The London School of Economics and Political Science

Private Sector Influence and the International Political Economy of Banking Regulation:

The Formation of the Basel II Accord 1998-2004

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Declaration

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Abstract

This study undertakes an empirical investigation of private sector influence over transnational financial regulatory policymaking. I examine the relationship between the content, context, and success of private sector attempts to influence the formation of the Basel II Accord between 1998 and 2004. I call these efforts 'private sector campaigns', and engage in an empirical analysis of campaigns organized at both the transnational level and at the national levels in Canada, Germany, Japan, the United Kingdom and the United States.

The analysis employs a mixed-method research design involving process tracing analysis, fuzzy-set Qualitative Comparative Analysis (fsQCA) and statistical regression analysis. Using extensive primary source material, I test a number of different hypotheses prevalent within relevant academic literatures regarding the specific means that private sector groups use to influence their regulators, as well as the transnational and national pathways by which private sector influence translates into actual regulatory policy change.

While I find evidence for a number of important instances of private sector influence over the content of the Basel II Accord, I find that this influence is much more contingent and context-dependent than depictions of 'regulatory capture' in the IPE of finance literature suggest. In particular, the presence of business conflict strongly affects the success of private sector campaigns. Furthermore, I find that while there are a number of necessary conditions that have to be in place for influence to occur, there is no individually sufficient condition for influence. Rather, only a particular combination of conditions is sufficient in generating private sector influence. This particular set of conditions is, however, highly fragile.

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with excellent critique of the most productive and useful kind. I am especially indebted to their engagement with my structural power claims as well as their encouragement to embolden my method and findings vis-à-vis the existing literature.

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Abbreviations & Acronyms

ABA	American Bankers' Association
ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
AD&C	Asset Development and Construction
AMA	Advanced Measurement Approach
ASF	American Securitization Forum
AVC	Asset Value Correlation
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority)
BaKred	Bundesaufsichtsampt Für das Kreditwesen (German Financial Supervisory Agency)
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BdB	German Bankers' Association
BDI	National Federation of Industry (Bundesverband der deutscher Industrie)
BMA	Bond Market Association
BVR	Association of Cooperative and 'Raffeisen' Banks (Germany) (Bundesverband Volksbanken und Raffeisenbanken)
CBA	Canadian Bankers' Association

CDO	Collateralized Debt Obligation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CMBS	Commercial Mortgage-Backed Securities
CMSA	Commercial Mortgage Securities Association
CRE	Commercial Real Estate
DIHK	German Association of Chambers of Commerce (Deutscher Industrie und Handelskammertag)
DSGV	German Association of Savings and Cooperative Banks (Deutscher Sparkassen und Giroverband)
EAD	Exposure at Default
EL	Expected Losses
FDIC	Federal Deposit Insurance Corporation
FGG	Financial Guardian Group
FMI	Future Margin Income
fsQCA	Fuzzy-Set Qualitative Comparative Analysis
FSR	Financial Services Roundtable
HVCRE	High-Volatility Commercial Real Estate
ICBA	Independent Community Bankers of America
IIDB	Institut International D'Etudes Bancaires

IIF	Institute of International Finance
IMF	International Monetary Fund
ISDA	International Swaps and Derivatives Association
ITWG	International Technical Working Group
JBA	Japanese Bankers' Association
JFSA	Japanese Financial Services Agency
KfW	German Bank for Reconstruction and Development (Kreditanstalt für Weideraufbau)
LGD	Loss Given Default
LIBA	London Investment Banking Association
MICA	Mortgage Insurance Companies of America
NAHB	National Association of Home Builders (US)
NAR	National Association of Realtors
NAR	National Association of Realtors
OCC	Office of the Comptroller of the Currency
OECD	Organization for Economic Cooperation and Development
OSFI	Office of the Superintendant of Financial Institutions
OTS	Office of Thrift Supervision (US)

PD	Probability of Default
PRPC	Permissive Regulatory Policy Change
QCA	Qualitative Comparative Analysis
QRREs	Qualified Revolving Retail Exposures
RER	Real Estate Roundtable
RMA	Risk Management Association
RMG	Risk Management Group
RWA	Risk Weighted Assets
SA	'Securitization Associations'
SIA	Securities Industry Association
SIFMA	Security Industry and Financial Markets Association
SMEs	Small and Medium Sized Enterprises
UKFSA	Financial Services Authority of the United Kingdom
UL	Unexpected Losses
VDH	German Association of Mortgage Banks (Verband deutscher Hypothekenbanken)
WGOR	Working Group on Operational Risk (IIF)
ZDH	Association of German Crafts (Zentralverband deutscher Handwerks)
ZKA	Central Credit Committee (Zentraler Kreditauschuss)

Introduction

Opening Up the Black Box of Private Sector Influence

Understanding the power of private sector groups in influencing financial regulation has long been a central concern for political economists. The emergence of new, transnational financial regulatory bodies over the last 25 years, whose decisions have wide-reaching effects and global implications, has made this issue both more pressing and more complex.[1] Extensive claims have been made within the International Political Economy (IPE) literature and elsewhere regarding 'regulatory capture' at this level of governance; such claims assert that private sector groups' influence over transnational regulation has been systematic and pervasive.[2] Yet surprisingly, for all the claims, and for a phenomenon that has far-reaching impacts on contemporary human welfare, very little is actually known about *how* private sector groups influence the content of financial regulation; concerning transnational financial regulatory standard formation, this knowledge is even sparser.[3] In this sense, private sector influence represents a 'black box': a phenomenon to which many refer, but seldom look inside or closely examine.[4]

In this study, I look inside the 'black box' of private sector influence. I do not seek to re-theorize that box; rather, I undertake a detailed, systematic empirical analysis to examine its contents. My analysis seeks to address of the following central question: How do private sector groups influence transnational financial regulatory policymaking? I investigate the different actions and strategies that private sector groups employ in their attempts to influence the content

[1] I employ transnationalism here to connote a rule-making institution which is organized above the level of the state, but which is not strictly composed of state representatives, and does not possess coercive authority. See Kahler and Lake 2008, pp. 269-70. Some international relations scholars use the term 'transgovernmental' to refer to relationships between state actors who are not members of executives/cabinets, a usage begun by Keohane and Nye 1974.

[2] See Stigler 1971. This term, and its use within the IPE of finance literature, is discussed extensively in Chapter 1.

[3] I understand private sector groups to connote private business enterprises and their associations.

[4] See Watson 2007, p. 14. On black boxes in social science generally, see Mahoney 2004.

of financial regulatory policy.[5] I call such private sector activity, and the context in which these actions took place, 'private sector campaigns'. I investigate the relationship between the content, context, and success of these campaigns through a variety of methods, both quantitative and qualitative. Using extensive empirical primary source material, I test a number of different hypotheses prevalent within relevant academic literatures regarding the specific means that private sector groups use to influence their regulators, as well as the pathways by which private sector influence translates into regulatory policy change at the transnational level.

Herein I specifically investigate the influence of private sector groups on transnational regulatory policymaking by investigating the formation of the Basel II Accord between 1998 and 2004.[6] Basel II is an international regulatory standard developed by the Basel Committee on Banking Supervision (BCBS), an informal group of central bankers and banking regulators drawn during this period from the 'G10' states: the United States, the United Kingdom, Switzerland, Sweden, Spain, the Netherlands, Luxembourg, Italy, Japan, Germany, France, Canada and Belgium.[7] As I detail in this study, the process of drafting the Basel II Accord involved years of detailed technical analysis, consultation, and negotiation. It evolved from a set of preliminary ideas about how best to approach banking regulation in 1998, into an extremely detailed 239 page document of regulatory policies in 2004, which included everything from the regulation of detailed risk models and internal bank operations, to the definition of capital itself.

By engaging in a systematic analysis of private sector campaigns directed at influencing Basel II's content, I find that private sector influence was much more uneven and circumscribed than depictions within the existing IPE literature suggest. Though private sector groups sometimes successfully influenced the content of the Accord, this success was contingent on a particular set of conditions. First, while private sector groups can utilize a diverse range of power resources in the realization of their ends, I find that their influence is highly contingent upon the factor of business conflict. Second, I find that a number of specific conditions are necessary for influence to occur, but that no individual condition is sufficient for influence. Third, I find that

[5] I use the term influence to connote the manner in which one or more actors induce change in an outcome such that it is different from what would have otherwise taken place. By private sector influence over regulatory policy, I refer to the manner in which a regulatory policy has been informed by actions taken by private sector groups which changed the content of that policy in a discernable way.

[6] Formally, the Basel II Accord is known as *International Convergence of Capital Measurement and Capital Standards: A Revised Framework.* See BCBS June 2004.

[7] Spain was invited to the BCBS in 2000, and did not formally participate in the BCBS before this point.

there exists an optimal *combination* of conditions which, once in place, are sufficient in generating private sector influence. This particular set of conditions is, however, highly fragile.

As I detail below, focusing on the formation of the Basel II Accord to understand how private sector influence operates has a number of distinct advantages. First, the BCBS is widely regarded as a central institution in the global governance of finance; its most recent regulatory standard, Basel II, is similarly considered an important transnational regulatory policy. Second, scholars of IPE have treated the formation of Basel II as the quintessential example of how private sector groups systematically influence the development of transnational financial regulatory standards.

The Importance of the Basel Committee on Banking Supervision

The BCBS is consistently identified as the archetypal example of a transnationally organized technical institution setting the pace of financial regulation, and is considered central to the system of global financial governance. [8] Alexander, Dhumale and Eatwell have noted that "[t]he Basel Committee has become the most influential international financial standard-setting body" in the world today.[9] This fact is relatively undisputed regardless of the normative evaluation of its policies. For example, Rude's Marxian critique has argued that the BCBS constitutes one of the "core features of neoliberal global capitalism's supervisory and regulatory regime."[10] Meanwhile, the *Financial Times*, hardly the bastion of Marxian sympathizing, has compared the BCBS to the financial-sector equivalent of the Council of Nicea, thereby suggesting that Basel II is as important to financial risk management as the Council to the rebirth of Christianity in the Middle Ages. [11] Even though Basel II has received tremendous criticism concerning its content and its legitimacy, Steel and Litan observe that bank regulators in the G10 nevertheless continue to "worship at the altar of Basel."[12] Basel II in particular is seen as a central example of either everything that is wrong with the current structure of global financial

[8] See, for example, Jordan and Majnoni 2003, p. 262; Porter 2003, pp. 535-537; Pauly, 2008, pp. 73-89; Alexander Dhumale and Eatwell 2006, pp. 34-78; Helleiner and Pagliari 2010, p. 2.
[9] Alexandar, Dhumale and Eatwell 2006, p. 54; Porter 2005, pp. 57-65; Davies and Green 2008, pp. 32-47.
[10] Rude 2008, p. 205.
[11] Pretzlik September 2003, p. 26.
[12] Steel and Litan 2006, p. 25.

regulation, or everything that is right about it. Regardless, Eatwell's recent remark that "[t]he analytical foundations of regulation over the past three decades are clearly defined in the structure of Basel II" seems prescient.[13]

