In the Wake of the 2008 Global Economic Crisis: Banking Structures Untouched. How the Financial Lobby Won the Battle in Brussels

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Despite their responsibility for the 2008 economic crash, the financial sector has successfully avoided major reform in the decade since. Their army of lobbyists has won almost all the major battles, leaving new legislation full of loopholes and conditions similar to those that created the crash in the first place.

Corporate Europe Observatory shows how the past ten years of financial lobbying have kept us vulnerable to future crises and costly bailouts.

Those days in September 2008, watching the proverbial towers of global finance crumbling, were both scary and full of hope. Scary because the financial crash unfolding was bound to create misery and poverty in the coming months and years, yet hopeful because this could have been a unique opportunity to secure much-needed radical reforms of the financial markets. The crisis itself had origins in the light-touch regulation of the preceding years, a fact acknowledged even by some of its architects. Now, in the face of acute and disastrous systemic failure, surely a U-turn would follow.

Yet that reform never materialised. It's not that nothing has changed. Supervision has been increased and various kinds of 'emergency brakes' introduced that allow regulators to step in with more tools if a severe risk is on the rise, say if a big financial corporation is in dire straits. But a decade on, initial hopes that the crisis would lead to a rethink of financial markets appear naïve. Over the past ten years all ambitious ideas have been watered down, delayed almost indefinitely, or simply brushed aside, in no small part due to the power of the financial lobby and the deep bonds between decision-makers and financial corporations.

Commission moves fast to let bankers set the agenda

The European Commission moved fast in the days and weeks after the crisis broke. In September 2008 Commission President Barroso announced he would set up a high-level advisory group to evaluate what reforms to financial regulation would need to be made. In mid-October his group was approved by the EU's member states. It was a group with deep links to some of the very institutions that caused the crisis. Of a group of only eight, one sitting member of the group had links to the infamous Lehman Brothers, another with Goldman Sachs, yet another with Citigroup, and the Chair Jacques de Larosière was tied to BNP Paribas. These 'wise men' would hardly take us very far. They delivered the 'de Larosière report' that set the agenda for the only EU institution with the power to introduce draft legislation, the European Commission.

This was a somewhat familiar pattern: by 2008 the Commission already had a long held a habit of consulting widely with financial lobbyists in its attempt to deepen the single market in financial services. For example the Commission had built up a tradition of gathering bankers and fund managers for a thorough chat well before anything was proposed. Sure enough, an investigation into the 'expert groups' the Commission consulted over the toxic issues related to the crisis, showed this is exactly what happened. The European executive had allowed financial lobbyists to take the role of advisors, bending the ideas of the Commission to their advantage, and in some cases by preventing initiatives altogether, as in the case of private equity funds and investment funds. In that area, on the advice of an advisory group set up in January 2006 dominated by lobbyists, the Commission decided not to propose rules on hedge funds.

Hedge funds: meek measures in return for free passage

This leniency did not go unnoticed. In the European Parliament there was a strong push for regulation, but this was ignored by the Commission. The crisis had opened a new era, and Commissioner McCreevy felt compelled to elaborate a proposal for regulating 'alternative investment funds' launched in April 2009. What followed was a vigorous battle that took place both in the media, at conferences, and in perhaps hundreds of meetings between politicians and lobbyists. With lobby groups European Venture Capital Association EVCA (private equity funds, today called Invest Europe) and AIMA (hedge funds) at the wheel, the financial sector launched a campaign that began with scaremongering. "Thousands of jobs and millions in tax revenues could be at stake," said one corporate think tank. "A total rewrite" was necessary, the AIMA said of the proposal.

In the following year, the fund industry put pressure on member state governments, including getting the UK Government to bring the US Government into the battle. What followed was a remarkably sharply-worded protest sent to EU heads of state from US Treasury Secretary Timothy Geithner who warned that new rules could lead to a trade war between the two powers.

Lobbying traffic in the European Parliament massively increased. For example in the first six months of 2010 no less than 46 meetings between UK Conservative MEPs and the fund industry took place. And the lobbyists were having an impact: once reform proceedings started in earnest, out of 1,600 amendments submitted by MEPs, half of which were actually written by lobbyists, according to one estimate.

All these moves bore fruit. While the European Parliament had many ideas about how to rein in investment funds, the Alternative Investment Fund Managers Directive (AIFMD)dene ended up being a directive that was mainly about transparency. And the fund industry was even given a major concession that would make the directive quite appealing: on the adoption of the directive, a fund would only need to be approved and registered in one EU member state to operate in all others, so-called passporting. Even the staunchest opponents of the directive were won over. The AIMA had its finest hour.

Shrewd scaremongering killed reform

The battle over banking regulation was far longer and it took place at more levels than the fund controversy. As key parts of banking regulation are agreed at the international level, this is where banks started fighting back after two years in the dock. In the summer of 2010 international negotiations took place at the Basel Committee with a view to strengthen banking regulation. Under review were the existing rules obliging banks to hold onto a certain level of reserves to protect against future crises, known as 'capital requirements'. The numbers in force were deemed too low and the way they were measured left too many loopholes for bankers. Calculation models developed by the banks themselves enabled them to keep capital reserves artificially low.

