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THE UK AS A CONFLICTED PACE-SETTER IN TRADING UP POST-CRISIS INTERNATIONAL DERIVATIVES REGULATION

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ABSTRACT

The United Kingdom (UK) hosts a leading international financial centre and has a large financial sector. This jurisdiction has traditionally been very influential in international standard-setting bodies in finance. Whereas prior to the international financial crisis, the UK was often keen to 'trade-down' international standards, after the crisis, the UK has pursued increasingly stringent financial regulation in certain financial sectors, such as derivatives. What accounts for this 'trading up' approach? In order to address this question, we adopt a two-step analytical framework. The first step examines the process of national preference formation by identifying three sets of key domestic players: elected officials (namely, government ministers and members of parliament); unelected officials (central bankers and financial regulators); and the financial industry. The second step explains the UK's regulatory strategies and influence over regulatory outcomes at the international level.

Keywords: Finance, Financial Regulation, Derivatives, Central Counterparties (CCPs), Clearing.

Introduction

The United Kingdom (UK) hosts the leading financial centre in Europe – the City of London – and the second main financial centre in the world. Moreover, it has a very large financial sector in absolute terms and compared to the rest of the national economy. Given its 'market power' (i.e. the size of its financial sector) as well as the subject-specific expertise

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of British policy-makers, the UK has traditionally been very influential in international standard-setting bodies in finance. Prior to the international financial crisis, the UK was widely perceived to be a 'market-maker' in financial regulation, favouring market liberalisation, light-touch and principles-based regulation (Bell and Hindmoor 2015; Mugge 2010; Macartney 2010; Quaglia 2010). Hence, the UK was often keen to 'trade-down' financial regulation at the domestic and international levels.

However, after the international financial crisis, UK has pursued increasingly stringent and prescriptive 'market-shaping' financial regulation in certain financial sectors. Notable instances of the UK's effort to 'trade up' post-crisis financial regulation concern the banking sector, specifically, capital requirements, structural reforms and resolution rules, which have attracted considerable scholarly attention (Bell and Hindmoor 2016; James 2016, 2017; Quaglia 2017). Another important, but so far understudied case, of the UK's effort to trade up financial regulation concerns derivatives markets, which are the world's largest market in finance (Helleiner *et al.* 2018). How can we account for this about-turn?

We maintain that existing explanations rooted in mainstream approaches in comparative and international political economy are not well equipped to account for the UK's changing preferences and influence in regulating global finance over the past decade. In order to address this blind spot in the literature, we adopt a two-step analytical framework. The first step examines the process of national preference formation by identifying three sets of key domestic players: elected officials (namely, government ministers and members of parliament); unelected officials (central bankers and financial regulators); and the financial industry. The second step explains the UK's regulatory strategies and influence over regulatory outcomes at the international level.

This paper is structured as follows. We first review the existing political economy literature that can be used to account for the UK's approach to international standard-setting. We then put forward a two-step analytical framework that we apply to the case study of the regulation of derivatives markets after the crisis. We argue that at the domestic level, whereas *elected officials* paid relatively little attention to derivatives, *regulators* became increasingly concerned about the regulation of this financial service. The *derivatives industry* did not actively seek to resist the imposition of more stringent rules for clearing, acknowledging that reform was both inevitable and desirable. Consequently, UK regulators had considerable scope and autonomy to pursue the trading up of derivatives regulation internationally. Leveraging its significant market power and regulatory capacity, based on London's prominent position in the global derivatives market, and forging a joint alliance with the United States (US), the UK acted as a pace-setter at the international level.