The governance of the BCBS has been a particular point of fascination for social scientists for some time due to its peculiar structure. The particular institutional design of the BCBS has meant that its decisions are several steps removed from sovereign authority. The participants within the BCBS are not elected representatives, and in most cases they have not even been formally delegated to take decisions within the BCBS on behalf of governments. Rather, participants are bureaucrats within regulatory agencies and central banks. Although such institutions are a part of the formal state apparatus, they are, by design, highly independent from elected legislatures and executives.[14] Additionally, the decisions of the BCBS itself are not subject to approval by any national government or external authority.[15] As Underhill and Zhang have correctly asserted, the BCBS is characterized "by virtual separation from any accountable political process."[16] Most decisions are made on the basis of technical discussion in a manner commensurate with 'deliberation', meaning that most engagement is informal in character, and the *de facto* decision-rule is implicit consensus.[17] However, as anyone familiar with the formation of the 1988 Basel Accord knows, this deliberative norm does not mean that power dynamics are absent from the BCBS.[18] Apart from the power dynamics between regulators and private sector, one must also consider the geopolitical tensions and power struggles among regulators themselves.[19]

The output of the BCBS has far reaching consequences in terms of how financial regulation is conducted all over the world. In addition to establishing regulatory standards for the G10, and because of strong incentives for states to emulate BCBS standards, it exercises global

[13] Eatwell 2009, p. 37.
[14] See Gilardi 2007; Gilardi 2002; McNamara 2002; Thatcher 2002.
[15] The G10 Governors within the Bank for International Settlements approve major policy outputs of the BCBS, but this role is largely ceremonial, and in any case is composed of some of the same institutions as the BCBS itself. See Davies and Green 2008, pp. 218-219.
[16] Underhill and Zhang 2006, p. 29.
[17] See, for example, Slaughter 2004, p. 160; Kussin and Kette 2006; These observations are also substantiated by interviews conducted with BCBS participants.
[18] As Kahler and Lake have argued, while the BCBS has exhibited some elements of hierarchy, on the whole it can be characterized as a network. Kahler and Lake 2008, pp. 269-272.
[19] See Kapstein 1992 for the BCBS; See also Drezner 2007.

influence.[20] International capital markets use Basel-based standards to evaluate the financial soundness of banks, and international institutions, such as the IMF, have also used BCBS standards as a crucial metric.[21] National regulatory agencies outside the G10 attempt to make their banking systems Basel-compliant to signal the good health of their financial systems to international markets.[22] For these reasons, and because of the peculiarities of the BCBS' governance structure discussed above, the output of the BCBS has been regarded as a prime example of 'soft law', as its standards are enforced, but not through legal, sovereign authority.[23] Additionally, Basel standards have a profound effect on the internal operations of banks around the world. They affect the daily practices of risk management, and are integrated into the culture of firms. The output of the BCBS thus indirectly constitutes, as one US banker put it, "the lingua franca of capital."[24]

Basel II and Private Sector Influence

During the period under study, Basel II was, as one observer put it, "the biggest thing happening in banking."[25] As a systematic revision to the original Basel Capital Accord of 1988, Basel II set out to develop detailed regulatory minimum standards for how banks were to assign regulatory capital to particular kinds of risks. Rather than specifying a simple, straightforward set of risk categories delineating banks' regulatory capital holdings as the original Accord did, Basel II attempted to evaluate, on a microeconomic basis, the specific level of risk associated with particular internal processes of banks. Because the BCBS and its output have far-reaching consequences, the particular content of the Basel II Accord was widely contested in numerous ways over the course of its development. Within the BCBS, regulators argued, and sometimes bargained over, the Accord's details. Private sector groups of all kinds also challenged the design of the Accord in various ways, at both the national and transnational levels.

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[20] See Kerwer 2005; Ho 2002. By 1998, over 120 countries either claimed to have adopted the 1988 Basel Accord or were in the process of doing so. See Alexandar, Rahul and Eatwell 2006, p. 42; Genshell and Plümper 1997, pp. 630-31.
[21] See Alexandar, Rahul and Eatwell 2006, pp. 41-42, 229.
[22] See Kern, Rahul and Eatwell 2006, pp. 42, 229. See Brownbridge and Kirkpatrick 1999.
[23] See Abbott and Snidal 2000; Panourgias 2001; Delonis 2004; Abbott and Snidal 2008.
[24] Interview 83P.
[25] Andrew Kuritzkes, a Managing Director at Mercer Oliver Wyman & Co., quoted in Paletta April 2004.

The extensive private sector activity that surrounded Basel II's formation has led many IPE scholars to assert that global 'regulatory capture' occurred, a pervasive argument I discuss in detail in Chapter 1. As we shall see, however, while some private sector campaigns were successful in influencing Basel II's content, many others were not successful at all. This variation serves as a useful means to explore how private sector groups influence transnational financial regulatory policymaking, because it provides a basis of variation on the *dependent variable* or 'outcome' of interest. While Basel II is a single regulatory standard, it has many different regulatory policies within it, which had substantial variation in outcomes – a point not well appreciated within the existing depictions of the Accord. There is also substantial variation in the content and context of private sector campaigns. Some campaigns were waged at the national level; other campaigns were transnational in character. Some campaigns were characterized by the use of detailed technical studies as part of a coordinated strategy to convince regulators of the need for regulatory policy change; other campaigns simply signaled that policies would be bad for business or the national economy more broadly. This diversity thus provides a source of variation in the main *explanatory variables* of interest, namely the specific content and context of private sector campaigns.

To analyze the relationship between the content and context of private sector campaigns and their varied outcomes, I investigate actual processes of advocacy and interaction, and compare patterns across the different campaigns. I draw upon the extensive paper trail of documents and studies that Basel II left in its wake. Private sector groups often posted their letters publicly on the internet; the BCBS itself produced innumerable studies and reports, as did national regulators; and many of the relevant parties offered their views in the form of speeches and interviews with journalists, during and after the period of interest. To complement this data, I conducted semi-structured interviews with 97 individuals involved in the advocacy surrounding, and formation of, Basel II; that is to say, I spoke with representatives of the private sector, relevant national regulatory bodies, and the participants within the BCBS itself.

Scope and Assumptions of the Study

Despite the advantages conferred by focusing on Basel, there are several limitations associated with having Basel II as the central focus of this study. Basel II is a regulatory standard

in the domain of banking, not the financial sector as a whole. It might thus be asserted that this study's findings are particular to the world of banking regulation, and not the wider world of finance, such as the regulation of hedge funds, currency trading, money laundering, securities regulation, etc. This focus on banking can indeed be regarded as a limitation. Banking is, however, a highly important domain of financial sector activity. In fact, banking is commonly considered the *central* pillar of the financial system, since banks are the central private institutions in the economy that generate the supply of credit.[26] Furthermore, most public policy consequences of financial regulation involve banks in some way, since banks act as intermediaries and participants in a wide range of financial activities *other than* the allocation of credit. Indeed, the policies examined herein involve the regulation of discrete aspects of bank behavior, such as their management of derivatives, securitized assets, and operational risk in addition to typical bank activity, namely, the management of credit risk. Additionally, several of the private sector campaigns investigated in this study involve not only the mobilization of banks, but also other groups within the financial sector and beyond it.

The approach taken here focuses at its core on the actions of private sector groups. I acknowledge that many approaches of political economy stress the rational interests of actors, and rather than trace actual processes of action and change seek to observe 'causal effects' of actors based on different institutional and structural constraints.[27] Rather than assuming the interests of actors, I ascertain their expressed preferences based on close empirical observation. Preferences are understood as subjectively perceived affinities – something an actor wants, but doesn't necessarily 'objectively' require. This understanding stands in contrast to 'interests', which is more of a constitutive property of an actor, irrespective of that actors' judgment, decisions, or subjective position. I emphasize the importance of observing preferences and action because it enables a different kind of empiricism than undertaken by many existing empirical studies. In this regard my approach differs from perspectives which do not examine the instrumental actions of actors, but rather focus upon the related institutional or structural conditions in which they operate, such as statist, institutionalist, and open-economy models of political economy.[28] In such work, institutions, or the structural conditions of action, are co-

[26] For a useful review of this widely held notion, see Busch 2009, pp. 23-24.
[27] See Lake 2009, p. 49; Frieden 1991; Rogowski 1989; Bates 1997; Frieden and Rogowski 1996; Posen 1993.
[28] Cf. Lake 2009; Drezner 2006; Konings 2008

varied with outcomes, and are understood to do the causal work. As such, the actual articulation of interest groups are empirically presumed rather than empirically examined. The claim that interests are endogenous to institutional conditions may be empirically correct, but evidence must be forthcoming in order to qualify it as an empirical claim; otherwise it is merely an assumption. Nonetheless, the approach taken in this study considers the role of institutions and the structural conditions of action seriously, not only by situating the processes described in their appropriate context, but by considering institutions and structural power variables as potential explanatory factors alongside the more 'agency-driven' factors at the core of the study.

Insofar as this study is primarily an exercise in empirical hypothesis testing, I do not associate the process of enquiry herein with any specific theoretical tradition within IPE. I recognize, however, that basic political ontologies represent distinct choices which one cannot abstain from. As such, this study adheres to the broad parameters of empirical pragmatism on the one hand, and neo-pluralism on the other. As a broad framework for understanding business influence, neopluralism considers not only the instrumental actions of private sector groups, but also their structural power resources as potential explanatory factors.[29] By empirical pragmatism, I refer to the notion, held by its practitioners, that patterns within social structures exist, and that observers can discern these patterns through empirical enquiry, if imperfectly.[30] Pragmatist accounts of political processes are explicitly committed to the refining and testing of empirical knowledge, but are less ambitious than neo-positivism in attaining law-like generalization.[31] As many have recently pointed out in meta-theoretical debates within IPE, empiricism need not coincide with restrictive quantitative approaches, or even all tenants of neo-positivism.[32]

This study combines empirical pragmatism with neo-pluralism in a substantive sense in that I not only consider a range of explanatory conditions and causal mechanisms, but I use a diversity of methods as well. Neo-pluralism as a mode of enquiry considers a plurality of causal factors in affecting outcomes of interest, and stresses the contingency of business influence. I adopt this perspective of contingency, but consider it an empirical proposition subject to testing.

[29] See Lindblom 1977; Cerny 2010; Falkner 2010; Sell 2000.
[30] See Farrell and Finnemore 2009, pp. 65-67; Katzenstein and Sil 2008; Grynaviski 2010, p. 7; from Dewey 1986, pp. 196-97
[31] Farrel and Finnemore 2009, p. 67. Though as Grynaviski notes, pragmatists do posit generalized propositions. See Grynaviski 2010, p. 7, from Dewey 1986, pp. 196-97.
[32] See Blythe 2009; Helleiner 2009, p. 381; Cameron and Palan 2009; see Jackson 2010 on the 'analyticist' alternative position.