During the negotiations the international lobby group for big banks, the Institute for International Finance (IIF), released a report with a dire warning to negotiators: if there were to be a hike in capital requirements, the result would be millions of job losses and growth rates would take a beating. The report would be followed up by other reports from big banks with identical claims. One could argue that low capital requirements had already led to just that outcome, but the context in 2010 turned out to work to the advantage of the mega-banks. Ambitions were duly lowered for capital requirements when an agreement was reached in August 2010. Only days later, the Bank of International Settlements issued two reports that belied the IIF's scaremongering claims but by then it was too late. The banks had once again set the agenda and secured only a small increase in capital requirements; including very modest changes to banks' own internal models that they used to calculate their capital requirements.

The banks would remain a concern for the European Union throughout the whole decade. Even today, the concern for bad loans and banks in risk of collapse remains.

Window dressing on bonuses, credit rating, and audits

Many other issues were settled in the years that followed. One particularly important to the European Parliament was the question of bankers' bonuses. The bonus structure made it too attractive for executives to play risky bets on the markets, and reform would cool their experiments. That was the thinking behind the main contribution to the banking debate from MEPs in 2010.

With London as the epicentre, banks started a campaign to convince lawmakers that by reforming bonuses they would undermine the competitiveness of European banks. In the end, the rules decided on seemed flexible enough for the banks with a bonus cap of up to 100 percent of salaries. Protests by bank lobbyists would continue throughout the legislative process; but in real life the rules adopted in 2013 proved to be full of loopholes. Banks were able to redefine bonuses as 'role-based pay', or simply increase salaries in other ways. Three years later the EU institutions acknowledged the problem but so far nothing has been done to fix it, and lavish bonuses continue to provoke the public.

There was also lobbying pushback in late 2013 over reform of accounting and auditing rules. The accounting and audit firms (the 'Big Four') were under the spotlight for their role in the crisis, having giving overly positive assessments of financial health for some major clients, including key examples such as Ernst&Young's role in providing window dressing for Lehman Brothers.

What needed to be done seemed obvious. Overly close links between any of the Big Four and their clients is risky; if a bank is able to rely on using the same audit firm for decades, the temptation for said firm to help out a reliable client in times of trouble is higher.

The EU rules adopted in early 2014 did little if anything to break up these overly cosy relationships. If all exceptions and loopholes are brought into play, the rules adopted in early 2014 allow a company to keep the same auditing firm for 24 years. This weak reform followed aggressive lobbying by the financial industry to either prolong the period or simply avoid imposing mandatory rotation in the first place.

No more ground was gained with the credit rating agencies. The problem with these agencies was that for quite a while in the run-up to the collapse of Lehman Brothers, these companies – paid to do risk assessments of securities – were ´Triple A factories', ie they were rating unsound entities as solid, low risk investments. Indeed, the very securities that were to become tightly linked with the financial crash were rated by them as super sound and secure investments up until days before it all turned out to be a lie. Many analysts were quick to spot the problem: a credit rating agency earns its money from the financial institutions whose products they rate – sometimes they are even co-owned by them.

Surprisingly, the EU reform would hardly even touch on this key conflict of interest. At the proposal of the Commission, the EU went for a version modelled on the US rules in force since 2002; in other words, the very rules that had proved so sadly insufficient.

Big banks can grow bigger

After years of 'financial reforms' that aren't fit for purpose, perhaps the most striking feature of the debate has been the agenda setting, in part due to Barroso's quick move in putting big bankers up front to define the scope of the EU's reforming ambition. The issue of the size of banks certainly emerged but in the political debate the demand to break up the banks has remained marginal. Even after the public purses in the European Union had put a staggering €4.5 billion on the table to bail out banks – with a final cost of 1,4 billion euros – there was little talk of fundamental measures.

While there was recognition that something needed to be done to avoid major payouts, the method chosen was one suggested by big banks themselves. Under the banking union, the banks themselves would pay a small amount to make up a 'resolution fund'. The fund would then be spent to provide for an orderly dismantling of bad banks. However, should there be too little in the pot – and if the bank in question is of significance there would be – then public money will once again be brought in to save the day.

It could be argued this is more a system of securing public bailouts than the opposite. But there is more. If we acknowledge the crucial systemic importance of the biggest banks represents a risk in itself, then the banking union is designed to make matters worse. In the process of deconstructing an ailing bank, it has been made easy for other big banks to buy them and grow bigger themselves in the process. When interviewed about the banking union, the Chief Executive of BNP Paribas, Jean-Laurent Bonnafé said: "Then the strongest part of the banking system could be part of some form of consolidation – either through an acquisition or through organic development plans." This fits neatly with what is now the official position of the European Central Bank: there are too many banks in Europe. Concentration is preferable to secure global competitiveness. One of the downsides is that we will be living with the 'too-big-to-fail' problem for years to come.

