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European Union Financial Regulation, Banking Union, Capital Markets Union and the UK.

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Introduction

The European Union (EU) undertook major reforms of its economic and financial governance framework after the international financial crisis and the sovereign debt crisis (for an overview, see *Journal of Common Market Studies* 2009; *Review of International Political Economy* 2015; and *Journal of European Public Policy* 2015). Three financial policy areas stand out: financial regulation, which was significantly revised in the wake of the international financial crisis; Banking Union (BU), which was the EU (to be precise, the euro area)'s response to the sovereign debt crisis; and Capital Markets Union (CMU), which was the EU's attempt to revamp financial activities and the real economy after two consecutive crises. These reforms were complex and intertwined. They built on the existing EU framework, notably the Single Financial Market in the case of financial regulation and CMU. The reforms enacted also substantially modified the existing framework, as in the case of BU, which was designed to complete Economic and Monetary Union (EMU).

This paper examines the dynamics of EU reforms in these policy areas by focusing on the preferences and influence of the United Kingdom (UK). The UK has often been considered as an 'awkward partner' in the EU. Stephen George's classic book, *An Awkward Partner: Britain in the European Community* (1990), points out the troubled relationship of the UK with the process of European integration since its inception. This paper argues that this view is somewhat unwarranted, especially in the case of financial policies. In these policies the UK has been a foot-dragger, a fence-sitter and a pace-setter, depending on the circumstances. The paper does not discuss in-depth the (often complex) intra-EU negotiations in these policy areas. At the same time, the domestic politics and political economy of these issues in the UK are not investigated in details. The aim of the paper is to explore how the EU policy-process and the domestic arena in the UK interacted and with what outcome. The material is organised as follows. Section 2 discusses some concepts that can be useful in order to examine the preferences and the influence of the member states in the EU policy-process. The empirical sections follow by and large a chronological order, discussing EU financial regulation first (Section 3), then BU (Section 4) and finally CMU (Section 5).

Member states in the EU policy process

This section discusses some concepts that are useful in order to examine the role of the member states in the EU policy process. It first outlines a typology of roles and then examines the domestic process of national preference formation and the sources of influence for the member states in the EU.

A typology of roles

In her seminal work, Boerzel (2002) distinguishes three roles that member states can perform in the EU policy process: foot-draggers, fence-sitters and pace-setters. Foot-dragging takes place when a member state seeks to block, delay or substantially water down a policy measure at the EU level because it does not reflect the preferences of that member state. Foot-dragging comes in two shades: opposition to the EU policy measure *tout court*; and partial foot-dragging by seeking to substantially reshape the proposed EU measure. Partial foot-dragging is something that goes beyond the traditional processes of negotiation whereby member states seek, for example, to fine-tune specific provisions of EU legislation. The foot-draggers are sometimes 'late-movers' if they do not have domestic templates already in place in given policy areas, as in the case of Southern European countries and environmental policy (Boerzel 2002). Post financial-crisis, the UK was at times a foot-dragger in the reform of EU financial regulation, albeit in different ways, sometimes calling for stricter EU regulation, other times calling for less strict EU rules, as elaborated in Section 3. In other cases the UK was a foot-dragger *tout court*, seeking to prevent the enactment of an EU measure, as in the case of the Financial Transaction Tax (Gabor 2015; Wasserfallen 2014), which, however, was controversial also for other member states.

Fence-sitting coincides with passive policy-taking, rather than active policy-making. It takes place if a member state does not have strong preferences on the EU measure under discussion or does not have the capacity to engage substantially in negotiations. Hence, the fence-sitter can build tactical coalitions with pace-setters and foot-draggers (Boerzel 2002). Often fence-sitters adopt a 'wait and see approach'. The Nordic countries in EMU are examples of this dynamic. At the time of the Maastricht Treaty, the UK sought to block EMU (Dyson and Featherstone 1999): hence it was a foot-dragger, rather than a fence-sitter. Member states can also be 'constructive' fence-sitters by supporting in principle a given EU measure, but opt-outing (*de jure or de facto*) and letting the others go ahead, as in the case of the UK in BU, which is discussed in Section 4.

Pace-setting takes place when a member state actively pushes for a certain policy measure at the EU level in a way that reflects its preferences. It often presupposes the presence of domestic policy templates to upload (in which case, the pace-setter is also a 'first-mover') and the capacity to do so, which in turn is based on the resources that a member state can mobilise. Typical examples of pace-setting are the Nordic countries and Germany in environmental policy (Borzel 2002); Germany in macroeconomic policies (Dyson 2000); and the UK in pre-crisis financial services regulation, especially the completion of the single financial market (Mügge 2010; Posner and Veron 2010, Quaglia 2010). Post-crisis, the UK was a pace-setter in the building-up of CMU, as elaborated in Section 4. Other examples of the UK's pace-setting role that are not examined in this paper due to space constraints are the UK's immediate response to the international financial crisis and the negotiations on the Transatlantic Trade and Investment Partnership (TTIP). In the midst of the financial crisis, the so-called 'British plan' provided a 'template' for the policy response of the EU and its member states (see Quaglia 2009). In external economic (trade) relations of the EU, the UK supported the Commission in the TTIP negotiations with a view to promoting the inclusion of financial services into the agreement (Jones and Macartney 2016).