The emphasis on contingency in IPE has been emphasized by many, not least by prominent proponents of neo-Pluralism.[33] Contingency is, however, an empirical claim: if a process or outcome is contingent, what is it contingent *on*? Contingency is an ontological claim as well; but has this ontology been matched with an appropriate methodology?[34] In terms of tracing the contingency of processes within cases, various methods have enabled the assessment of such contingency, such as the emphasis on path dependence in historical institutionalism, the extended-form games of analytic narratives, and the multiple, and unexpected, equilibria of agent-based modeling. All of these methods expand social scientists' capacity to trace and observe contingent social processes within cases.[35] When analysis *across* cases is concerned, however, the breadth of practices is less impressive, since many analysts simply rely on statistical analysis as a matter of course.[36] The recent innovation of Qualitative Comparative Analysis (QCA) is a method of across-case analysis which is particularly adept at analyzing the contingency of social processes. While it has been increasingly employed in comparative politics and sociology, it has not been applied to IPE. This study employs this method as the central form of across-case analysis.

Before proceeding, I want to clearly define some terminology used within this study. I use the encompassing term 'regulators' rather than 'supervisors' for reasons of consistency, and because this study focuses exclusively on regulatory policy formation, rather than implementation. When I refer to members of the BCBS I refer to these as 'regulators' rather than as 'central bankers and regulators'. This decision can be justified because BCBS members' behavior in Basel II formation reflects the concerns of regulators rather than central bankers, who are primarily concerned with the conduct of monetary policy. Finally, I do not employ the language of 'lobbying'. While lobbying is sometimes understood broadly as the attempt to influence a policy, it is often understood as activity undertaken by professional lobbyists calculated to influence elected representatives. Since this study is interested in relationships between a variety of actors, and legislators are not the sole or even central focus, I do not use the term lobbying except when a professional, registered lobbyist is involved.

[33] Cf. Amin and Palan 2003; Cerny 2009; Cerny 2010; Macartney 2009.
[34] On such alignment, see Hall 2003.
[35] See North 1990; Bates et. al. 1998; Miller and Page 2007.
[36] See Malianak and Tierney 2009, p. 19. Even within statistical analysis, complex interdependencies and interactions are employed but often poorly understood, as demonstrated by recent interventions within the methodological literature. See Franzese and Hays 2008; Brambor et. al. 2006.

Plan of the Study

This study is divided into 10 different chapters. Chapter 1 surveys and engages with the existing academic literature on the power relationships between private sector groups and financial regulation. I argue that within the relevant IPE literature, understandings of private sector influence in banking regulation are not adequately developed, and I make this case with reference to the existing research on the formation of the Basel II Accord. In particular, I assert that both the empirical and logical standards of the existing literature are unsatisfactory, especially in light of strong claims regarding 'regulatory capture'. I draw from both the IPE literature as well as the wider literature on the political economy of regulation to derive several testable hypotheses regarding how private sector groups influence transnational financial regulation. A total of eight hypotheses are derived - four concern the 'means' that private sector groups use to influence their regulators, two important scope conditions, and two concerning the pathways that private sector groups utilize to effect influence.

Chapter 2 sets out the research design of the study. The methodologies employed in the study – process tracing, fuzzy-set qualitative comparative analysis (fsQCA), and statistical regression analysis – are discussed in terms of their respective strengths and weaknesses. I define the main dependent variable that I employ, 'permissive regulatory policy change', and I describe the constitution and measurement of the wide variety of explanatory variables used in the study. I then outline the process by which private sector campaigns were selected for investigation, and specifically define what this study understands as a 'case'.

Chapters 3-9 engage in detailed process tracing analysis of different private sector campaigns associated with a range of different regulatory policies. The first of these, Chapter 3, examines different private sector campaigns which were organized *transnationally*. Six different transnational campaigns are analyzed, ranging from efforts to advocate for the use of internal bank models to assess risk, to efforts to change policies concerning specific risk parameters. I analyze and evaluate the success of transnational mobilization over these policies, and find that while in a number of instances private sector influence occurred, the extent and character of influence is not congruent with the depictions in the existing IPE literature.

Chapter 4 examines a private sector campaign organized at the national level in Germany to target the Accord's treatment of commercial real estate. I find that while private sector groups played an important role in securing their desired policy outcome, their influence was over the bargaining strength of their national regulators within the BCBS negotiations, and not over the position of these regulators.

Chapter 5 examines national private sector campaigns concerned with Basel's provisions on lending to small and medium-sized enterprises (SMEs). This chapter discusses campaigns in the UK and Japan, but focuses on the successive national private sector campaigns within Germany which sought to create a specific new regulatory policy that would protect lending to SMEs.

Chapter 6 engages in an analysis of the extensive private sector campaigns against the Accord's operational risk policy. This chapter focuses on campaigns waged within the US, and details their efforts from 2001 to 2004 in a series of complex efforts involving different coalitions and legislative oversight.

Chapter 7 examines the private sector campaigns concerned with two policies designed to regulate banks' real estate exposures. I focus first on a very specific regulatory policy designed to regulate 'high volatility' commercial real estate lending, and find that an extensive coalition of small banks, large banks, and real estate groups organized to successfully influence this policy in the US, but that a second attempt at influence failed. I then describe the private sector campaigns associated with the Basel II policy toward residential mortgages, where business conflict was persistent.

Chapter 8 examines private sector campaigns regarding Basel II's treatment of banks' 'expected losses' and credit card exposures. I examine both a number of national and transnational efforts to change these policies, and find that it was only in the United States that private sector campaigns were successful, but only under very particular conditions. I find that while private sector groups were very successful at influencing their regulators, their influence over Basel II's actual policy content was much more limited.

Chapter 9 examines private sector campaigns associated with the Accord's policy toward securitization. I find that while a number of different campaigns at both the national and

transnational level were unsuccessful in influencing the securitization policy, one concerted US-level campaign was successful, albeit in a highly circumscribed way.

Chapter 10 engages in detailed across-case analysis to assess the empirical patterns found in the different campaigns examined. Using fsQCA, it finds general support for a number of different hypotheses in the study when understood as *necessary* conditions. However, no individual hypothesis is *sufficient* in explaining private sector influence. Rather, I find that private sector influence was associated with a particular 'recipe', that is, a particular *combination* of conditions sufficient to explain influence across cases. Private sector groups not only have to provide information to their national regulators and have non-bank allies, but they have to do so in the context of both a particular legislative environment and the absence of business conflict. I test the robustness of this 'recipe' using both statistical regression analysis and further fsQCA, and find that a variety of different methods support this particular combination of conditions.

The study concludes by reflecting on its central empirical findings. I argue that existing understandings of private sector influence over financial regulation have provided a useful framework for discussion, but that many of the depictions and conclusions within the existing literature are misleading. Private sector influence over transnational financial regulatory policymaking, I contend, is a much more contingent and fragile force than is commonly assumed. While private sector influence has been pervasive in that it occurred throughout Basel II's formation and over a range of different regulatory policies, I argue that this influence was highly contingent and contextually bound. Private sector groups were not only unable to influence Basel II in the presence of business conflict, but there is actually a very specific combination of conditions which are both necessary and sufficient for private sector groups to succeed in their efforts. This recipe of conditions, however, is itself highly fragile, since its individual components are not under the control of any one actor. I discuss the relevance of these findings for existing research traditions within political economy and reflect on the particular approach taken in this study.

Chapter 1

Existing Literature and Hypotheses

This chapter outlines the existing research on the political economy of banking regulation, from which it derives a series of testable hypotheses regarding how private sector groups influence their regulators. The chapter is divided into three sections. Section One situates the study in the context of the International Political Economy (IPE) of finance literature, and argues that the understanding of private sector influence in banking regulation is not well developed. Section Two makes the case that such a weakness exists by surveying the existing research on the formation of the Basel II Accord. It is argued that both the empirical and logical standards of the existing literature are unsatisfactory, especially in light of strong claims regarding 'regulatory capture'. Section Three then surveys the broader literature on the political economy of banking regulation and derives eight testable hypotheses regarding how private sector groups influence transnational financial regulation.

Section 1
International Political Economy and Private Sector Influence

Describing and analyzing policy outcomes and power relationships in the domain of finance has been an important component of many research programs within IPE. Yet it is in the realm of finance that the analysis of private sector power remains relatively elusive. The power resources available to private sector groups to influence financial regulation are often theorized;

and they are described even more often.[37] However they are seldom subject to empirical scrutiny by means of empirical hypothesis testing.[38] Perhaps part of the reason for this is because of the normative-ontological focus of much of the engagement with the political economy of financial regulation. A normative focus is hardly surprising, given the manifold and far-reaching policy consequences of financial regulation. Likewise, an ontological focus has been important – not only because "ontology lies at the beginning of any enquiry,"[39] as Cox wisely remarked, but also because an acceptable conception of the international financial system, and the power relations within it, has been a central concern to early scholarship within IPE.[40] Yet one can also concur with Watson's recent critique that a large amount of work in the IPE of finance focuses on normative critiques of the outcomes of contemporary economic processes, rather than interrogating the empirical basis behind such processes. As Watson has remarked,

> Much excellent work as recently been published in this vein, feeding powerful moral arguments about why it would be desirable to transcend the existing state of affairs. But this still does not negate the need for a rather deeper understanding of the actual practices which dominate the day to-day operation of the international financial system.[41]

Watson encourages us to engage in "unpacking the 'black box' of international finance" through detailed empirical study.[42] In this vein, this study aims to make a contribution to the IPE of finance literature by engaging in a detailed empirical analysis of private sector influence over transnational regulatory policymaking. As I argue below, this is an area of enquiry which has been traversed extensively in recent years, but which remains unsatisfactory in terms of the empirical standards which are actually brought to bear. After reviewing the existing literature on the BCBS, I make this point with reference to the extensive literature investigating the formation of Basel II.

Section 2
The Existing Literature on the BCBS

[37] See, for example the recent high-profile comments of Strauss-Kahn in IMF Survey Online, 2009; Tett and Turner in Ford 2009.
[38] Exceptions include Busch 2007; Underhill and Zhang 2008; Griffith-Jones and Persaud 2008
[39] Cox 1996, p. 114.
[40] Cf. Strange 1988; Braudel 1984; Underhill et. al. 2000.
[41] Watson 2007, pp. 212-213.
[42] Watson 2007, p. 212. A similar case has been made by Burn 2006, pp. 4-10.

Within the IPE of finance literature, the BCBS and its activities have occupied an important place. Indeed, many of the central research contributions to thinking about regulatory cooperation have focused on the BCBS. In particular, there has been a concerted focus on the formation of the 1988 Basel Capital Accord, and more recently on the Basel II Accord, as we shall see below.