State of the Art and Theoretical Framework

The UK is a global player in finance. The London Stock Exchange is by far the largest in Europe and the second largest in the world in terms of stock market capitalisation and daily trading turnover. The UK has the second largest banking sector in the EU and half of EU investment bank activity is based in the UK. Indeed, the UK is 'Europe's investment banker' (Carney 2017). The UK hosts four-fifths of hedge fund managers in the EU, and internationally it is the second main location for hedge fund managers, after the US. London is the main centre for clearing euro-denominated instruments, despite being outside the euro area. Finally, the British insurance sector is the largest in the EU and the third largest in the world. Lloyds is the largest reinsurance market worldwide. The financial services sector contributed more than 7 percent of UK GDP and employed an estimated 1 million people. The consultancy Oliver Wyman (TheCityUK 2016) calculated the annual financial revenues at around £200 billion, £90-95 billion of which was domestic business, £40-50 billion related to the EU, and £55-65 billion related to the rest of the world. The UK net exports of financial services were the largest in the world: $71 billion, contributing to decrease the large deficit in the UK balance of payments.

A significant body of scholarly work in political economy emphasises the importance of the institutional configuration of national economic systems, especially the financial sector, in shaping national preferences in regulating finance (Fioretos 2010; Howarth and Quaglia 2016). Hence, national policy-makers engage in a 'battle of the systems' (Story and Walter 1997) by pursuing international regulation that protects the comparative institutional advantages of the national financial industry. In this mould, some works have analysed the politics of EU financial services regulation (Quaglia 2010) and later of Banking Union (Howarth and Quaglia 2016) by looking at the configuration of the financial sector. Other works have adopted historical institutionalism (Fioretos 2010) or constructivism (Busch 2008) in order to investigate competition between national financial systems. From this perspective, one would expect the UK to seek to defend and promote its national variety of capitalism, which is heavily reliant on a large, competitive and less stringently regulated financial sector.

A second body of scholarly work in political economy suggests that the key drivers in regulatory politics are actors that can coordinate their activities across borders (Cerny 2010). This literature points to powerful transnational forces that were pivotal in driving EU financial market integration prior to the crisis (Mügge 2010; Macartney 2010) and, more generally, the liberalisation of international financial markets (Tsingou 2015). More re-

cently, works on the 'new interdependence' (Farrell and Newman 2016; Newman and Posner 2018) and 'transnational pluralism' (Cerny 2010) explain how cross-border coalitions of regulators and/or private actors have shaped regulatory outcomes in finance. For example, empirical studies argue that financial lobbying in international regulatory fora has resulted in the 'capture' of financial regulators (Baker 2010; Tsingou 2008; Underhill and Zhang 2008). These explanations would predict that the power of transnational finance should be particularly pronounced in the UK, given the high level of internationalization (inward and outwards) of its financial sector.

Finally, the literature on business power identifies two main sources of firm influence in the policy process (Bell and Hindmoor 2016; Culpepper and Reinke 2014; Pagliari and Young 2014; Woll 2014): structural power and instrumental power. These approaches highlight the structural dependency of the state on the financial sector and the formidable lobbying capacity of large financial firms. For example, a distinctive feature of the UK in the past was the close interactions between the City, the Treasury, and the Bank of England – the so-called 'nexus' (Baker 1999) – which served well the interest of the financial sector (Hopkin and Shaw 2016). Given the large size of the financial sector in the UK in absolute and relative terms, and the prominent role of the nexus in UK economic policy making, one would predict the significant influence of the financial industry in shaping financial regulation.

All these distinct theoretical explanations point in the same direction, which fitted well with the empirical record of the UK pre-crisis, when the UK championed the trading down of international regulation in several financial sectors. However, since the crisis, the UK has actively pursued more stringent financial regulation in certain (but, by no means all) areas, most notably, banking and derivatives. We focus on the derivatives, which have so far mostly been overlooked in the literature. Specifically, we set out to explain two components of the UK's post-crisis financial regulatory preferences concerning key aspects of derivatives markets: *regulatory content*, which concerns the stringency of regulation (hence, the UK might prefer to 'trade up' or 'trade down' rules, seeking international rules that are more or less strict); *regulatory strategy*, which concerns the promotion of, resistance to, or indifference towards international regulation (that is, it may act as a 'pace-setter', 'foot-dragger' or 'fence-sitter' in negotiations). We also investigate the UK's *regulatory influence*; that is, how effective the UK has been in shaping the outcome of international regulatory negotiations since the financial crisis (hence, the UK can be successful, partly successful, or unsuccessful in uploading its preferences into the final agreement).