It is noteworthy that the adoption of one of these roles by a member state varies over time: the 1980s and 1990s were the 'golden age' for the pace-setters on the Single Market and EMU (see Armstrong and Bulmer 1998; Egan 2001; Jabko 2006; Dyson and Featherstone 1999). There is variation across policy-areas: for example, the UK is more likely to be a pace-setter in areas related to the Single Market than, for example, in social policy, from which it temporarily opted out (Falkner

2003). There is also variation within a policy area: the UK was very supportive of CMU; it opposed certain pieces EU post-crisis financial legislation, such as hedge funds rules, but supported other measures, such as a new framework for bank resolution. The political party (or party coalition) in office only minimally affects these dynamics. For example, the UK was a Single Market pace-setter in the 1980s under the Conservative government (Moravcsik 1998), which was, however, a foot-dragger on EMU in the same period (Dyson and Featherstone 1999). In the 1990s, the UK was a pace-setter in the completion of the single financial market (Mügge 2010; Posner and Veron 2010; Quaglia 2010) under the Labour government. With a Conservative government, the UK was a pace-setter in the making of CMU and the TTIP negotiations (Quaglia et al 2016), a fence-sitter on BU (Howarth and Quaglia 2016) and a foot-dragger on certain pieces of EU financial services legislation (Pagliari 2013; Quaglia 2012; Woll 2013).

The domestic process of national preference formation

In order to explain why member states adopt one of the roles outlined above it is crucial to understand the domestic process of *national preference formation* with reference to specific EU policy areas. Domestic politics and domestic political economy interact in the formation of national preferences (e.g. Moravcsik 1997, 1998), which are the aggregated preferences of the public authorities and private actors at the domestic level. The preferences of the public authorities are affected by the economic and political costs of the proposed measure for their country and the lobbying efforts of specific interest groups in the domestic arena. National policy-makers might also be sensitive to the allocation of new powers to EU bodies, which might be a contested move in domestic politics, especially in some member states, such as the UK.

The preferences of interest groups depend of the expected economic costs and benefits of the proposed EU measure, particularly financial policies, which have clear-cut costs and benefits. The groups most affected by the measure are likely to mobilise the most, albeit subject to resource constraints (Mahoney 2007). Particularly important in the UK are the preferences of the financial sector, the City of London, given the large size of the financial sector in the national economy. Moreover, the financial industry has the economic and human resources to be an effective lobbyist (Baker 2010). The British financial industry follows closely and systematically contributes to the policy discussions on these matters at the national and EU levels. On the one hand, different part of the financial industry have sometimes different preferences (Pagliari and Young 2014) or certain issues are salient for some (e.g. hedge funds) but not for others (e.g. collective investment funds, on which see Woll 2013). On the other hand, one often speaks of the national financial 'system' (rather than just 'sector') because the various parts of the national financial industry are generally interlinked. Indeed, the literature on varieties of financial capitalism seeks to tease out typologies or common features of national financial systems (Allen and Gale 2000; Hardie and Howarth 2013).

The sources of member states influence

The influence of a member state in the EU is affected by a variety of sources: economic and political power (such as GDP, votes in the Council); the size of the specific sector under discussion; subject-specific expertise and general negotiating skills (for a review, see Bailer 2010). The UK is the third largest member state in the EU in terms of GDP. Under the current Qualified Majority Voting (QMV) rules in the Council, the four largest member states (Germany, France, the UK and Italy), together with any other EU member state, have sufficient votes to block any proposed piece of legislation. The UK financial sector is by far the largest in the EU and London is the largest financial centre in Europe and the second largest in the world. Given the size of the financial sector, the British authorities have considerable subject-specific expertise on matters related to finance. The influence of the UK in financial policies has been considerable, given the conspicuous resources it can mobilise.

The following empirical sections examine EU post-crisis financial regulation, BU and CMU, explaining the dynamics of the EU policy process with a particular focus on the preferences and influence of the UK, explaining why it was a foot-dragger, fence-sitter, and pace-setter depending on the circumstances (for an overview, see Table 1).