The 1988 Basel Capital Accord

An extensive academic literature studies the formation of the 1988 Basel Capital Accord. The central concern of this literature has been to explain the impressive degree of transnational regulatory co-operation which facilitated the realization of the Accord. Kapstein has argued extensively that such cooperation was the product of the assertion of US-UK financial market power alongside a shared set of norms for banking supervisors to cooperate for the purposes of financial stability.[43] While market power is central to this analysis, it is the decisions of states that is of paramount interest. In this regard, Kapstein argued that the US pressured foreign governments (in particular the Japanese) by threatening to cut off their access to the US financial system.[44] Similarly (but as part of a comparative study of capital market regulation more generally), Simmons has also analyzed the formation of the first Basel Accord, and posited the central role of US initiatives to use US financial sectoral power as leverage to generate an international standard.[45]

In contrast to these studies, Oatley and Nabors have argued a more central role for private sector groups in the formation of the 1988 Accord, as their account sought to emphasize the dimension of redistribution and conflict, rather than functionalism and cooperation they attributed to the original work of Kapstein.[46] Reflecting a public choice model of regulation, Oatley and Nabors have underlined the importance of private sector initiative in forging the Basel Accord. In their depiction of the 1988 Basel Accord's formation, US regulators were motivated by the promotion of the private preferences of US banks.[47] Seeking to minimize the

[43] See Kapstein 1989; Kapstein 1992; Kapstein 2006.
[44] See Kapstein 1992, p. 226; Genschel and Plümper 1997, pp. 629-31.
[45] Simmons 2001.
[46] Oatley and Nabors 1998.
[47] Oatley and Nabors 1998.

impact of new domestic capital adequacy regulation in the US, US banks pressured Congress and the US regulators to seek international regulatory cooperation in a process they called 'redistributive cooperation.' Singer has in many ways drawn from and expanded this model, and has used the 1988 Basel Accord as an example of the conditions under which international financial regulatory cooperation occurs.[48] In this regard, his model posits that while domestic regulators have an incentive to engage in international cooperation, it is not until either a negative financial shock or the spectre of legislative intervention that a regulator will do so. Regulatory cooperation is thus motivated not by technical issues and functionalism, but by the broad political constraints on the regulators' objectives, a mechanism which is discussed below.[49]

While the literature on the formation of the 1988 Basel Capital Accord may have contributed to the understanding of international financial regulatory cooperation, the focus of this literature has been on the *demand* for such cooperation, rather than the actual content of the regulations themselves once a commitment to cooperation was relatively secured, i.e. its *supply.* The literature on the formation of the 2004 Basel Capital Accord (Basel II), however, has put the influence of private sector groups at its core, arguing that the supply of regulation has been very heavily informed, if not determined, by particular private sector groups.

Existing Literature on the 2004 Basel Capital Accord

Basel II is discussed in a wide variety of academic literature, but typically it is in regard to a normative evaluation of its orientation and its consequences, rather than an explanation for how its regulatory policies came into being.[50] The manifold and extensive critiques of the Accord's content in this regard will not be reviewed here. Suffice it to say that Basel II is commonly regarded as virtually synonymous with modernization in banking regulation, with all its innovations, strengths, and problems.[51] A wide variety of literature has critiqued not only the content of Basel II, but also the context in which it was developed – especially in light of its

[48] Singer 2004; Singer 2007.
[49] Singer (2007) noted a number of dynamics at play in the Basel II negotiations, such as extensive private sector critique of Basel II and US congressional involvement, but such engagement was descriptive rather than analytical. See Singer 2007, pp. 62-65, 121.
[50] See Alexandar Dhumale and Eatwell 2006, pp. 227-238.
[51] As evident in multiple discussions within Mayes and Wood 2007.

shortcomings in light of the contemporary regulatory environment.[52] Amidst the plethora of normative critiques of Basel II, there have been a number of empirical evaluations of the role of private sector groups in its formation as well.

The Existing Literature on Basel II and Private Sector Influence

A wide variety of academic literature has commented on the relationship between private sector groups and the construction of Basel II. There is considerable conjecture in this regard, but very little actual evidence brought to bear. Most accounts of Basel II's development in the academic literature refer to Basel II's content being the result of private sector influence, but the extent, or details, or mechanisms of this process are not analyzed. Rochet, for example, states that Basel II involved "intense bargaining with large banks", and Flemming has asserted that the formation of Basel II involved "intense lobbying" by banking associations and individual financial institutions, but neither author provides any details or analysis of how this occurred, let alone evidence of its existence.[53] Steel and Litan state that the formation of Basel II was "at times influenced by the banks it purported to regulate."[54] How such influence operated, or the extensity of it, is not discussed, and only anecdotal examples are used.[55]

Other depictions also suggest a substantial mobilization of large banks followed by policy change aligned with their preferences, but the analysis begs the question of whether or not such correlation was causally spurious or not, especially in light of the lack of evidence provided. For example, in his extensive normative critique of the content of Basel II, Tarullo has argued that the formation of the Accord was characterized by involvement of large internationally active banks who "organized themselves to maximize their influence in pursuit of their shared interest..."[56] and that "...the large international banks with potentially the most to gain from a change of regulatory paradigm...had organized themselves both at national and international

[52] For earlier contextual critiques, see, for example Wade 2007, pp. 126-127; Barth, Caprio and Levine 2006, pp. 67-69; Siebert 2009, p. 160; Power 2005, p. 595.
[53] Rochet 2008, p. 273; Fleming 2003, p. 47.
[54] Steel and Litan 2006, p. 27.
[55] See Steel and Litan 2006, pp. 23-24.
[56] Tarullo 2008, p. 100.

levels in an effort to influence the final Basel II rules."[57] Despite their implied success in this regard, no empirical evidence is provided in regard to how this process of influence operated.

Aside from stylized descriptions of private sector influence, the formation of Basel II has been consistently cited within the IPE literature as an instance of 'regulatory capture' by private sector interests, invoking the notion from Stigler that the content of regulation is designed in the interests of the regulated industry itself.[58] Claessens, et. al. argue that the claim that BCBS was a victim of policy capture "might be exaggerated", but that "the long-institutionalized relationship between regulators and the regulated in financial supervision...approximates conditions of capture." In this regard, the claim is that Basel II "derived directly from the proposals of the private sector."[59] Underhill and Zhang make the same claims, but also advance the case for capture further by stating that the formation of Basel II[60] represents a case of "the growing ability of private market agents to set rules"[61] and a prime example of "the domination of global financial supervision and regulation by private actors."[62]

The mechanisms of such 'policy capture' are sometimes hypothesized, but the analytical strength of the actual analysis is not as strong as the empirical assertions made. Underhill and Zhang for example suggest that regulatory authorities have become dependent on the information and expertise provided by private sector groups.[63] In the context of Basel II, Griffith-Jones and Persaud provide more detail for a similar hypothesis. They posit that private bankers possess better technical expertise than regulators, as well as superior resources to pay for studies that better inform their positions. They suggest that "...through superior expertise and information, regulators often become persuaded of the bankers' position. This is the most perfect and least visible form of influence – a capture of minds."[64] This argument posits an interesting causal mechanism which, unfortunately, is not tested empirically, but rather is simply posited. Griffith-Jones and Persaud note that large banks interacted with the BCBS, and furthermore that many of

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[57] Tarullo 2008, p. 104.
[58] See Stigler 1971. The Stiglerian notion of regulatory capture is discussed in more detail below.
[59] Claessens, Underhill and Zhang 2008, p. 321.
[60] Their study consists of not only the BCBS, but also the International Organization of Securities Commissions.
[61] See Underhill and Zhang 2008, pp. 546, 537.
[62] Underhill and Zhang 2008, p. 553.
[63] Underhill and Zhang 2008, p. 553. See Cerny 1994a, p. 331.
[64] Griffith-Jones and Persaud 2008, p. 266.

the policies within the Accord are advantageous to large banks.[65] This observation leads them to the conjecture that large banks have systematically influenced the formation of such policies. Rather than demonstrating this case, private sector influence is presumed on the basis of co-variation alone, rather than by examining the process by which decisions were actually made, or by examining how different regulatory policies within the Accord had different contents.[66]

Within recent work by Helleiner and Porter, Basel II is cited the prime example of "capture of the regulatory process by the industry it is supposed to regulate."[67] Helleiner and Porter refer specifically to the problem of elite technocracy that the BCBS implies, positing that the highly technical character of regulatory networks like the BCBS "provide privileged access points for business", making it "especially susceptible to 'capture' by the financial firms they are supposed to be regulating."[68] As support for this hypothesis, they cite the fact that the Institute of International Finance "worked very closely" with the BCBS, "successfully suggesting and promoting the use of the internal risk models."[69] As evidence for this claim, they submit only a reference to a retrospective document of the Institute of International Finance, which claims that these changes were initiated at its own behest.[70] While Helleiner and Porters' conclusions may be correct, we have no way of evaluating such claims on the basis of such sparse evidence.

Tsingou's research on the formation of Basel II is more focused and analytical than most other analyses, but the analysis is itself insufficient in understanding the operation of private sector influence. In one work, Tsingou uses the formation of Basel II as the main example in arguing that, "[in] the banking industry, the private sector is writing its own script, increasingly influencing not just the function of regulation but also that of supervision."[71] She argues that "a wide variety of established business associations have taken over a standard-setting regulatory role at various stages of the policy process", citing the Institute of International Finance in this regard in playing an active consulting and lobbying role in the formation of the Basel II Accord. While the mechanisms of such influence are not explored, a subsequent work provides more

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[65] In their words, "one means of assessing the degree of influence wielded by the various players is to determine who wins and who loses" Griffith-Jones and Persaud 2008, p. 264.
[66] Griffith-Jones and Persaud 2008, p. 226.
[67] Helleiner and Porter 2009, p. 20.
[68] Ibid.
[69] Ibid.
[70] See IIF 2007. See also the similar claims in Porter 2009, p. 4; Porter 2006, pp. 107-108.
[71] Tsingou 2004, p. 11.

detail, whereby Tsingou argues that private interests have become internalized within the BCBS during the making of Basel II, because the process itself is characterized in a way. It is argued that private sector preferences have been internalized in the making of Basel II – not necessarily because of a "conscious and deliberate strategy of capture but rather, as a consequence of formal and informal practices of public-private interaction and agreement among an increasingly coherent and transnational policy community."[72] Tsingou argues in this regard that a small elite group of private actors have acquired semi-institutionalized functions in the making of Basel II. Like Helleiner and Porter, she cites the influence of the Institute of International Finance, with the evidence being that this organization was extensively involved in the consultation process during the drafting of the Accord, offering feedback and providing expertise during this period[73] A particular focus of Tsingou's critique in this regard is that the Accord's policies are market-based or market-generated and favor large sophisticated banks, which match the Institute of International Finance's own preferences.[74] Rather than supporting this hypothesis on the basis of the content of actual interaction between the Institute of International Finance and the BCBS, it is supported by the fact that interaction between the IIF and the BCBS took place at all, and by the fact that policy outcomes are understood to match private sector preferences.[75]

Another prominent work in the IPE of finance literature which has analyzed the formation of Basel II has been put forward by Wood. Wood devotes an entire book to a broad study of the BCBS' work since its origins, and has devoted a chapter to describing and assessing the creation of the Basel II Accord (until 2003, thus before it was fully completed). Wood's analysis is richer in detail and nuance than many of his contemporaries, but like them he asserts that private sector influence occurred without demonstrating *how*. Wood states, for example, that "the BCBS has been forced to back down on a number of issues where big banks have refused to accept the Committee's proposals," seeing a number of policy changes as "capitulation by the Committee" and sees existing regulatory policies as "essentially concessions" to large banks. These claims are not supported with reference to empirical evidence beyond the basic correlation that large banks critiqued policy proposals, and at a later time they were changed.[76] In a similar

[72] Tsingou 2008, pp. 61-62.
[73] Ibid.
[74] Ibid.
[75] See Tsingou 2008, pp. 60-61.
[76] Wood 2005, pp. 123, 141, 132-33.

manner to Claessens et. al., Wood argues that "the specter of regulatory capture is not far away."[77] Unlike many of his contemporaries, Wood attempts to illustrate regulatory policy changes which occurred at various points in the formation of Basel II. However the analysis is descriptive only, in that the specific reasons why "US financial actors" were able to influence their regulators is not explored.