We develop an analytical framework that uses a two-step method (for more details, see James and Quaglia 2020). At the domestic level, we consider the need for financial regulators to balance competing pressures for financial stability (from elected officials) and international competitiveness (from industry), as well as regulatory concerns about managing cross-border externalities. At the international level, we analyse how negotiators seek to leverage both domestic and external resources (including market power, regulatory capacity, and alliance building) to shape the outcome of international regulatory negotiations.

The first step in our analysis is to explain the UK's post-crisis regulatory preferences in regulating derivatives. Preferences here refer to the revealed policy positions of UK government representatives in international regulatory negotiations. Our objective is to explain UK preferences with respect to the stringency of post-crisis regulation: whether following the crisis UK regulators supported or resisted the development of international rules that are more strict than existing rules (i.e. 'trading up'). We focus on three key sets of actors in the domestic political arena that are critical in shaping national regulatory preferences: elected officials, unelected regulators, and the financial industry.

The preferences of elected officials concerning financial regulation in general, and derivatives in particular, are twofold: to appease voters (who value financial stability, especially in the wake of a crisis) and to appease the financial industry (which seeks competitiveness) (Singer 2007). Elected officials mostly defer to the technical expertise of regulators and de facto delegate most financial regulation to them, except when financial regulation becomes 'politically salient', as in the wake of a crisis (Pagliari 2013). The preferences of (unelected) regulators concerning financial regulation are twofold, the first one being to preserve their autonomy. However, financial regulators also have their own distinct regulatory preferences that reflect their mandate, regulatory outlook and ideas, which are periodically challenged by economic crises and policy failures (Busch 2008; Bell and Hindmoor 2015). Thus regulators can develop their own preferences in favour of trading up (or down) financial regulation, aside from assuaging political pressure from elected officials or the competitiveness concerns of industry. Financial regulators set international standards through negotiations in technical transgovernmental fora of like-minded officials (Bach and Newman 2014; Quaglia and Spendzharova 2019) who issue international 'soft law' (Newman and Posner 2018). Yet, regulators are mindful of the preferences of elected officials and the financial industry back home because international standards will need to be given legal effect through domestic regulation and will have to be enforced vis-a-vis the financial industry. The preferences of the financial industry derive from the specific

business model of private actors, and their cost-benefits analysis of the proposed rules.

The second step of the analysis involves explaining the UK's regulatory strategy and influence in international standard-setting. This means evaluating whether the UK has been a pace-setter, foot-dragger or fence-sitter in international regulatory negotiations (see Quaglia and Spendzharova 2017), and explain whether it has been successful, partly successful or unsuccessful at uploading its regulatory preferences into the final agreement. To do so, we draw on theories of two-level games (Putnam 1988) and liberal intergovernmentalism (Moravcsik 1998). Our explanation rests on the assumption that in international negotiations, national negotiators must ensure that whatever agreement is reached has sufficient domestic support (Putnam 1988: 434). To explain the post-crisis regulatory strategy of UK negotiators, we, therefore, consider the extent to which international regulatory proposals are supported by a coalition of domestic groups: namely, elected officials, financial regulators and the financial industry. This leads to the following expectations: UK negotiators will act as pace-setters when international regulatory initiatives command sufficient support from key domestic groups; as foot-draggers when agreements lack sufficient domestic support (either because they are too stringent, and so threaten competitiveness) or too lax (which may undermine voter confidence); and as fence-sitters when agreements have little or no impact on domestic groups. The bargaining power of a jurisdiction in shaping international regulation derives from three main sources: market power (i.e. the size of the domestic market) (Drezner 2007), regulatory capacity (the ability to regulate the domestic market) (Posner 2009) and alliance building, leveraging resources through transnational regulatory networks, and/or other jurisdictions that shared the UK's preferences, most commonly the US and Switzerland.