Table 1: Overview of the UK's roles in selected financial policies in the EU

Pace-setter	
Pre-Crisis	Financial Services Action Plan, most EU legislation (e.g. Solvency II, Lamfalussy directives in securities markets)
Post-Crisis	British (Brown) plan, CMU, TTIP (finance), some EU legislation (BRRD)
Fence-sitter	
Pre-Crisis	Stability and Growth Pact
Post-Crisis	BU, some EU legislation (e.g. EMIR)
Foot-dragger	
Pre-Crisis	EMU-TEU
Post-Crisis	Most EU legislation (e.g. AIFM, FTT)

Post-crisis EU financial regulation

A host of new financial legislation was issued by the EU in the aftermath of the international financial crisis. The main pieces of legislation formally adopted by the EU are listed in Table 1, which does not include the measures concerning BU, discussed in Section 4. The vast majority of these measures regulated activities or entities that were previously unregulated (or subject to self-regulation) in the EU and its member states such as credit rating agencies (CRAs); or at the EU level (such as hedge funds and bank resolution); or at the national, EU and international level (Over the Counter Derivatives (OTCDs)). In other instances, they imposed heavier, more prescriptive and more burdensome requirements on financial entities that were already regulated prior to the crisis, as in the case of higher capital requirements for banks and new liquidity management rules (the Capital Requirements Directive IV, CRD IV), or they set in place more substantial protection for depositors (the revised Deposit Guarantee Scheme Directive). Some of the post-crisis EU rules had potential protectionist effects due to the contentious provisions concerning the access of third-country entities or products to the EU market, for example in the legislation concerning credit rating agencies, hedge funds and OTCDs (Quaglia 2015). The reform of the financial services architecture following the de Larosière Report (2009) was designed to strengthen financial supervision at the EU level and to foster macro-prudential supervision in the EU (Buckley and Howarth 2011; Hennessy 2014).

By looking at the entirety of EU post-crisis legislation, the UK was often a foot-dragger, and less frequently a fence-sitter and a pace-setter. First, the UK was a foot-dragger concerning the legislation on hedge funds, rating agencies and the Financial Transaction Tax. These pieces of legislation were resisted by the UK on the ground that they would impose unnecessary costs, damaging the competitiveness of the financial industry in Europe and reducing the attractiveness of European financial centres as a result of regulatory arbitrage. The UK stressed that EU financial regulation should support the development of 'open, global markets' (Darling 2009). The concern about international 'regulatory arbitrage' has traditionally been at the forefront of policy-makers' minds in Britain, given the fact that London hosts many non-British-owned financial institutions and successfully competes with other financial centres worldwide to attract business (Quaglia 2010).

A combination of domestic politics and domestic political economy accounts for British preferences on the regulation of hedge funds, rating agencies and the Financial Transaction Tax. The UK hosts approximately 80% of all the EU hedge fund managers and several non-EU hedge funds operate in London. The main CRAs that are based in North America use their subsidiaries in London in order to issue ratings across the EU. Moreover, financial products traded in London have ratings issued within and without the EU. Hence, EU legislation on hedge funds and CRAs *de facto* mainly 'hit' the UK. Lord Myners, a UK Treasury minister in 2009, suggested that it was easy for other European countries to make political capital out of demanding 'intrusive regulation of an industry of which they have little or no direct experience' (*Financial Times*, 1 July 2009).

Similarly, the Financial Transaction Tax would be detrimental to international financial centers, such as the City of London and Wall Street, which mostly operate in the wholesale market (*Financial Times*, 23 September 2011; *Reuters*, 4 November 2011). Indeed, several reports (House of Lords 2012; London Economics 2014) indicated that up to 80% of the Financial Transaction Tax in the EU would be collected in the UK. Moreover, there was the possibility that part of the taxes collected in the UK would be transferred to the EU and/or shared with other EU countries that hosted firms party to financial transactions taking place in the UK (House of Lords 2012). The Chancellor of the Exchequer, George Osborne, went so far as to argue that the 'financial transaction tax is not a tax on banks or bankers; it is a tax on pensioners and people with savings and investments' (BBC, 20 April 2013). Eventually, the UK brought the case before the European Court of Justice, which dismissed the challenge as premature because the details of the tax had not been finalised (*Financial Times*, 6 May 2014).