Since the recent global financial crisis, the claims of the BCBS falling victim to regulatory capture have only increased; yet instead of insufficient evidence used to support this claim, no evidence is used at all, but rather either only reference to previous studies. Ocampo has argued that the BCBS has been subject to "the capture of regulation by large multinational banks"; Tsingou has commented that Basel II is regarded as "the perfect example of regulatory and supervisory capture"; and Golden and Vogel have argued that the BCBS "fell victim to regulatory capture by large international banks, which allowed these institutions to influence and lobby regulatory outcomes to their individual advantage, but to the detriment of financial stability."[78] Indeed, regulatory capture in general is often discussed self-evidently, given the size of the global financial crisis and the policy calamity that is understood to underlie it.[79]

Central Weaknesses in the Literature

While the existing literature on the role of private sector groups in Basel II's formation is very diverse, there are nevertheless two central weaknesses which stand out. First, specific hypotheses are not tested, based on a range of evidence. This weakness is related to the fact that there is no variation in the dependent variable of interest – the content of regulatory policy itself. In this regard, existing analyses have emphasized regulatory policies within Basel II which are understood as favorable to private sector groups, however conceived, whether they are "US financial actors", the Institute of International Finance, or "large banks." However, the regulatory policies of the Accord which were *not* favorable to these private sector groups, and which were vigorously opposed, are not examined. In some ways this non-variation reflects the objectives of

[77] Wood 2005, p. 157.
[78] Ocampo 2009l, p. 10; Tsingou 2010, p. 24; Goldin and Vogel 2010, p. 13.
[79] See for example the remarks by Stiglitz on capture in Stiglitz 2009, pp. 5-6; Mattli and Woods 2008, p. v.

the research, which is not to examine private sector influence systematically, but rather to provide suggestive evidence that it has occurred.

As the widespread use of the term 'regulatory capture' signifies, much of the foundational thinking that informs the IPE of finance work is informed by Stigler's pioneering work on the political economy of regulation. Stigler argued that public officials were wont to design regulation to favor groups that offer them the highest degree of political support. As such, the content of regulation would reflect private interests – particularly those groups that could successfully influence policymakers – rather than the public interest at large.[80] In this guise, Stigler sought to point out that regulation can be 'captured' by private sector groups (typically concentrated producer groups) who have organized to influence regulators.[81] While the public choice literature which followed Stigler was much less certain of the extent to which capture was possible, the notion of capture provided an analytic device for many to pursue nonetheless.[82] Following this tradition, many studies within the wider political economy literature have sought as their objective to demonstrate evidence which supports the notion this 'private interests' view of regulation.[83] This literature can be regarded as analytically superior, because it considers a range of regulatory policy outcomes, and utilizes a research design which hypotheses are explicitly tested, rather than simply posited. However the objective of this research, like most IPE research, is to argue that influence occurred – not to examine *how*.

The second central weakness within the existing literature is that the standards of evidence employed are weak, especially in comparison to the claim of regulatory capture, which implies a substantial and unequivocal degree of private sector influence. In most of the above analyses, public-private interaction is assumed as a sufficient condition for private sector influence. To simply assume this is potentially very misleading. Evidence that a private sector group interacted with the BCBS does not mean that it managed to have its preferences met

[80] See Stigler 1971.
[81] In his words, "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit." See Stigler 1971, p. 3.
[82] In particular, Becker and Pelzman were much more critical of the notion that in a liberal democratic context where there are a plurality of different interests vowing for state influence, that capture will be extensive. See Becker 1983; Peltzman 1976; Pelzman 1989.
[83] See Kroszner and Strahan 1999; Kroszner 2001; Kroszner and Strahan 2001; Heinemann and Schüler 2004.

because of that interaction.[84] Such a notion is an empirical issue that has to be subject to scrutiny, rather than simply assumed. Similarly, it is logically possible that public-private interaction isn't even relevant to the content of regulatory policy at all. If we consider the possibility that large banks exert structural power over regulatory policies, for example, interaction with the BCBS may not even be a necessary condition for influence to take place, let alone a sufficient one. Once again, this is an empirical question – and it would be equally fallacious to simply assume the answer either way.

Any conjecture about private sector influence over regulatory policy – including the strong 'regulatory capture' prevalent within the IPE literature cited above – cannot be supported through simple correlative evidence alone. A correlation between policy outcomes and private sector preferences is not necessarily indicative of influence because that correlation may be due to an additional factor, for example the endogenous preferences of regulators, or a bargaining dynamic between them which has nothing to do with private sector groups and their preferences. This relates to what Mahoney has called the 'black box' problem in social science.[85] When a study is based on co-variation alone, researchers cannot meaningfully identify the connection between cause and effect. Furthermore, to the extent that correlative analysis can be a useful tool for assessing patterns in empirical phenomena, basic standards of inference dictate that one needs variation in the outcome being explained; however, none of the existing academic literature on Basel II's formation has researched such variation.

While the existing literature on the influence of private sector groups on the formation of the Basle II Accord can be regarded as unsatisfactory, there are nevertheless a number of analytical tools available within the broader literature in the IPE of finance and also the broader political economy literature that can provide a way forward. Exploring if, and how, private sector groups influence transnational financial regulatory policymaking entails an understanding of two dynamics. First, we need to understand what *means* private sector groups possess to potentially influence their regulators, organized either at the national or transnational level. Second,

[84] See Fuchs 2007, pp. 89-90. Dür and De Bièvre have recently demonstrated this problem with respect to European trade policy, whereby NGOs have been given unprecedented access to policymakers, but have not influenced actual policy. See Dür and De Bièvre 2007.

[85] See Mahoney 2004, pp. 464-465; see also Gerring 2008 on 'looking inside the black box' of causal processes. The attempt to look inside the 'black box' of 'regulatory capture' has been pursued by Boehm 2007, although this has been in relation to the economics of corruption specifically.

assuming private sector groups employ those means successfully, we need to know what possible *pathways* private sector groups have at their disposal for securing regulatory policy change at the transnational level.

Section 3
Private Sector Influence over Banking Regulators: Hypotheses

The relationship between private sector groups and regulators in the financial sphere has been the subject of considerable attention within political economy for some decades. In order to derive hypotheses from the existing literature, I first review the political economy literature which has posited hypotheses regarding the specific *instrumental actions* which private sector groups take to influence financial regulation. I then review the ways in which private sector groups are understood to exercise *structural power* over their regulators, and thus influence financial regulation not by the actions that they take, but by the way in which their presence is constituted in the political economic context of the time. Third, I review the particular scope conditions that have been hypothesized within the literature; in other words, the contextual circumstances which are understood to affect and condition the influence of private sector groups over financial regulators.

The Instrumentalist Tradition

Central to a large body of work within political economy of financial regulation has been the notion that private sector groups exert influence by engaging in particular actions which can shape the content of regulation in line with their preferences. Fuchs and Lederer have recently labeled these 'instrumental' perspectives on private sector influence, and therefore I group these together as 'instrumentalist perspectives.[86] Within the diversity of literature that has followed this trajectory of thinking, two different research programs can be demarcated, which emphasize different kinds of means. One tradition, drawing from public choice theory, has emphasized

[86] Fuchs and Lederer 2007.

formal pressure on regulators, while another tradition, drawing from policy network theory, has emphasized recurring and mutually constituting relationships between private sector groups and regulators, as a communicative process.

Legislatures, Executives, and the Means of Pressure

Those emphasizing the role of formal institutions of governance, such as national legislatures have emphasized the ways in which private sector groups interact with legislators desire for re-election. Lukauskas, for example, has explicitly utilized the Stiglerian public choice model of regulatory policymaking and applied it to financial regulation in the country case of Spain, whereby legislative calculation plays the primary explanatory role in explaining both financial market restrictions and liberalization.[87] Rosenbluth and Schaap have conducted an across-case analysis of 22 industrialized democracies and find evidence that electoral rules affect banking regulatory outcomes, suggesting evidence for the notion that banks can utilize the legislative process in some way to shape regulation in their favor. [88] In a detailed study of the US savings and loans crisis and its aftermath, Kane has investigated the efforts by US savings and loan institutions to influence the US congress.[89]

Other work in this tradition has been much more explicit in terms of mechanisms specified. A central focus, especially within US-focused literature, has been on the direct financial support that private sector groups can provide to elected officials in order to assist in their reelection. This 'campaign contributions' hypothesis has been central to the research of Kroszner and Stratmann, who have examined the way in which Political Action Committees have been formed to finance special US Congressional committees, and also in the recent work of Broz on the relationship between the US Congress and the IMF, where large commercial bank's campaign contributions are found to be statistically correlated with votes regarding the IMF budget.[90] More recently, Igan, Mishra and Tressel have demonstrated a robust statistical

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[87] See Lukauskas 1997.
[88] Rosenbluth and Schaap 2003.
[89] Kane 1990.
[90] Cf. See Kroszner and Stratmann 1998; Broz 2009.

relationship between how much a bank spends on lobbying and how risky their lending practices are, suggesting that banks can purchase the benefits associated with moral hazard.[91]

The literature exploring the 'campaign contributions' hypothesis has represented an important part of the broader literature on private sector influence. However there are two reasons why it is not a engaged with in this study, however.[92] First, while private sector campaign contributions to elected officials is a widespread practice in some countries (especially in the United States), it is not in other countries (such as Canada, the UK, or Germany). While the study of campaign contributions may be relevant to US domestic policymaking or US foreign policy, it is not a hypothesis that can be tested across different country contexts (and certainly not at the transnational level). Secondly and more substantively, like many regulatory policies, the construction of Basel II was not constructed by legislators, but rather was constructed by regulatory bureaucracies within the *executive* branch of government. The issue which is most relevant, therefore, is how a specialized regulatory institution within an executive-branch bureaucracy can be influenced by private sector groups.[93] This raises an explanatory challenge because financial regulatory policy is often delegated to regulatory bureaucracies which are, by institutional design, relatively insulated from forms of political influence – especially in recent years.[94]

If the issue of influence on a formally independent regulatory bureaucracy is what needs to be explained, rather than on a legislature itself, what can provide this explanation? A specific causal mechanism of private sector influence seems at first glance to be elusive, because the interests, actions, and malleability of an elected legislature are different from that of an unelected regulatory bureaucracy. As Hamilton once put it, central bankers are "always at one remove from their political masters."[95] While not engaging with financial sector regulation, Weingast and Moran's seminal study of legislative influence on regulatory agencies suggest that such pressure can be systematic by the ever-present threat of discipline on the parameters of the regulatory

[91] See Igan, Mishra, and Tressel 2009. See also Mian, Sufi and Trebbi 2009.
[92] I have pursued this hypothesis elsewhere in the context of a variety of US regulatory decisions at the legislative and executive level.
[93] See Furlong 2005.
[94] McNamara 2003; Thatcher and Stone-Sweet 2003; Gilardi 2007.
[95] Hamilton 1986, p. 199.

bureaucracy's decisions.[96] Engaging with this line of inquiry within the IPE literature, Singer has posited a more specific mechanism in the context of financial regulation. Following Ferejohn and Shipan's work on bureaucratic autonomy, Singer has argued that the threat of legislative oversight acts as the "bane of a regulators' existence", since it threatens a regulators autonomy and prestige.[97] This suggests a specific causal mechanism for how private sector groups influence executive-level regulatory bureaucracies: by utilizing legislative oversight to discipline regulators' behavior.