The UK and the Post-crisis Regulation of Derivatives

A derivative is a contract between two or more parties (or counterparties), the value of which is derived from an underlying asset, such as stocks, bonds, commodities, currencies, interest rates and market indexes. Typically, derivatives are used for 'hedging' as they provide a form of insurance against risk generated by fluctuations in the value of the underlying asset. However, they can also be used for speculation in betting on the future price of an asset or movements in exchange rates or interest rates. The most common types of derivative contracts are futures (an agreement between two parties for the sale of an asset at an agreed upon price), options (similar to futures, but without the obligation to undertake the transac-

tion), and swaps (an agreement to trade loan terms). Derivative contracts can be standardised and traded over an exchange, which increases transparency and reduces counterparty risk (i.e. the risk of default by one party to the contract). But in the decade prior to the crisis, there was a massive growth in the use of over-the-counter derivatives (OTCDs), particularly interest-rate derivatives and credit default swaps (CDS), which are traded directly between two parties. Accounting for approximately 90% of the market, OTCDs were largely unregulated.

At the height of the financial crisis, regulators became increasingly concerned about how derivatives contributed to fragility and volatility in the financial system by facilitating the growth of speculative trading, and enabling banks to become over-leveraged and accumulate counterparty risk. A variety of new rules concerning derivatives markets were adopted post crisis. Here we focus on the regulation of derivatives clearing through Central Counterparty Clearing Houses (CCPs), and the regulation of the resilience, recovery and resolution of CCPs. These were some of the most significant regulatory changes adopted following the crisis and were crucial for financial stability. In fact, clearing through CCPs reduces counterparty risk because CCPs bear most of the risk between buyers and sellers when clearing transactions. At the same time, the mandatory clearing of several types of derivatives through CCPs after the crisis made CCPs crucial nodes of the financial system, hence new regulation concerning their resilience, recovery and resolution was needed.

The Domestic Level

After the crisis, UK regulators at the Financial Services Authority (FSA) and the Bank of England became increasingly concerned about the role of derivatives. Although derivatives were a non-banking issue, they had direct implications for the stability of the banking system as a whole, as well as financial stability more broadly. Recognising the connection between the growth of unregulated derivatives in the decade prior to the crisis, and the instability and massive losses afflicting much of the banking sector in 2008, senior UK regulators came to the conclusion that regulation needed to be overhauled. In March 2009, the Turner Review (FSA 2009) declared its support for 'the objective of achieving robust and resilient central clearing house arrangements for CDS clearing'. This was followed in December 2009 by a joint paper published by UK Treasury and the FSA (2009), which recommended: greater standardisation of OTCDs, so as to facilitate their trading on organised trading platforms; the increased use of CCPs clearing; and registration of all relevant OTCDs trades in trade repositories.' Regulators also suggested that OTCDs that were not centrally

cleared to be subject to higher capital requirements and margins (HMT and FSA 2009: 4).

At the Bank of England, senior regulators devoted increasing attention to derivatives, as detailed in the Bank's annual *Financial Stability Review* (2009, 2010, 2011), numerous publications (studies, working papers etc), and several speeches by senior officials (Bailey 2012, Gracie 2015, Tucker 2011, 2014). Deputy Governor Paul Tucker (2011) defined the CCPs as 'system risk managers' as well as 'super-systemic', especially those clearing globally-traded instruments. He also warned that if a CCP 'went bust', the result would be 'mayhem' that would be 'as bad as, conceivably worse than, the failure of large and complex bank…We, therefore, need effective resolution regimes for CCPs and other financial market infrastructures'. Thus, post-crisis regulation should focus on two aspects: minimum standards to ensure that CCPs did not fail (resilience); and a clear ex ante framework for limiting disorder if a CCP failed (recovery and resolution).