Finally, the UK was a partial foot-dragger in the negotiation of the CRD IV legislative package designed to implement the Basel III accord in the EU by replacing the 'old' CRD III with a directive that governs the access to deposit-taking activities and a regulation that establishes prudential requirements for credit institutions. However, in this case, unlike those of CRAs and hedge funds, the UK authorities resisted EU rules because they were regarded as not strict enough and not in line with Basel III (for a discussion of the main differences between Basel III and the CRD IV, see Howarth and Quaglia 2013). Speaking at a meeting of the Economic and Finance ministers held to discuss the CRD IV, the British Treasury minister affirmed that 'we are not implementing the Basel agreement, as anyone who will look at this text will be able to tell you' (*Financial Times*, 2 May 2012). Indeed, the Basel Committee on Banking Supervision (BCBS) subsequently found the EU materially non-compliant with Basel III (BCBS 2014). Moreover, the UK authorities and those who argued in favour of EU standards that exceed the Basel minimum successfully opposed the initial proposed for maximum capital ratio, which meant that national regulators would not have been able to impose higher capital requirements on domestic banks should they have deemed it necessary to do so (James 2016). By contrast, an issue on which the UK authorities lost their battle in Brussels and that differentiate the CRD IV package from the Basel accord was the legally binding cap imposed on banker bonuses. This had been an amendment introduced and strongly advocated by the European Parliament (EP) with some support from continental countries (Greenwood and Roederer-Rynning 2014).

A combination of domestic politics and domestic political economy account for British preferences on the CRD IV (and Basel III) (see James 2016). At the time of the CRD IV negotiations, the main British banks were relatively well capitalised in part as a result of the state-led recapitalisation in the wake of the crisis, whereas the banks in many continental European countries were under-capitalised. The impact of stricter capital requirements on lending to the real economy was less of a concern for the UK because the City is mostly 'disconnected' from the real economy in the UK. By contrast, continental European countries have a bank-based financial system, where banks provide funding to small and medium enterprises. Finally, during the crisis, the UK authorities had engaged in a massive bail-out of banks using taxpayers money. Hence, banking regulation became politically salient for politicians and public opinion in the UK (Howarth and Quaglia 2013).

British policy-makers were partial foot-draggers concerning the setting up of the European Supervisory Authorities, given the British reluctance to transfer powers away from national supervisors to bodies outside their borders (*Financial Times*, 20 March 2009), thereby granting decision-making powers to EU-level authorities while public funds to tackle banking crises came from national budgets. To this effect, Gordon Brown, the British Prime Minister, secured a guarantee that the new supervisory system would not include powers to force national governments to bail out banks (Buckley and Howarth 2011).

UK policy-makers were (constructive) fence-sitters on other EU legislative measures, such as the European Market Infrastructure regulation (EMIR) (James 2015). On this piece of legislation, UK preferences were mostly in line with those of the other member states and the measures proposed by the Commission. The EMIR prescribed the shifting of OTCDs trading to central counterparties (CCPs) and the mandatory reporting of transactions to trade repositories. It also set harmonised rules for CCPs and trade repositories, which would be subject to EU supervision. There were two controversial issues for the UK in the negotiations of the EMIR. First, there was the complex third-country regime for CCPs and trade repositories. Without going into much detail, the British authorities were keen to ensure open markets by setting 'broad' criteria to ascertain the equivalence of the regulatory framework of third countries. They also objected to the concept of reciprocity proposed by the Commission and supported by France (see Pagliari 2013; Quaglia 2015).

The second controversial issue for the UK was the provisions concerning the location of CCPs and their access to central bank liquidity. Some regulators – notably the French – believed that CCPs clearing OTCDs should have access to central bank liquidity in the same currency as the product being cleared. In other words, a CCP would have to be located in the euro area and clear euro-denominated products in order to access European Central Bank (ECB) liquidity. The British authorities successfully opposed this view because London is one of the main locations for derivatives trading and clearing worldwide, also for euro-denominated assets (Buckley, Howarth and Quaglia 2012). The measures initially proposed would have be detrimental to the clearing houses located outside the euro area – first and foremost, those currently operating in the London OTCD markets (*Risk Magazine*, 10 January 2011).

On bank resolution, the UK was a pace-setter. The Bank Recovery and Resolution Directive (BRRD) was controversial in the EU and was therefore issued with considerable delay: it was agreed in 2014, even though the Commission began consulting on cross-border bank resolution as early as 2009 (Commission 2009) and held two successive consultations (Commission 2011, 2013). It was a matter that touched upon politically sensitive issues and had potential fiscal implications. The UK authorities actively contributed to the policy debate by developing the concept of the bail-in and loss-absorbing capacity that were new resolution tools devised post-crisis. The idea of bail-in was initially put forward by two senior economists of Credit Suisse, Paul Calello and Wilson Ervin, in an article in *The Economist* in January 2010. It immediately gained traction at the Bank of England because the 'traditional' way to resolve banks was seen as unsuitable for large cross-border banks, especially Globally Systemically Important Banks (G-SIBs).