This 'legislative oversight' hypothesis is highly germane to this study, because it posits a specific mechanism by which private sector groups influence members of the BCBS. A private sector campaign which can utilize the lever of legislative oversight would be expected to have success in achieving the objective of influence (or, stated probabilistically, *more* success than a campaign without such a lever). Formally stated, this hypothesis is as follows:

> H_1: *The Legislative Oversight Hypothesis.* Private sector groups influence financial regulation if they utilize the lever of legislative oversight over their regulators.

The omnipresent threat of legislative oversight can be assessed empirically by taking into account by examining the level of formal regulatory independence that a regulatory bureaucracy has from the legislature. The more direct threat of legislative oversight is also readily observable in the content of legislative oversight hearings. Observable evidence in support of the legislative oversight hypothesis would be that the introduction of formal legislative oversight is found to affect the observed actions of a regulator such that the regulator acts in a manner more closely aligned with the preferences of the private sector campaign. This could be manifest either through a changed position that a regulator has with respect to a given regulatory policy, or through the changed behavior that the regulator exhibits subsequent to such oversight. For a description of the manner in which these observations are made, and the sources of empirical material in this regard, see Chapter 2.

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[96] Weingast and Moran 1983.

[97] Singer 2004; Singer 2007; Ferejohn and Shipan 1990. Posen's work has also posed a notion of a legislative oversight threat affecting the behavior of the US Federal Reserve Board. See Posen 1993, p. 53.

Policy Networks: Communicative Means of Influence

Another tradition within the literature on the political economy of financial regulation has been to conceptualize the relations between private sector groups and regulators as part of the same 'policy network', in which there is a diffuse but reoccurring set of social relationships which serve the functional objectives of each member of this network.[98] Rather than emphasizing relations of power and antagonism, this tradition emphases interaction and interdependence.[99] This tradition has arguably been central to research on the political economy of financial regulation, especially qualitative research, with early work in the field such as that of Mayer and Moran, and more recent work by Cerny and Tsingou that explicitly uses a network-relational ontology to understand the operation of financial sector power.[100] The literature reviewed above which has explored the formation of Basel II has also described the relationship of private sector groups and the BCBS as one of a policy network.[101]

The aim of such literature is not always to explain private sector influence (often it is to simply describe the fascinating relationships which exist), but a number of research programs have sought to do explain private sector influence. Reinicke's extensive study of banking regulatory reform in the United States in the 1980s explicitly utilizes a notion of a domestic policy network, with private sector mobilization at the heart of the analysis.[102] More recently, Busch has conducted an extensive historical study of the politics of banking regulation in the context of globalization, and traces the evolution of the banking sectors of Germany, Switzerland, the United Kingdom and the United States from 1974 to 1999, and has also used this frame.[103] While this tradition tends not to emphasize antagonistic relationships between private sector groups and financial regulators, this should not suggest that there are no hypothesized means through which private sector groups exert their influence. On the contrary, there are two hypothesized means by which private sector groups can exert influence in the

[98] For policy network theory, networks are understood and analyzed as institutions, especially due to their capacity to establish rules and long-lasting patterns of social relations for how agents react. See Thatcher 1998.
[99] Compston 2009.
[100] See for example the notion of a network employed in the early work of Mayer, and even more explicitly in the work of Moran. Mayer 1974, pp. 361-362; Moran 1986. More recently, Cerny has explicitly advocated a network-based understanding of relationships within the financial sector. See Cerny 2002; Tsingou 2010, p. 22.
[101] Both Porter and Tsingou refer to the relationship as a policy network, Claessens, et. al. have called it a "long-institutionalized relationship". See Claessens Underhill and Zhang, p. 321; Porter 2010.
[102] Reinicke 1995.
[103] Busch 2008.

context of a policy network: through mobilization, and through the transfer of detailed information.

On the one hand, private sector groups can *mobilize* in order to voice their preferences with respect to a proposed or potential regulation. Mobilization can be understood as the instrumental effort that made by private sector groups to communicate their views to regulators.[104] As such the 'mobilization hypothesis' can be stated as follows:

> *H_2: The Mobilization Hypothesis.* Private sector groups influence financial regulation if they work to communicate their preferences to the relevant regulator(s).

Mobilization can take a number of different forms, such as authoring and sending a letter or comment on a given regulatory policy, offering comment within a public forum, or through direct personal interlocution with regulators themselves. Inherent in the notion of mobilization is that the communication of preferences is not automatic, but rather involves an intentional effort and process of organization.[105] Observable evidence in support of this hypothesis would be that (a) regulator(s) changed their course of action on a given regulatory policy following sustained efforts by private sector groups to mobilize around this same policy.

The other communicative 'means' by which private sector groups are understood to influence financial regulatory policy is by providing *detailed information* to regulators as they are constructing regulatory policy. The notion is that regulators can be persuaded by new and detailed information that they receive from private sector groups which causes them to change a prior regulatory policy decision.[106] Alternatively, regulators might be *dependent* on private sector groups for information, such that the mechanism is not so much persuasion, but private sector-sourced information (and thus bias) as an input to the regulatory policymaking process itself. Information can be understood as a critical resource because of the ways in which regulatory agencies lack certain forms of information about the potential costs and benefits to the policies

[104] The language of mobilization is used explicitly in Reinicke 1995; Fuchs 2007; Sell 2003. For a critique, see Macartney 2008.
[105] Even studies of private sector oppositional signaling within the central bank literature presuppose that critical commentary requires some degree of organization. See Maier and Bezoen 2004; Maier Sturm and De Haan 2002; Havrilesky 1993.
[106] On the strategic use of information, see Bouwen 2002 (p. 360 uses the example of banks).

they design and implement.[107] Alternatively, such informational dependencies might persist because the mathematical complexity of financial markets supersedes regulators' understanding – a point first posited by Cerny within the IPE literature.[108] Sometimes referred to as the "coin of the realm" of interest group politics, the importance of information is recognized throughout the IPE of finance literature when it focuses on banking regulation.[109] This hypothesis can be stated as follows:

> *H_3: The Information Network Hypothesis.* Private sector groups influence financial regulation by offering information to their regulators which supports their case for regulatory policy change by adding to their knowledge.

Empirical evidence in support of this hypothesis would include the transmission of evidence-based, empirical assessment of a regulatory policy by one or more private sector groups which adds to regulators' knowledge in a way favorable to private sector preferences. This exchange of information would have to be discerned to be a contributing factor in initiating a regulatory policy change which was in line with the critics' preferences. This hypothesis is germane to this study not only because it has been widely hypothesized within the political economy literature generally, but also because it has been posited as a specific reason for Basel II's particular content as well, as discussed above.[110]

One further hypothesis which exists within the literature is that private sector groups influence regulatory policymaking by means of their close sociological relationships with regulators themselves, in particular the fact that regulators retire into positions within banks, and vice versa. This 'revolving door' hypothesis is sometimes posited within the literature, but is not a focus of this study.[111] Examining such a hypothesis in detail requires an examination of inter-personnel ties and relationships in a manner which is outside the scope of this study.[112] The

[107] This is why, within the business and politics literature, lobbying is sometimes viewed as a "legislative subsidy". See Hall and Deardorff 2006. See also Compston 2009.
[108] Cerny 1994a, p. 331; Cerny 144b
[109] See Warwick Commission 2009, pp. 6-7; Kerch 2007; Fuchs 2007 Hardy 2006, p. 5; Porter 2009, p. 7; Sell 2003, pp. 98-100; Bouwen 2002.
[110] See Tsingou 208, p. 61; Underhill and Zhang 2008, p. 553; Kussin and Kette 2006, p. 298; Griffith-Jones and Persaud 2008.
[111] See Gormley 1979; Gormley 1983; Cohen 1986.
[112] For a recent theoretical engagement with this hypothesis, Seabrooke and Tsingou 2009. See also Santos 2006, pp. 55-58.

difficulties of measuring the revolving door have been remarked upon extensively within the political economy literature, however, and thus I consider it an institutional variant which may affect outcomes. Thus the revolving door is considered both when evaluating countries in the process of case selection (in Chapter 2) and in assessing across-case patterns within the campaigns and outcomes investigated (in Chapter 10).

The Structuralist Tradition

In contrast to the tradition of political economy which has sought to explore the instrumental actions that private sector groups take in order to influence financial regulation, what is sometimes referred to as a 'structuralist' tradition emphasizes the ways in which private sector groups wield influence not through the actions they take, but by their nature as economic entities and their embeddedness in the political economic contexts in which they operate.[113] The literature which explores structural power is very diverse. As a concept in political science it is often regarded as emerging from the critiques of liberal pluralism within American political science (e.g. Dahl), in which scholars of power such as Bacharach and Baratz and Lukes emphasized the dimensions of power which are less readily observable in the behavior of agents (and for Lukes, sometimes even uncontested).[114] Lindblom brought such interventions more directly to the study of private sector influence, by emphasizing the privileged role of business in governmental policymaking.[115] Long before this pluralist tradition, thinking about structural power was prominent in Marxian scholarship, from the work of Kautsky to Kalecki to Althusser and Poulantzas.[116]

Within IPE, it was Strange who popularized the formal use of the term structural power. While she understood the concept as derived from Marxian theory,[117] Strange also sought to extend the concept to relations of security and knowledge as well (and argued that neo-Marxian

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[113] The use of the term 'structuralist' is widespread in both the business and politics literature and in studies within global governance. See Fuchs and Lederer 2007; Sell 2000, p. 92.
[114] See Dahl 1961; Bacharach and Baratz 1970; Lukes 1974.
[115] See Lindblom 1977; Lindblom 1980.
[116] See Poulantzas 1978; Kalecki 1943
[117] Ssee Strange 1984, p. 191; Strange 1988, p. 30

scholarship understood finance very poorly).[118] Strange formally defined structural power in various different ways,[119] but the meaning of the concept is generally the same: that an actor can exert influence the behavior of other actors without taking an action, by means of the structural relation both are situated within. Thus the application of direct (and hence observable) pressure is absent from many power relationships; however, such indirect interaction does not mean that power itself is absent. As Barnett and Duvall have recently pointed out, structural power is understood to operate through the social relations of constitution, rather than through the exercising of specific instrumental actions.[120]

Despite the fact that research on structural power adheres to a core principle, scholars have envisaged a variety of ways in which structural power is actually exercised. Some scholars refer to the structural power of *states* in the international economic system.[121] This is perhaps not simply an artifact of the realist tradition in international relations theory, but rather a consequence of the fact that monetary policy decisions and international financial diplomacy are the typically the domain of states. Other work however has emphasized structural power not in terms of relations between states, but by considering relations *within* them. In this vein, a vast literature within both neo-pluralist and Neo-Marxian traditions has explored the state's 'structural dependence of capital', a claim that denotes the ability of firms to exercise influence over policymaking by virtue of their ability to control the investment function in capitalist societies.[122] Within studies of the IPE finance in particular, there is an emphasis on the articulation of structural power by means of firms' ability to (potentially) decide their jurisdiction, and to shape the parameters of policymaking under the particular opportunity structure afforded to states under conditions of internationally mobile capital.[123] Other literature associated with the World Systems approaches and the 'French Regulation School' of political economy has emphasized the structural dependence of capitalist states on financial sector