Derivatives regulation is a highly technical field generally characterised by a low level of political salience and voter knowledge. After the financial crisis, elected officials in the UK paid relatively little attention to derivatives. However, elected officials responded positively to the concerns raised by regulators about the impact of derivatives (first and foremost, OTCDs) on financial stability. Unlike banking regulation, the issue of derivatives provoked relatively few disagreements between elected officials and regulators because the rules were less 'granular' and it was difficult for ministers to challenge the technical expertise wielded by regulators. As one acknowledged, 'Issues concerning CCPs are more technical. It is more difficult for the Treasury to get its head around it, so it is harder to disagree' (interview, May, London 2018). In response to concerted pressure from regulators, the Financial Services Act in 2012 shifted responsibility for supervising CCPs from the FSA to the Bank of England. The Act established a permanent resolution regime for CCPs, similar to that already in place for the banking sector. In addition, the UK authorities also called for new bail-in powers to allocate losses to creditors and members of CCPs.

In pioneering the development of tougher post-crisis rules for OTCDs, UK regulators became the initial target for lobbying by the financial industry. However, unlike in other areas of financial regulation, such as banking and hedge funds, industry groups struggled to forge a consistent position (interviews, London and Brussels, May 2018). CCPs strongly supported central clearing because it was a good opportunity to expand their business. The dealer banks initially resisted the push for greater central clearing of OTCDs, on the grounds that it was unnecessary from a financial stability perspective. Dealer banks also complained that it would diminish their profits, and allied with (non-financial) end-users who worried that clearing

through CCPs could increase costs (due to the compensation for the clearing services). However, central clearing also involved the benefit of netting transactions and reduced the risk related to bilateral dealing (e.g. the risk that the counterpart of the transaction would not complete it) for dealer banks and end-users (Helleiner 2011).

On the recovery and resolution of CCPs, differences soon emerged over the broad question of 'who pays' for CCP's resolution as clearing members, end-users, and CCPs had different, and often competing, interests. Each group was keen to shift the costs of recovery and resolution onto the other groups. Briefly, CCPs wanted direct and indirect participants to contribute to CCPs recovery, so as to avoid resolution. Direct participants wanted indirect participants to contribute to CCPs recovery, so as to avoid resolution. Indirect participants opposed their contribution to CCPs recovery, and preferred resolution instead. These divisions served to undermine the collective influence of the financial sector (interview, Brussels, June 2018).

The UK had powerful incentives to pursue harmonised standards at the international level in order to manage the significant cross-border externalities generated by derivatives. This challenge was particularly acute for the UK, which has the largest market in the world for OTCDs. Derivatives trading and clearing is an international business whereby the main players are dealer banks and CCPs. Several dealer banks are based in the UK. Furthermore, the City of London is home to three global CCPs, which, together, account for most of the cleared activity in OTC interest rate derivatives globally, and for a substantial proportion of the cleared activity in other asset classes. The majority of 'margins' posted with CCPs based in the UK come from clearing members not located in the UK, with about 40% provided by clearing members based outside the European Economic Area.

Given the internationalised nature of derivatives markets, domestic rules on central clearing and CCPs would not suffice to secure financial stability – unilateral action could not address negative externalities. Andrew Gracie (2015), senior official at the Bank of England, explained that the international standards on CCPs resilience were 'important not only in their own right, but also to provide the market – the users of CCPs – with the tools and incentives to monitor resilience and drive effective risk management in CCPs themselves. To encourage *competition* between CCPs on *resilience*, not *cost*' (emphasis in *italics* added). With reference to recovery and resolution, Paul Tucker (2011) explained

> The largest CCPs are systemically relevant at a global level, important for financial stability in multiple jurisdictions due to the nature of their business and the composition of their members and users. They serve multiple markets, having

dozens of clearing members from different countries and clearing products in multiple currencies. A patch-work of approaches to recovery and resolution would risk regulatory arbitrage and competitive distortion and so, whilst the fiscal backstop against the unsuccessful resolution of a CCP is ultimately a national one, it is best that the answer on how to avoid this backstop ever being used is developed at a global level.