As early as July 2010, Andrew Bailey (2010), who later became the director responsible for financial stability at the Bank of England, argued that 'an alternative worth exploring, drawing on the tools used to restructure non-banks, is creditor recapitalisation', or 'bail-in'. In September 2010, Tucker (2010a) reiterated that the bail-in should be considered as a resolution tool. In December 2010, well before the Financial Stability Bond (FSB) included the bail-in in the *Key Attributes*, and well before the BRRD (2014), the Financial Stability Report of the Bank of England (Bank of England 2010) stated that the bail-in should be extended to other potentially systemic institutions, including investment banks and market infrastructures. The Independent Commission on Banking (the so-called Vickers Commission) (2011 a,b) recommended statutory bail-in powers and a loss-absorbing capacity of at least 17%-20%, which was broadly in line with the standard subsequently on loss absorbency capacity set by the FSB in 2015.

Table 2: Overview of post-crisis EU financial regulation*

Regulatory change in the EU: - new rules introduced - existing rules amended - institutions established or reformed	Content of new or amended rules
Banking	
Deposit Guarantee Scheme (DGS) Directive amended (2008)	Minimum level of coverage for deposits increased; payment time reduced
DGS Directive revised (2014)	Harmonisation of coverage, simplification of payout, ex-ante scheme
Capital Requirements Directive IV (2013)	Definition and level of capital, leverage ratio, liquidity rules, bonuses
Bank Recovery and Resolution Directive (BRRD) (2014)	Harmonise resolution rule, set up new tools (notably, bail-in) and improve cross-border cooperation
Securities and Investment Funds	
Regulation on Credit Rating Agencies (CRAs) (2009)	CRAs compulsory registration and compliance with rules concerning conflict of interest and quality of rating
Directive on Alternative Investment Funds Managers (AIFMs) (2011)	Legally binding authorisation and supervisory regime for all AIFMs, European passport for AIFMs
Regulation on OTC derivatives, central counterparties and trade repositories (EMIR) (2012)	Reporting obligation for OTC derivatives to trade repositories, clearing obligation for standardised OTC derivatives through CCPs, common rules for CCPs and trade repositories
Institutional Framework for Regulation and Supervision	
Directives on ESRB, ESFS and ESAs (2010)	Transformation of level-3 Lamfalussy committees into European Authorities; creation of a European System of Financial Supervisors at micro-prudential level and of the European Systemic Risk Board dealing with macro-prudential oversight

*** This table reports the main pieces of EU post-crisis financial legislation adopted, it does not include soft law and legislation proposed but not adopted.**

Banking Union

BU was the main (and delayed) response of the euro area to the sovereign debt crisis that began in Greece in 2010 and subsequently extended to Ireland, Portugal and Spain. When the crisis threatened to extend to Italy, BU was proposed, even though the final version of BU agreed is less ambitious than that which was initially planned (on the politics of BU, see Donnelly 2015; Epstein and Rhodes 2016; Schafer 2016). In June 2012, the President of the European Council, the President of the Eurogroup, the President of the Commission and the President of the ECB jointly presented an interim report, entitled 'Towards a Genuine Economic and Monetary Union', that laid the foundations for BU. Afterwards, the various components of BU were set in place, with one important exception.

The Regulation for the establishment of a Single Supervisory Mechanism (SSM) was adopted in October 2013. The SSM applies only to the euro area member states and to the non-euro area member states that decide to join BU. In the SSM responsibility for banking supervision was assigned to the ECB in cooperation with national competent authorities (see Howarth and Quaglia 2013). This was followed by the adoption of the BRRD in June 2014 (discussed in the previosu section) and the Regulation on the Single Resolution Mechanism (SRM) in July 2014. The SRM, which was to complement the SSM, was responsible for the planning and resolution phases of cross-border banks and those directly supervised by the ECB, while national resolution authorities would be responsible for all other banks.

The revised DSG directive was finalised in June 2014, but a common EU deposit guarantee scheme did not materialise, mainly because of German opposition. In November 2015 the Commission launched a proposed regulation for the creation of a European DGS. The European Stability Mechanism (ESM) – which was established by an intergovernmental treaty finalised in 2012 to replace the temporary European Financial Stability Facility – began operation in September 2012. It was envisaged that, subject to certain conditions, the ESM could provide financial support to ailing banks as well as to the governments of countries experiencing severe financial difficulties.

BU was designed to rebuild financial market confidence in both banks and sovereigns – especially in the euro area periphery – by stabilising the national banking systems exposed directly to a vicious circle. In fact, the sovereign debt crisis created a 'doom-loop' between the instability of the banking sector – which had to be bailed out in the majority of euro area countries – and the fragility of public finances, which were becoming unsustainable in some countries (Howarth and Quaglia 2013). BU was also to reverse the fragmentation of European financial markets that had begun with the international financial crisis and was worsened by the sovereign debt crisis. BU transferred powers from the national to the EU (to be precise, the BU) level. It was also significant because not all EU member states joined: it included only euro area member states, even if other EU member states were able to opt in. Hence, BU increased the trend towards differentiated integration in the EU (Dyson and Sepos 2010; Schimmelfennig 2016; Schimmefennig *et al.* 2016), which posed a major challenge to the EU as a whole and to the opt-out countries – first and foremost the UK, given the size of its financial sector and its interconnection to the euro area. Non-euro area countries had a choice about joining (or not) the SSM and faced incentives and disincentives.