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[118] Strange 1988, pp. 26,30; Strange 1986, p. 86-90
[119] See, for example, Strange 1988, pp. 24-5; Strange 1984, p. 191; Strange 1988, p. 31.
[120] See Barnett and Duvall 2005, pp. 52-53. They also note the important differences from institutional power.
[121] See for example Strange 1984, p. 190; Strange 1989. Consider as well the work closer to a realist tradition see Simmons 2001, Drezner 2007. Finally, see the Marxian scholarship which emphasizes the US state-financial sector relationship as a state-driven nexus of power which structures the international environment. See Gowan 1999; Gowan 2001; Panitch and Gindin 2008; Konings 2008; Wade and Veneroso 1998.
[122] See Bloch 1977; Lindblom 1977; Lindblom 1980; Przeworski and Wallerstein 1988; Swank 1992. For an application, see Bernhagen and Bräuninger 2005
[123] See the early exponents in Gill and Law 1989, pp. 487-88, Strange 1990, Andrews 1994, Crystal 1994; Pauly 1995. For empirical applications of this articulation of structural power, see Gill 1995; Mosley 2003; Hardie 2006.

accumulation in particular, pointing out the structural imperatives to protect the profits of finance's leading arenas of innovation in order to stave off a wider crisis of late capitalist development, such as in conjectures concerning 'financialization' of capitalist economies.[124]

Empirical research which addresses structural power in the domain of financial affairs is variegated. Most work which focuses on the political economy of financial regulation does so by describing broad processes of regulatory change, rather than specific regulatory policy decisions. Articulations of 'statist structural power' and 'mobility structural power' have engendered associated research programs, and occasionally hypotheses are tested in this regard.[125] However much of the literature which articulates the 'structural power of capital' and processes of 'financialization' does so as part of larger normative-ontological efforts, often emphasizing the *consequences* of regulatory change that systemic transformations of capitalism have brought about, rather than seeking to explain the causes of that change.[126] For the purposes of this study, the testable hypothesis can be states as follows:

> *H_4: The Structural Power Hypothesis.* Private sector groups influence financial regulation in situations where they have a structural advantage in having their preferences met.

Observable evidence in support of this hypothesis could take a variety of different forms, depending on the particular way in which structural power is understood to operate in different contexts. As such, and because structural power is challenging to account for empirically (a point discussed below), I test this hypothesis by considering different dimensions and forms of structural power, and using a variety of measurements, variables, and methods to do so. As Bernhagen has pointed out, there are no established standards for measuring structural power.[127] This lack is perhaps not because structural power comes in many variants, but because the vast majority of work on structural power is dedicated to either exploring the concept or describing its presumed effects, rather than analytically testing hypotheses in relation to it. Because of this

[124] See Lipietz 2001; Arrighi and Moore 2001; Epstein 2006; Bellamy-Foster 2007.
[125] As evinced by Dresner 2008, 2009; Mosley 2004; Mardie 2006.
[126] Cf. Panitch and Gindin 2005; Raviv 2008; Sassen 2010. Notable exceptions include the empirical work of Bernhagen and Bräuninger 2005, Bernhagen 2007, Helleiner 2008, and Bernhagen 2008.
[127] Bernhagen 2008.

dynamic, and following Bernhagen, I employ multiple measures of structural power, as detailed in Chapter 2 and analyzed in Chapter 10.[128]

Scope Conditions of Private Sector Influence

A number of factors also need to be considered which might *condition* the extent to which private sector groups are successful in achieving their objectives of influencing financial regulation. These can be treated as hypothesized 'scope conditions' that may condition the efficacy of the other explanatory factors discussed above. Two hypothesized scope conditions stand out within the literature: the role of private sector ("business") conflict and the role of private sector coalitions.

Recent research within IPE has demonstrated the efficacy of private sector conflict in conditioning private sector influence, both at the national and international levels.[129] Some quantitative studies have found inter-industry rivalry to be an important factor in affecting influence.[130] Other political economy research uses different language to emphasize the same phenomenon, such as the Neo-Marxian literature which emphasizes 'fractionalization of capital', as relevant for determining the influence of private sector preferences over policy outcomes.[131] Indeed, whether or not the interests of the financial sector and the rest of business community are fundamentally 'opposed' or 'fused' has been at the center of many debates within political economy, and recent work in IPE of finance is no exception.[132] For the purposes of this study, business conflict can be stated as a formally hypothesized scope condition as follows:

> H_5: *The Business Conflict Hypothesis*. The ability for one or more private sector groups to influence financial regulation is conditional on the extent of fragmentation within the campaign.

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[128] Bernhagen 2008, pp. 90-91.
[129] See Nowell 1996; Cox 1996; Polborn and Sahakyan 2007; Falkner 2010. For a case study on trade, see Stant 1996. On environmental policy, see Falkner 2001; Falkner 2007.
[130] On banking regulation, see Kroszner and Strahan 1999; Kroszner 201; Kroszner and Strahan 2001; Heinemann and Schüler 2004
[131] See Van der Pijl 1984, p. 3; Marx 1978, pp. 109-179; Overbeek 2004; Van Apeldoorn 2004; Skidmore-Hess 1996
[132] See Patich and Gindin 2008; Macartney 2009; Schwartz has recently depicted this division as one stemming back to institutionalists such as Veblen, and Marxists such as Hilferding. See Schwartz 2009, pp. 126-127; Hilferding 1981. See also Hendershott, Less and Tompkins 2002.

Observable evidence used to assess this hypothesis would include the degree of preference unanimity or degree of fragmentation within a given private sector campaign. A campaign characterized by private sector groups expressing a singular, unified position regarding a given regulatory policy can be discerned from a campaign where there is discord, and private sector groups express different preferences for the same policy, with some private sector groups opposing the campaign.

Another scope condition to be considered is the extent to which private sector groups are able to organize their advocacy in coalitions. A prominent observation within the political economy literature is that private sector groups utilize the coordinative and representational advantages of associability.[133] Private sector coalitions are part of many different hypotheses explored within the IPE literature, and a number of studies put this factor at the center of their analysis.[134] The importance of coalitions has also been emphasized in a variety of literature examining the influence of banks and banking regulation, such as in the work of Posen, Lütz and Eberle, and Gould.[135] Stated formally, this emphasis on coalitions is formally stated as follows:

> *H_6: The Coalitional Hypothesis.* The ability for one or more private sector group to successfully influence financial regulation is conditional upon them forming explicit or implicit alliances with other private sector groups.

Observable evidence used to test this hypothesis would be the presence of coalitional activity among private sector groups as they attempt to influence regulatory policymaking. If their success is conditional upon the presence of such coalitions, then this hypothesis receives support. It should be noted, however, that the coalitional hypothesis is not a scope condition for structural power (at least when structural power is considered by itself), since coalitional activity is a form of instrumental action. This hypothesis is fundamentally different from H_5 in the sense that the presence or absence of private sector coalitions is not the same phenomena as whether or not a given campaign features private sector conflict. For example, a campaign can feature a strong coalition between a variety of private sector groups trying to influence a given regulatory policy, at the same time that other groups offer regulators strong support over that same policy, and

[133] See Grote, Lang and Schneider 2008; Gray and Lowery 1999.
[134] See Nitzan 2001, p. 252; Aitken 2005, pp. 337-338.
[135] Posen 1993; Lütz and Eberle 2007; Gould 2003, p. 561; Gould 2006.

speak out against the oppositional coalition. Since private sector coalitions can take a variety of forms, as Chapter 2 outlines, I consider two different variables in this regard.

In addition to exploring the means that private sector groups use to influence regulators, it is also important to know how such influence over a given regulator translates into concrete regulatory policy change. It is a logical necessity that in order to influence the content of Basel II, private sector groups have to influence the decisions of the BCBS in some way. But *how* does this actually work? Two different possibilities are formally hypothesized below, and are justified based on the substantive issues within the literature.

Pathways of Influence

As Dür and De Biévre have recently pointed out, the study of private sector influence over policymaking is challenging precisely because of its different channels, or possible 'pathways', of influence.[136] The present study takes this concern seriously, especially because it is possible that private sector influence operates differently at different levels of governance. One particularly prominent hypothesis already within the literature on Basel II is that private sector groups influence the BCBS by organizing at the transnational level and influencing it directly. Many scholars have argued that one private sector group in particular, the Institute of International Finance, exercised influence over Basel II in this way. In this regard, Helleiner and Porter, Underhill and Zhang and Tsingou have all posited a transnational pathway of influence.[137] Stated formally, this can be expressed as follows:

> H_7: *The Transnational Pathway Hypothesis.* Private sector groups successfully influence regulatory policy outcomes by targeting the collective decisions of regulators as a group, i.e. as they are organized at the transnational level.

Empirical evidence in support of this hypothesis would demonstrate that a given private sector campaign is shown to have an observable effect on a regulatory policy outcome as it is being designed at the transnational level. Aside from being a prominently posited hypothesis within the

[136] Dür and De Biévre 2007, p. 8.
[137] Helleiner and Porter 2009, p. 20; Underhill and Zhang 2008, p. 553; Tsingou 2006, pp. 61-62.

existing literature on Basel II, this hypothesis also connects in clear ways with the broader literature on private sector influence in global governance, which has argued that private sector groups have expanded their influence in transnational decision-making processes in particular.[138]

It is also possible for private sector groups to influence individual regulators at the national level, and to have them then bargain on behalf of private sector demands, in the manner commensurate with 'two level games' literature.[139] Given that the decision rule within the BCBS is implicit consensus, this pathway of influence would seem very plausible, because any one member of the BCBS could have their demands relatively easily met in such an environment. In this regard, it is possible that private sector groups organized at the national level influence their national regulators, who then translate this influence into regulatory policy change within the BCBS of which they are members. Such a national pathway of influence has been explicitly posited by Steel and Litan, Tarullo, and Wood in the context of Basel II.[140] A similar, but more general, depiction has been made by the Warwick Commission when they state that in the context of transnational regulatory policy decisions "[c]aptured national regulators became champions of their national banks abroad."[141] Stated formally this hypothesis can be represented as follows:

> H_8: *The National Carrier Hypothesis*. Private sector groups influence a regulatory policy outcome by affecting the position and/or behavior of a national regulator who is successful in securing negotiated agreement at the transnational level for this position.

