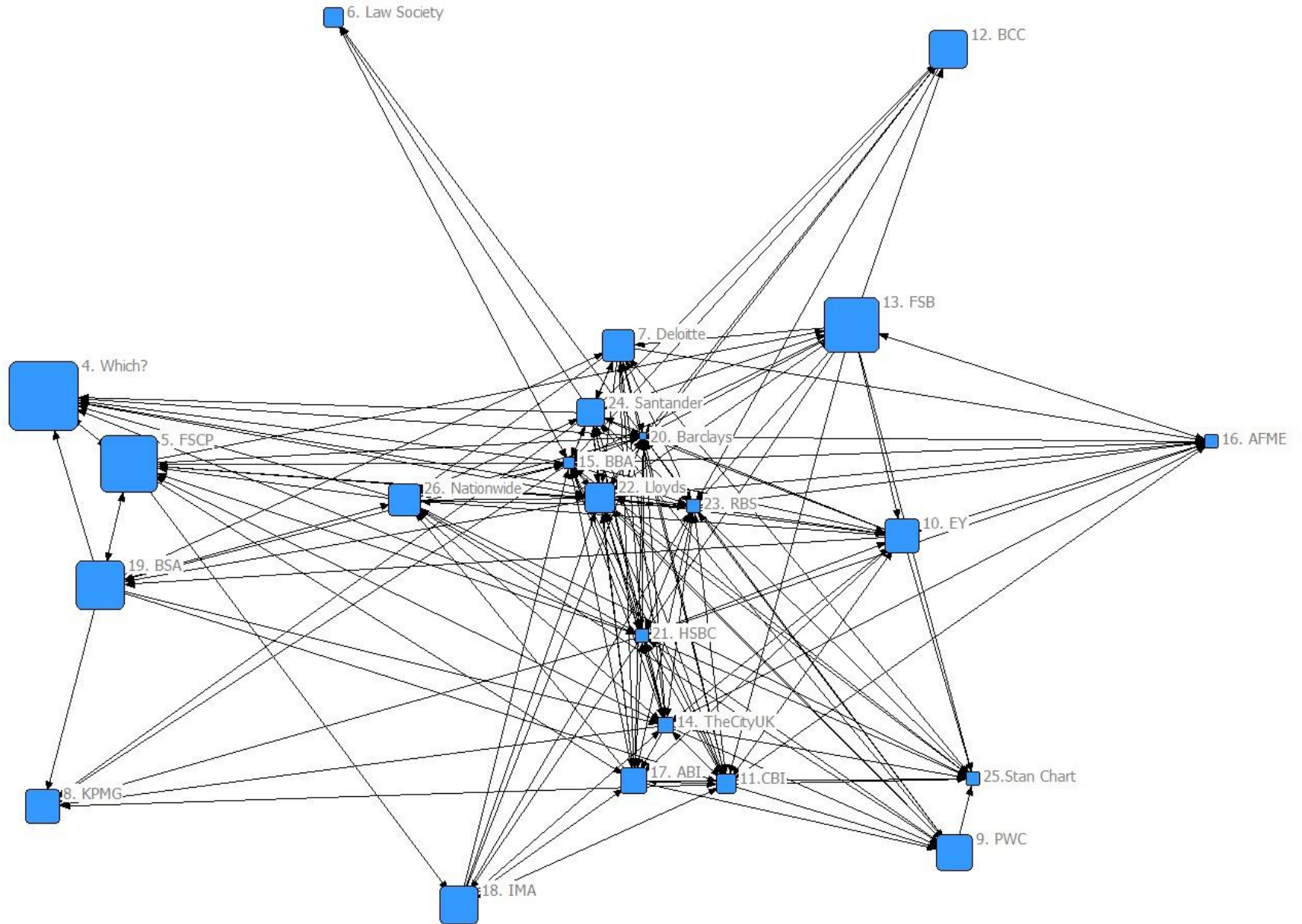
Explaining lobbying collaboration

Trade associations

- BBA and TheCityUK highly central given brokerage role
- Hostile to ringfencing; but low leadership (due to scandals and competing interests)
- CBI high centrality and leadership: highly critical of impact on economy and pushed for delayed implementation
- Limited business collaboration: preference divergence between large manufacturing (CBI) and SME sector (BCC and FSB)

Consumer groups

- *Which?* scores highly for leadership due to prominent role through Future of Banking Commission
- But low centrality as consumer issues marginalised and perceived to be outlier on reform

Banks

Preference divergence
- Barclays, HSBC and RBS most hostile to reform due to impact
- Nationwide viewed it as opportunity to level the playing field
- Santander and Lloyds supportive for strategic reasons