The International Level

Before the financial crisis, there was limited international regulation concerning derivatives, particularly OTCDs, and it was mostly issued by the private sector. The US and UK authorities were reluctant to discuss the regulation of OTCDs internationally and domestically. In 2000, the US authorities passed a bill that prevented domestic regulation of OTCDs, despite criticism from Warren Buffett that derivatives were 'financial weapons of mass destruction'. The Federal Reserve, the Bank of England, and the BCBS saw an unregulated OTCDs market as serving the public good by enabling banks to diversify risk and expand the supply of credit, thereby ruling out more intrusive regulation (Lockwood 2018). But as the banking crisis hit, regulators were quick to blame OTCDs for posing a systemic risk to financial stability by underpinning the inter-connectedness of the banking system and exacerbating the impact of major bank failures (see Helleiner *et al.* 2018).

Attention at the international level, therefore, turned to expanding the sphere of public regulation to derivatives markets. Broadly speaking, international efforts focused on four objectives, which mirrored, inter alia, the ones discussed by the report by the FSA-HMT (2009): a) increasing the trading of standardised OTCDs on regulated markets (exchanges or trading platforms); b) expanding OTCD clearing through CCPs, whenever possible; c) ensuring that all OTCD contracts (cleared through CCP or not) were reported to trade repositories; and d) increasing the margins and capital requirements for OTCDs not cleared through CCPs. In addition, regulators sought to tighten regulation of CCPs, including new rules on the resilience, recovery and resolution of CCPs, in recognition of the fact that they had the potential to concentrate systemic risk.

The private sector moved in earnest in an attempt to head off the imposition of more stringent regulation (Pagliari 2013). For instance, in April 2009, the ISDA revised its Master Agreement and introduced the so-called 'Big Bang Protocol' with the objective of improving contractual standardisation within CDS markets. The ISDA and the main dealer banks also issued so-called 'commitment letters', pledging to clear increasing volumes of derivatives via CCPs. Yet, this did little to halt the momentum for tough-

er rules because regulators from the two main jurisdictions with the largest derivatives markets, namely the US and UK, reversed their pre-crisis support for self-regulation. Recognising the unique risk that OTCDs posed to their economies, they began to push strongly for the trading up of international standards (Helleiner and Pagliari 2010; Pagliari 2013).

The regulation of OTCDs was discussed in three main international fora: in the Group of Twenty (G20), which brought together the political authorities of the G20 jurisdictions; the FSB, which was a transgovernmental network coordinating the actions of different national financial authorities and international standard-setting bodies; and the CPSS[1]-IOSCO, which were, respectively, a transgovernmental network of national central banks, and a trangovernmental network of national securities markets regulators. The G20 summit in London in April 2009, under the UK presidency, called for the 'standardisation and resilience' of credit derivatives markets through the establishment of central clearing counterparties, subject to effective regulation and supervision. In September 2009, G20 leaders agreed in Pittsburgh that all standardised OTCD contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through CCPs by the end of 2012. They also added that henceforth OTCD contracts should be reported to trade repositories, while non-centrally cleared contracts should be subject to higher capital requirements.

The FSB was tasked with coordinating the activity of the international standard-setting bodies and monitoring the implementation of these reforms. Finance ministry officials were not directly involved in the details of the new standards, which were left to technical standard setters. But they did inject some 'political drive' into the process and engaged in the discussions on the resolution of CCPs because public money was at stake (interview, London, May 2018). This made regulators determined to design more stringent standards: 'There was the need to move away from recommendations, to something stronger. It was the first time that there was so much focus on this group of international standard setters' (interview, London, May 2018). However, there was also a recognition that, in order to be effective, new standards needed to promote a consistency of approaches across jurisdictions to avoid market fragmentation and discourage a 'race to the bottom'.