The UK was a constructive fence-sitter on BU: it was by and large supportive of BU and specifically the SSM for euro area member states, notably as a way to tackle the sovereign debt crisis that was distressing the euro area periphery and to ensure financial stability therein (see, for example, *The Telegraph*, 13 December 2012, 19 December 2012). In the midst of the sovereign debt crisis in the euro area Osborne called for 'permanent changes' to stabilise the euro area in the medium and long term (BBC 21 July 2011; Financial Times 20 July 2011). He supported 'greater harmonisation of fiscal policies' in the euro area, arguing that there was a 'remorseless logic' for a banking and fiscal union in the euro area. He stressed that the UK not would be part of that union but would require 'safeguards' to protect its financial industry. The UK did not want to be part of BU because of domestic politics and domestic political economy considerations. BU implied a considerable pooling of power at the EU/BU level, first and foremost the supranationalisation of banking supervision, which was politically unacceptable in the UK. Moreover, the institutional and decision-making framework of BU was primarily designed for euro area members – and in fact none of non-euro area countries joined it.

As for domestic political economy, the British banking system was not only the most 'Europeanised' of the largest six EU member state banking systems in terms of the holdings of other EU-headquartered banks in the UK (as both a percentage and in total terms) and British bank holdings elsewhere in the EU (in total terms), it was also very internationalised in terms of non-EU headquartered banks active in the UK and the activities of British banks abroad. The UK was most exposed to the potential instability of globally systemic banks, which affected the British banking system more in relative terms than others in Europe (Howarth and Quaglia 2016). British banks by and large supported the creation of the SSM, but none sought British participation (British Bankers Association 2012).

During the negotiations on Banking Union, British policy-makers feared that a euro area majority would be able to impose its rules on non-euro area members in the European Banking Authority (EBA) (*Financial Times*, 13 December 2012). Hence, they demanded an EBA voting reform, whereby any decision by the Authority should be approved by a minimum number of member states outside BU and thus effectively by a 'double majority' of member states inside and outside the BU. Some euro area member states, first and foremost France and Germany, resisted British requests and eventually an agreement was reached on the creation of a double majority system until the number of non-BU member states dwindled to less than four. However, the safeguard in EBA will end once the number of non-BU member states is less than four (Howarth and Quaglia 2016). All in all, the UK was a constructive fence-sitter on BU and carefully negotiated specific issues that were significant for non-euro area countries.

BU will have significant implications for the single financial market. First, it will increase financial integration in the euro area, hence creating a 'market within a market'. Second, BU will promote the formation of a coalition of member states with similar interests and hence potentially voting as a block on several issues concerning EU financial (banking) regulation. The 'double majority' safeguard in EBA that euro area outsiders, first and foremost the UK, obtain will end once the number of non-BU member states is less than four and there is no such safeguard in the

Council of Ministers. Third, and related to the previous point, there is a potentially uneasy relation between the European Banking Authority, which remains responsible for developing regulatory policy and technical standards for the single rulebook in banking across Europe, and the SSM, which has the ECB at its centre and was given regulatory powers in addition to supervisory powers.

The building of CMU

The idea of CMU was first mentioned in the 'Political Guidelines' of the (then) newly appointed President of the European Commission, Jean-Claude Juncker, in October 2014 (European Commission 2014). The project of CMU was fully in line with the 'Investment Plan for Europe' (*aka* the Juncker plan) of November 2014, which set out to remove obstacles to investment, providing funding and technical assistance to investment projects. According to the Commission, CMU would 'improve the financing of the economy ... cut the cost of raising capital, notably for SMEs, and help reduce the very high dependence on bank funding. This would also increase the attractiveness of Europe as a place to invest' (European Commission 2014: 8).

In February 2015, the Commission (2015a) published the Green Paper, 'Building a Capital Markets Union', which was subject to a public consultation. At this stage, CMU was a 'mixed bag' – it was a 'long shopping list' of things to do in order to complete the single financial market and boost EU's capital markets. In September 2015, the Commission (2015b) put forward an Action Plan for CMU, together with a package of two legislative proposals to promote securitisation. Furthermore, the Commission began preparing a proposal for the revision of the Prospectus directive and the Solvency II directive. Finally, it opened a consultation on venture capital and social entrepreneurship funds, a consultation on covered bonds in the EU and a call for evidence on an EU regulatory framework for financial services. The member states reached an agreement on the securitisation proposals in a matter of weeks, but the EP refused to fast-track the proposals mainly because left-leaning MEPs called for a thorough review in order not to revive pre-crisis excesses (*Financial Times,* 3 March 2016).