Relational differences
- High centrality (Lloyds, HSBC), moderate centrality (Santander, Barclays, RBS), low centrality (Standard Chartered and Nationwide)
- RBS and Lloyds lacked political capital so leveraged influence through alliances
- HSBC and Barclays high for leadership as ran assertive lobbying campaigns
- HSBC built quiet alliances, but Barclays became public face of opposition

Explaining organisational centrality

Exponential Random Graph Model (ERGM) tests three hypotheses on network structure:

1.   Reputational leadership
2.   Preference similarity
3.   Perceived utility loss
4.   Organisational type (control)

Can test for sender and receiver effects

ERGM results

Estimation results
NOTE: t-statistics = (observation - sample mean)/standard error
NOTE: SACF (sample autocorrelation)

Effects	Lambda	Parameter	Stderr	t-ratio	SACF	
ArcA	2.0000	-7.4089	0.902	-0.004	0.127	*
ReciprocityA	2.0000	1.2591	0.323	-0.035	0.136	*
ATA-T	2.0000	0.9875	0.425	-0.005	0.094	*
ATA-C	2.0000	0.1549	0.270	-0.048	0.195	
ATA-D	2.0000	0.7608	0.349	-0.009	0.097	*
ATA-U	2.0000	-0.6860	0.291	-0.048	0.168	*
LEADERSHIP_SenderA	2.0000	-0.1767	0.179	-0.014	0.102	
LEADERSHIP_ReceiverA	2.0000	1.5071	0.301	-0.010	0.117	*
UTILITY LOSS_SenderA	2.0000	0.1853	0.122	0.094	0.328	
UTILITY LOSS_ReceiverA	2.0000	-1.0283	0.172	0.014	0.059	*
ORG TYPE_MatchA	2.0000	0.0642	0.211	-0.011	0.065	
Dissimilarity_ArcA	2.0000	-0.0733	0.097	0.033	0.185	

Organisational type is <u>not significant</u>

Leadership (of receiver) is <u>significant and positive</u>
- Organisations try to leverage influence by collaborating with powerful others; powerful organisations have no need to collaborate

Preference similarity (of sender/receiver) is <u>not significant</u>
- No evidence that organisations prefer to collaborate with others that are 'like-minded'

Utility loss (of receiver) is <u>significant and negative</u>
- Organisations try to leverage influence by collaborating with perceived 'winners' from reform, but shun 'losers'

Part 2.
Explaining the outcome of banking reform

How can we explain industry influence?

Business Power

Instrumental power
- Collective action (Olson)
- Regulatory capture (Stigler, Carpenter)

Structural power
- Government dependency (Lindblom, Block)

- Mediating role of issue salience (Culpepper)
- Ignores role of politics and institutions

The Game of Bank Bargains

(Calomiris and Huber, *Fragile by Design*, 2014)

Banking systems are implicit **partnerships** between governments and private actors

The Game operates according to the **logic of politics**, not efficiency

Governs **entry and competition**, the **pricing of credit**, and **allocation of losses**

Who is in the partnership **varies across countries** and **within countries over time**

Countries do not 'choose' their banking systems; they get the banking system that their **political institutions** will permit

Renegotiating the
British Game of Bank Bargains

Actor-centered institutionalism (Scharpf 1997)

- Players (industry v's regulators)
- Preferences (divergence)
- Modes of interaction (non-cooperative)

Banking reform as three-stage game:
Game 1. ICB
Game 2. White Paper
Game 3. PCBS

Variable instrumental power

Game 1 (ICB)
- Industry influence weakened as commission-inquiry format empowers non-financial groups

= Ringfencing

Game 2 (White Paper)
- Industry influence greater as gain structural advantage from informal networks and information asymmetry

= Bank-specific bargains

Game 3 (PCBS)
- Public hearings and scandals enhances legislative and bureaucratic power

= 'Electrification'

Variable structural power

- Collective action problems force regulators to strike bargains with individual banks

- Banks with power to defect (not bailed-out, large overseas operations) able to secure better bargains

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o De minimis exemption: granted from ringfencing for banks with core deposits under £25bn (BBA)
o Leverage ratio: initially reduced from 4% to 3% in line with Basel 3 rules (Nationwide, Barclays)
o Exemption for overseas assets excluded from Primary Loss Absorbing Capital requirements (HSBC, Standard Chartered, Barclays)
o Exclusion of private banking (Standard Chartered)
o Sale of simple derivatives: banks able to undertake simple interest rate and currency swap trading within the ringfence (HSBC, Barclays, Santander)
o Banks avoid further forced sales of branches and full competition inquiry in return for 7-day account switching service (Lloyds)

Conclusion

- 'Winners' or 'losers' irrelevant: iterated process of negotiation

- UK banking reform is the outcome of a game of bank-specific bargains

- The product of political institutions which mediate industry influence

- Banking reform is a *choice*: but different regulatory outcomes require different institutions and processes