The technical bodies were given the task of issuing new standards on market infrastructures, including CCPs. In 2012, the CPSS-IOSCO issued the *Principles for Financial Market Infrastructures* in 2012. According to the

[1] In 2014, the CPSS was renamed the Committee on Payments and Market Infrastructure (CPMI).

new standards, in order to deal with *credit risk*, CCPs should maintain financial resources sufficient to cover a wide range of potential stress scenarios. Specifically, credit requirements were to cover the default of the two participants and their affiliates that would cause the largest credit exposure to the CCP. The previous CPSS-IOSCO (2004) *Recommendations for CCPs* only required the coverage of the largest single exposure. This so-called move from 'cover one' to 'cover two' was advocated by UK and US regulators in recognition of the fact that they hosted large, international CCPs. By contrast, the measure was resisted by those jurisdictions that had small, mainly domestic, CCPs on the grounds that moving to 'cover two' would be costly and difficult to implement. A compromise was eventually reached requiring 'cover one' for simple (mostly, domestic) CCPs which clear equities, and 'cover two' for large CCPs clearing OTCDs. However, the application of different standards to global CCPs and domestic CCPs remains a significant bone of contention amongst regulators (interviews, London, May, 2018).

As for *liquidity risk*, the CPSS-IOSCO standards stipulated that CCPs should maintain sufficient liquid resources in all relevant currencies to settle securities-related payments. In contrast to the requirements on credit risk, a CCP should only 'consider' maintaining additional liquidity resources sufficient to cover the default of the two largest participants, whereas the coverage of the largest two exposures was a hard requirement for credit risk management. This difference was due the fact that a given requirement for liquidity risk was significantly more demanding than the same requirement for credit risk (interview, London, May 2018). CCPs should also have risk-based margins which should not only consider 'normal' market conditions (as required by the older CPSS-IOSCO *Recommendations for CCPs*), but also extreme events. As for *non-financial risk*, new rules were introduced concerning the segregation and portability of the positions of a participant's customers and the collateral provided to the CCP with respect to those positions. *Collateral* requirements were strengthened in particular with a view to avoiding concentration risk, wrong way risk and pro-cyclicality (CPSS-IOSCO 2012).

Although there was a broad consensus amongst regulators on the CPSS-IOSCO *Principles for Financial Market Infrastructure*, the development of international standards on the recovery and resolution of CCPs was delayed because of national sensitivities related to the potential use of taxpayer's money (interview, London, May 2018). In 2014, the CPSS-IOSCO issued a *Report on Recovery for Financial Market Infrastructures*, including CCPs, which was intended to provide guidance on the recovery planning process and the content of the recovery plans, as well as a menu of tools for recovery. In 2017, the CPMI-IOSCO issued *Resilience and Recovery of Central*

Counterparties (CCPs): Further Guidance on the Principles for Financial Market Infrastructures, which was intended to provide clarity and granularity on the implementation of the *Principles* with reference to CCPs. The *Guidance* included more details about how to put recovery into practice: the definition of the internal procedures that CCPs should follow; their sequencing; the rebuilding of depleted financial resources; the testing of recovery plans. It also discussed new items, namely, the amount of CCP's skin in the game and the possibility for CCPs to issue bailanable debt.

In parallel to the CPSS/CPMI-IOSCO's discussion on the recovery of financial market infrastructures, the FSB carried out work on the resolution of financial market infrastructures. In 2014, after public consultation, the FSB reissued the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, incorporating guidance on their application to non-bank financial institutions in four new Annexes. Annex 1 *Resolution of Financial Market Infrastructures*, including CCPs, was developed by the FSB in conjunction with the CPMI and the IOSCO. It was a start, but more detailed provisions were necessary, and the FSB continued its standard-setting work. In July 2017, the FSB issued *Guidance on Resolution and Resolution Planning for Central Counterparties (CCPs)*, which complemented the FSB *Key Attributes* by providing guidance on implementing the Attributes in the resolution of CCPs. The Guidance covered: the policy objectives for CCPs resolution; the powers of the resolution authorities; the indicators for entering a CCP into resolution; the use of loss allocation tools in resolution; the no creditor worse off safeguard;[2] resolution planning, including resolvability and cross-border cooperation, also through crisis management groups for systemically important CCPs.