The European Commission was the main policy entrepreneur on CMU, which was enthusiastically supported by the UK, joined by those member states with the most well-developed and diversified financial sectors, including Ireland (2015), the Netherlands (2015), Sweden (2015) and Luxembourg (2015). These member states unequivocally supported the market liberalisation agenda in CMU. The main continental countries – notably France and Germany (Schäuble and Sapin 2015) – expressed their reservations on CMU and so did some of their domestic players (e.g. domestic banks and investment firms). By contrast, the most competitive parts of the financial industry, the main transnational players, such as large banks engaged in securitisation, insurance companies and the international financial centres in the EU, first and foremost the City of London, were supportive. The new measures designed to promote securitisation would benefit the large banks based in the UK, but also in France, Germany, the Benelux countries, Italy and Spain. Small banks would benefit from the new proposed legislation on securitisation, but the large banks would benefit the most, as they are the most engaged in shadow banking (Gabor and Westergaard 2015).

The proposed revision of the Solvency II directive, *de facto* reduced solvency requirements for insurers that invest in long-term infrastructural projects. It would benefit insurers, in particular the large ones, which were more likely to invest in these sort of activities. Large insurers are mainly based in the UK, but also to a lesser but still significant extent in Germany, France and Italy. The revision of the Prospectus directive and future legislative and non-legislative measures designed to harmonise securities market legislation and ease cross border activities would be particularly advantageous for the largest, most competitive financial centres, first and foremost the City of London, that would be able to attract business from the periphery of the EU, but also potentially from Paris and Frankfurt (Quaglia *et al.* 2016).

British policy-makers were pace-setters on CMU, at least compared to other member states. First, a British national, Jonathan Hill, was chosen to lead the CMU project at the European Commission and was appointed as Commissioner 'for Financial Stability, Financial Services and Capital Markets Union', one of the few examples in European Union history where a Commissioner's job title matched that of a specific project. Second, UK policy-makers and stakeholders engaged extensively in the agenda-setting process. For example, almost a quarter of the Commission's responses to consultation were from the UK, 16% from Belgium (EU-level financial associations are located in Brussels), 13% each from France and Germany, and 4% each from Italy and the Netherlands. The House of Lords (2015) produced a timely report on CMU, urging the 'the UK, where capital markets are better established than in other Member States, to take the lead in spearheading this Capital Markets Union'. Third, the areas prioritised for action, namely securitisation (banking), Solvency II (insurance) and Prospectus (securities markets), were those that would benefit the UK the most and indeed were indicated by the UK government as the three top priorities for action on CMU (UK response to Green Paper 2015). The call for evidence on an EU regulatory framework for financial services also chimed well with British concerns about the EU's over-regulation following the international financial crisis. Furthermore, the strong UK government opposition to further centralisation helps to explain the absence of institutional measures in both the February 2015 Green Paper and the September 2015 Action Plan (Véron, 2015).

Of all EU member states, the UK had the most potentially to benefit from the financial liberalisation and diversification promised in the CMU project, given the diversity of its financial sector and, in particular, the high concentration of wholesale market activity, private equity and hedge funds (Véron, 2014). As noted by Dawson (2015):

> If a single capital market is established, demand for funding will be Europe-wide, but supply will be dominated by the City. The policy plays precisely to Britain's area of expertise. UK financial services could provide the funding for businesses and investment projects across a £10 trillion market – a move potentially as transformational as the 'Big Bang' in 1986. This is not something that can be replicated outside the EU. What would give capital markets union its power is the sheer scale of the European market.

In a speech made to the City of London Corporation Policy Committee, Commissioner Hill noted that 'from here investment flows out across the continent: UK banks lend more than $2 trillion into other European countries … More than a third of UK private equity funds' investments go to companies elsewhere in the EU. So the success of the City is tied to a successful Europe'.

In the UK, given the fact that CMU would also involve new EU regulation and further centralisation, there was some reluctance to proceed on the basis of national sovereignty (Véron 2014). In its responses to the Commission's consultation on CMU, the UK government (2015) opposed: the transfer of direct supervisory responsibilities to European institutions and tax and solvency law harmonisation. This might also explain the somewhat different views of Commissioner Hill and Commission President Juncker as to the institutional content of CMU. Commissioner Hill and the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) officials did not discuss institutional reform in their presentations on CMU. By contrast, President Juncker in the Five Presidents Report (2015) argued that CMU 'should lead ultimately to a single European capital markets supervisor'. Hence, domestic political economy and domestic politics in the UK pulled in somewhat different directions with reference to CMU.