Banking structure untouched

Truth be told, not every initiative from the EU institutions have been meek and toothless. In 2012 a high-level group chaired by Finnish central banker Erkki Liikanen was published. It contained a series of proposals to address the question of the banking structure in Europe, and while it did not touch on the size of the banks as such, it did go into the question of the way banks invest their own money. In the US there has been some sort of separation between investment banks and retail banks since the 1930s and the adoption of the Glass-Steagal act. The basic idea is to prevent banks from using own money or customers money to invest. In the US the act was rolled back before the crisis but returned in July 2015 in a weaker, new form called the Volcker Rule which restricts banks' "proprietary trading".

Something along those lines, albeit weaker, was proposed in the Liikanen report. But the launch of the report in 2012 acted as an alarm bell for the banks. One of the first moves they made was to go for intense lobbying at the national level to have rules adopted in the area, chiefly in Germany, France, and the UK. Then the financial lobby managed to secure the introduction of a text in the draft law that would let member states apply their own rules even if new European rules were adopted. But more importantly, through lobbying at the member state level, negotiations between governments became complicated and in 2017 the whole exercise was dropped entirely, to the dismay of campaigners.

Financial Transaction Tax in a coma

But perhaps the most monumental defeat for financial reform is over the Financial Transactions Tax. This is a proposal for a tiny tax on all transactions on financial markets, which could create considerable funds for important purposes and bring down the number of transactions considerably. High-speed speculation would be curtailed and few outside the trading rooms would miss it.

Oxfam GB's 2010 campaign video for the financial transaction tax, dubbed "The Robin Hood Tax":

It became clear quite quickly that the financial industry would not sit on its hands when confronted with such a challenge. Reports were produced quickly, for instance by the Global Financial Markets Association, to convince decision-makers it would be a highly costly affair that could take 0.5 per cent of estimated growth in years to come. Governments hostile to the proposal such as the Danish and UK governments picked up this message. Still, due to a political agreement in Germany the most powerful nation was in favour and so was France. A group of 11 member states was formed to introduce the tax, even if the other member states were reluctant.

The tenacity of the group of 11 forced the financial lobby to seek new avenues. Instead they worked at the member state level to make governments to secure a push for a watered down version of the tax. The first breakthrough came in France from a campaign spearheaded by the Fédération Bancaire Française that argued a tax would cripple the development of the French financial sector. This led to significant downscaling of the ambitions of the French Government. Since then, negotiations between the member states in the FTT camp have been slow and complicated. Formally, the FTT is still in process, but the die-hard anti-FTT campaigners in the City of London can note with satisfaction in their reports that nothing is happening.

A victorious army

With these experiences in mind there is little doubt that the financial lobby won the battle in Brussels. And this fact is underlined by two recent developments. The first is about the infamous subprime loans. As part of the attempt to strengthen the securities market 'products' will be awarded special treatment provided they fulfil certain conditions. But these conditions, Dutch analysts Engelen and Glasmacher argue, actually open the door to "the European equivalent of subprime borrowers". The second is about banking regulation and the infamous Lehman Brothers. When the first package of international guidelines for banks was issued after the Basel negotiations in 2010, it included a cautious suggestion to introduce a maximum 'leverage ratio' – the ratio between a banks' own capital and its exposures. The message was not received politely by European banks who fought against the idea from the beginning; as they did with the 'risk reduction package' discussed recently. While in May 2018 the risk reduction package was finally adopted and a mandatory leverage ratio is to be introduced, looking at the number suggested – a ratio of three percent – it makes you wonder what they are trying to achieve. With a mandatory leverage ratio of three percent, banks don't even have to be as resilient as Lehman Brothers in 2008 shortly before its collapse.

Though the financial lobby has been forced to go on the defensive on several occasions, it is difficult to find a single financial lobby association in Brussels that is not broadly happy about the outcome of the package. They come out of the crisis era in triumph. The legislative response to the financial crisis could have threatened their interests, but it may actually have given them a boost. After all, even if the financial sector is doing everything by the book, this is no help to society if the rules in the book are made by and for the financial sector.

There are many reasons for that. One is the close cooperation and the camaraderie between decision-makers and the financial lobby. A fresh example is the overwhelming dominance of financial industry representatives in the advisory groups of the European Central Bank. Another is the ease with which former Commissioner Jonathan Hill could go from a high level EU position to becoming an advisor for the financial industry. And last but not least, we have seen the former Commission President José Manuel Barroso join the ranks of Goldman Sachs.

Another reason is the lobbying power of financial corporations in and of itself, which is a crucial factor. In member states they are able to swing governments, and in their lobbying to influence Brussels an army of at least 1,700 lobbyists stand ready to attack any attempt to impose stronger regulation of the sector. They are not on the defensive either. In recent years many attempts have been made to roll back the feeble achievements of financial reform and to invent new projects that have deregulation and liberalization at its core.

Any attempt to reform the financial system has to factor in their power.

While this picture is bleak, it would be a mistake to ignore the effect of public outrage and campaigning – one of the reasons the financial sector has such highly paid lobbyists in the first place. Social movements have fought for a tax on financial transactions (FTT) for the better part of 20 years; where once it was seen as a marginal demand, in Europe it is now an issue discussed seriously by governments. Sooner or later it will materialize and even if it is only in a watered down version, there will be a clear platform for taking the next steps.

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