The *pace-setters* on OTCD standards in international standard-setting bodies were regulators from the US, the UK and, to a lesser extent, the ECB. Their influence derived from three main sources. First, the volumes of derivatives trading and clearing conducted in the US and UK enabled regulators from these jurisdictions to leverage their unique market power to shape the design of post-crisis rules (interviews, London, May, Brussels, June 2018). Second, senior regulators were able to exploit their prominent role within transnational regulatory networks. Central to this was the fact that William Dudley, President of the Federal Reserve Bank of New York, and Paul Tucker, Deputy Governor of the Bank of England, chaired the CPSS during this critical phase, using their high-profile positions to call for

[2] According to the no creditor to worse-off safeguard, clearing members, equity holders and creditors should have a right to compensation, if the resolution authority departed from the loss allocation under the CCP's rulebook, or if they did not receive in resolution, at a minimum, what they would have received in the case of liquidation.

a renewed focus on the importance of financial market infrastructure (for example, see Tarullo 2011; Tucker 2014).

Third, the US and UK could draw upon significant regulatory capacity and expertise at home. As one regulator acknowledged: 'The UK was well placed to take the lead as it had four global CCPs and many global banks; it had been exposed to thinking by industry experts and sophisticated risk models, and it also had a developed legal system' (interview, London, May 2018). The most important source of this expertise derived from the fact that the UK, in particular, was a first mover in designing tougher rules on market infrastructure, including CCPs. For example, while the UK had a resolution regime for CCPs in place by 2012, the FSB did not issue rules on this until 2014, while the EU only proposed legislation in 2016. This enabled UK regulators to exert a significant influence over the regulatory outcome at the international level; in effect, they were able to upload domestic rules on credit and liquidity risk, and collateral, into international standards.

In addition to the US and UK, the ECB also proved to be an important international actor and, indeed, a senior ECB official, Daniela Russo, co-chaired the CPSS-IOSCO working group that drafted the new international standards. The ECB had declared its support for the FSB's efforts to increase the central clearing of OTCDs and to expand the range of potentially clearable products through enhanced standardization (Tumpel-Gugerell 2010). The ECB had its own distinctive agenda on derivatives clearing, however, linked to the financial stability of the euro area. It argued that as a rule, the core infrastructures for the euro 'should be located in the euro area'; if not, they should 'be subject to effective oversight by euro area authorities' Cœuré 2012). This issue came prominently to the fore in the context of Brexit because the UK, where the bulk of euro-denominated derivatives are cleared, would become a third country, and would no longer be subject to EU regulation (James and Quaglia 2019).

Conclusion

Derivatives regulation is a highly technical field characterised by a low level of political salience and voter knowledge. There was, therefore, relatively little political pressure from elected officials for the adoption of more stringent regulation of derivatives markets after the crisis. At the same time, the financial industry remained relatively muted in its opposition to the imposition of tougher rules on clearing and CCPs, not least because different parts of the sector had divergent preferences and because these reforms had benefits as well as costs for private actors. Given the absence of

political pressure for tougher regulation to reassure voters, and limited resistance from industry on competitiveness grounds, UK regulators were in the driver's seat in order to trade up OTCD regulation after the crisis. They had a powerful incentive to pursue harmonised international standards in order to manage the significant cross-border externalities generated by derivatives. This challenge was particularly acute for the UK because the City of London is one of the world's most important centres for OTCDs trading and clearing. Therefore, UK regulators acted as pace-setters at the international level to shape the new standards issued by the CPSS/CPMI-IOSCO and the FSB. Leveraging their significant market power and regulatory capacity, the UK proved highly influential in aligning international rules with its own regulatory preferences.

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