Given the implications of BU for the single financial market (see Section 4), CMU was deliberately framed as an initiative to complement BU and ultimately to complete EMU (see Juncker 2015), even though CMU involves all the 28 member states. Some commentators (for example, Ringe, 2015: 5) interpret CMU, in part, as an attempt to repair the strained relations between the UK and the EU/euro area by giving 'a political signal to strengthen the Single Market as a project of all 28 Member States', not only to the euro area countries, and in an area where the UK had a clear competitive advantage. Hence, CMU was designed to attract the support of those member states that had not joined BU and/or EMU (first and foremost, the UK). Hence, it was a way to address the concerns of the repercussions of 'differentiated integration' – linked to EMU first and BU – on the single financial market.

Conclusion

The UK has been a key player in the post-crisis reforms of European economic and financial governance, albeit in different ways and with varying intensity. The (at times considerable) British influence was geared towards the attainment of preferences that were shaped by domestic politics and political economy, first and foremost the interests of the financial services industry and the City of London. The UK was mostly a foot-dragger (with important exceptions) on the 'market-shaping' post-crisis EU financial services regulation, unlike in the previous period when the UK had been a pace-setter in the completion of the single financial market, notably the so-called Lamfalussy directives on securities markets and Solvency II in insurance. The UK was a (constructive) fence-sitter on BU, unlike in the making of EMU, which the UK had tried to block, acting as a foot-dragger. Finally, the UK was a pace-setter on CMU very much in the same way it had been in the completion of the single financial market in previous decades. Thus, the UK supported EU financial policy measures whenever they reflected the British 'market-making' approach (see Quaglia 2010a,b, 2015) and had economic benefits for the City of London. The main exception was the BRRD, which had a considerable British 'input' but no direct benefit for the financial industry. The UK opposed EU policy measures that were excessively market-shaping and were therefore very burdensome for the financial industry, especially the City. The main exception was the CRD IV, whereby the UK was in favour of stricter EU rules (see James 2015, 2016). The UK was a fence-sitter on issues that mainly concerned the euro area, albeit paying attention to the implications of those measures for non-euro area members (see Howarth and Quaglia 2016).

The result of the British referendum on continuing membership of the EU represents a turning point in the relationship between the UK and the EU. The economic and political effects of Brexit will be far reaching for the UK and the EU. Although the events are still unfolding, Brexit raises a set of important questions to address with reference to the financial policies discussed in this paper: what are the implications of Brexit for the UK and what are the implications of Brexit for the EU? Since the UK opted out of EMU, declined to join BU but was a full member of the Single Financial Market, the impact of Brexit will be felt principally on access to the single financial market and on issues related to financial regulation. Much will depend on the new relationship put in place between the UK and the EU.

British authorities and the UK financial sector face a 'dilemma' in the Brexit negotiations. On the one hand, if the UK loses unrestricted access to the single financial market, UK-based financial entities and activities will need to relocate partly to the continent in order to continue to benefit from passporting across the EU (that applies only to some financial services). Moreover, the UK will no longer serve as the main point of entry into the EU for third-country financial entities and products, which will likely therefore choose to place a range of operations in other EU member states to secure access to the passport. Finally, the UK will no longer be able to challenge the efforts of the European Central Bank and a number of other member states to transfer euro clearing to the euro area.

On the other hand, if unrestricted access to the single financial market is retained, the UK will have to continue to comply with EU financial regulation on which it ceases to have a direct say in policy- and law-making. In the past, the UK financial sector frequently complained about excessively burdensome EU financial regulation. As this paper has argued, in several financial policy areas, the UK has wielded considerable influence in 'calibrating' (at times, toning down) EU financial rules. Hence, EU financial regulation is likely to be different in the future without the UK's 'market-making' approach, and will likely make EU rules less suitable for the financial industry based in the City. Moreover, euro area member states will tend to develop specific preferences on binding technical standards on supervision (etc.) through their cooperation in BU.

The EU also faces a Brexit dilemma. Any 'special deal' for the financial services sector in the UK is politically unpalatable for the EU because it would give the UK important benefits of EU membership, namely, unrestricted access to the single financial market, including passporting. It would be the kind of 'pick and choose' approach that so far has been ruled out by the EU, whereas the UK authorities tend to speak of a 'bespoke deal'. There might also be a political trade-off between the four freedoms, in particular, the freedom of movement of people (including control of immigration) and the free circulation of financial services and capital. At the same time, the City is by far the main financial centre in Europe, so there might be incentives to retain it in the single market. Furthermore, many continental banks, insurers and securities dealers operate in London. For both the EU and the UK, it will be a challenging circle to square.

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