Empirical evidence in support of this hypothesis would need to fulfill two criteria. First, a given private sector campaign would have an observable effect on a national regulator, either in terms of changing their behavior or their position with respect to a given policy. Second, this influenced national regulator would then have to take actions which secure negotiated agreement within the BCBS on the terms desired by the private sector campaign. Existing empirical

[138] See Higgott, Underhill, and Bieler 2000; Fuchs and Lederer 2007, p. 5.
[139] See Putnam 1988; Evans 1993.
[140] Steel and Litan 2006, pp. 23-24; Wood 2005, p. 158; Tarullo 2008, p. 104; See also the passing accounts of Koenig-Archigbugi and Zürn 2006, p. 247; King and Sinclair 2003, p. 351.
[141] Warwick Commission 2009, p. 27.

research within the IPE of finance has demonstrated some support for this particular hypothesis.[142]

This 'national carrier hypothesis' is a challenging hypothesis to empirically test, because there are different ways in which a national regulator can be influenced at the national level that could affect outcomes. On the one hand, because each member of the BCBS takes part in a deliberative process, and because their consent is required for regulatory policymaking decisions, the *position* of the national regulator matters. By position I refer to the stance that a national regulator takes with respect to a given regulatory policy. On the other hand, the substantial literature on international negotiation theory suggests a second possibility as well. What this literature suggests is that negotiated outcomes are the result not only of the positions of negotiating actors, but also their bargaining resources. This study considers both of these possibilities and, as I detail in Chapter 2, I develop different criteria for empirically measuring these different possibilities.

This section has established three different kinds of hypotheses which exist in the literature concerning private sector influence over financial regulation, as denoted in Table 1.0 below. First, there are hypotheses that posit specific power resources, or what I have called 'means' potentially available to private sector groups in the pursuit of regulatory policy change. Four such hypotheses were laid out: the use of legislative oversight, mobilization, the use of detailed information, and the deployment of structural power. Second, two hypotheses have specified particular scope conditions under which private sector influence over a regulator might be conditioned, namely private sector conflict and the presence of private sector coalitions were laid out. Third, two separate hypotheses were established which describe the different possible pathways by which private sector influence translates into regulatory policy change.

[142] See, for example, Posner 2009, p. 687; Quaglia 2008; Mattli and Büthe 2003.

Table 1.0: Summary of Hypotheses

	Name of Hypothesis	Hypothesis is Discerning...
H_1	Legislative Oversight	The Means of Influence
H_2	Mobilization	The Means of Influence
H_3	Information Network	The Means of Influence
H_4	Structural Power	The Means of Influence
H_5	Business Conflict	A Scope Condition Affecting Influence
H_6	Coalitions	A Scope Condition Affecting Influence
H_7	Transnational Pathway	The Pathway of Influence
H_8	National Carrier Pathway	The Pathway of Influence

With these eight hypotheses now explicated and justified in the context of the existing literature, Chapter 2 explains in detail the research design of the study which subjects them to empirical testing.

Chapter 2
Research Design

Discerning private sector influence on any policy process is a challenging task. Not only do the multiple possible paths to an outcome make hypothesis testing against empirical material challenging, but influence itself can also be a process which is difficult to examine empirically. This study seeks to explain how, whether, and under what conditions private sector groups influence transnational financial regulatory policy outcomes by testing a variety of hypotheses within the literature elucidated in Chapter 1. This chapter describes the research design employed in the study, and is divided into five sections. Section 1 describes the methodological approaches used in this study, emphasizing the mixture of methods employed. Process-tracing, qualitative comparative analysis (QCA), and statistical regression analysis are all employed in order to capitalize upon their respective strengths and minimize their respective weaknesses. Section 2 focuses on the definition, measurement, and calibration of the dependent variables of interest to the study. Section 3 then describes and elaborates the relevant explanatory variables under consideration, noting how these are calibrated and measured. Section 4 describes how private sector campaigns are selected for analysis as the basic unit of analysis within the study.

Section 1
Methodological Approach of the Study

At the most elementary level, this study investigates one relationship: the relationship between private sector campaigns and regulatory policy outcomes. This relationship is investigated using a variety of different methods. Process-tracing analysis is employed for within-case analysis, i.e. in order to investigate the relationship between a given private sector

campaign and a regulatory policy outcome within a given case. Across-case analysis investigates a number of different private sector campaigns as they corresponded to different regulatory policy outcomes, and assesses patterns which exist across these relationships. Two different methodologies are employed in order to assess such patterns: fuzzy-set qualitative comparative analysis (fsQCA), and statistical regression analysis. Each of these methodologies have particular strengths and weaknesses, which are discussed below.

Process Tracing For Within-Case Analysis

To explore causal relationships between the particular content and context of private sector campaigns, the reactions of regulators and policy outcomes, I employ the method of process tracing.[143] Process tracing analysis identifies the key events, individuals, relationships, and decisions that link causal conditions to outcomes.[144] Because of its emphasis on empirical detail, process tracing enables the researcher with an in-depth knowledge of the events and processes within each case examined. For this reason, Gerring has described the method as getting "inside the box" and investigating the detailed mechanisms and events which interact over time to shape outcomes.[145] Thus, in contrast to across-case analysis, which rely on forms of inference that observe association and/or variation across variables/conditions and outcomes, process tracing explains the decision-making process by which initial conditions within a case *are actually translated* into outcomes.

This method is especially well suited to this study, because it allows for the rich contextual background of cases to be highlighted, for decision-making among actors to be explored, and for the elaborate causal process to be explained.[146] Process tracing allows for the exploration of causal linkages between events in a chronological fashion as events unfold in a narrative.[147] A detailed description of how policies were constructed, contested, and negotiated among relevant actors enables an in-depth analysis of how private sector campaigns interacted with regulatory responses over time. Yet process tracing is not just description, since the analysis

[143] George and Bennett 2005.
[144] Mahoney 2000b; Collier, Brady and Seawright 2005.
[145] Gerring 2008.
[146] See the discussion in Dür 2008a. See also Dür 2008b, p. 1224.
[147] George and Bennett 2005, 206.

seeks to both simultaneously provide a thick description of empirical phenomena and to analyze these phenomena with explicit reference to external criteria.[148] In this regard the analysis traces processes of private sector campaigns and regulatory responses, but does so with the aim to assess the strength of the particular hypotheses developed in Chapter 1. Because process tracing takes a narrative form, the number of falsification points are maximized, thus subjecting inferences to additional scrutiny and transparency.[149] Furthermore, spurious correlations between observed phenomena can be revealed within a case, and thus such cases can be omitted from later across-case analysis in order to prevent the distortion of results. It is entirely possible, for example, that private sector groups took a number of actions in a given campaign, and this corresponded ('co-varied') with a particular regulatory policy outcome. This does not mean however that the private sector campaign is the cause of that outcome. Indeed, there may be a variety of other factors that led to a particular regulatory policy outcome. Process tracing helps to establish this by considering a range of evidence which highlights potential causes other than the one of interest. As Bennett has recently pointed out, process tracing is also invaluable in assessing whether or not there are additional factors present *outside* the realm of causes which are investigated in a given study.[150] To the extent that evidence of a regulatory policy outcome exists which has nothing to do with a private sector campaign, I consider the relationship between the private sector campaign and regulatory policy change to be causally spurious.

Despite its advantages, process tracing analysis has at least three weaknesses that relate to the aims of this study. First, process-tracing is extremely demanding empirically. The empirical demands of process-tracing interest group influence are particularly acute, given the number of causal steps in a chain that require empirical evidence. Processes of private sector lobbying, and regulatory decision-making are lengthy, complex, involve a plethora of actors, decisions, and interactions. These heavy empirical demands relate indirectly to the second weakness of process-tracing analysis, that of generality. If a causal process is uncovered for a particular case, how unique is that process, and how well does it speak to more general trends in the phenomena being studied? Generalizations across cases are not possible, not only because the number of cases

[148] Falleti 2006.
[149] This is a point recently raised in Bennett 2008. More generally, Büthe has discussed the particular challenges associated with the use of narratives, but noted that these challenges are reduced by the use of multiple narratives. See Büthe 2002.
[150] See Bennett 2008.

typically considered in process tracing analyses is typically very small, but also because the method itself has no tools for across-case analysis. Third and most substantively, the method of process-tracing may obfuscate the less observable causal pathways of interest group influence. As Dür has recently pointed out, in particular, process-tracing may lead researchers to strongly associate levels of interest group activity to influence.[151] This may mean that spurious relationships are deemed causal, when indeed they are not. Alternatively, it may mean that some less observable causal mechanisms of influence are obfuscated from view. For example, structural forms of power, or low levels of interest group activity which are nevertheless powerful beyond the recognition of the researcher, will be either elusive or, worse still, missed altogether, because they cannot fit within the causal chain of events being 'traced.'

Each of these weaknesses is addressed in this study by a combination of thorough attentive analysis and the complementing of process-tracing analysis with other methods. While the empirical challenges of process-tracing are omnipresent in any research, in this study I address this by utilizing extensive and diverse primary sources. The formation of the Basel II Accord left a paper trail of publicly available documentation that is more extensive than most (if not all) previous international financial negotiations. This extensive documentation included not only the detailed comment letters by private sector groups, but also studies conducted by the BCBS itself, speeches given by its members, and press reports of progress made during the negotiations. Financial journalists also tracked events as they occurred, creating a record of comments made by BCBS members and private sector groups as well. More substantively, 97 semi-structured focused interviews were conducted with those individuals involved in Basel II's development, from both private sector groups and the regulatory community (See Appendix 1). The challenge of generalizing across findings is not overcome through process-tracing itself, but rather from the fact that the findings from each policy case investigated are summarized and used in later fsQCA. The challenge of attributing influence to an easily observable process rather than an elusively observable one is overcome both by considering less easily observable phenomena in the narrative and by complementing process tracing with across-case analysis.

Fuzzy-Set Qualitative Comparative Analysis (fsQCA)

[151] See Dür 2008a, p. 563.

In order to facilitate across-case analysis, I engage with a comparison of the findings from each of the cases examined through process-tracing. Typical employments of the comparative method utilize a comparison of a small number of carefully selected cases, whereby the presence or absence of particular characteristics within each case are compared as the basis for across-case causal inference.[152] While the specific research design in this comparative tradition varies, the ability to generalize across all possible instances of a given phenomenon of interest can often be limited, given the small number of comparisons actually being made. In response to these perceived analytical shortcomings, recent research in political economy has employed statistical techniques in order to assess processes of co-variation across a wide range of cases, typically through linear regression analysis.[153] While there are distinct benefits of such a method (see below), one significant limitation of this tradition is that for results to have statistical significance, and hence for covariate inferences to be made, a very large number of cases, or 'observations' are required.

Recent methodological innovations within social science have provided a means to conduct across-case analysis in a way that overcomes this limitation. Qualitative comparative analysis (QCA) builds on the basis of comparative method but allows for a larger number of possible cases to be considered than would otherwise be manageable in a simple case-comparative analysis.[154] A key distinction from linear statistical analysis is that QCA understands processes of social causation to be fundamentally *configurational*, as opposed to *additive*, and allows the researcher to conduct tests of whether or not a given causal condition can be deemed as necessary and/or sufficient for an outcome to occur.[155] Across-case analysis is conducted on the basis of its adherence to *logical* premises of set-theory, rather than the *probabilistic* mode of analysis of statistical co-variation.[156] Relatedly, the issue of equifinality – that there may be more than one causal pathway to an outcome – is overcome through the use of Boolean algebra, which is an alternative to linear algebra.[157]

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[152] See Ragin 1987.
[153] As Maliniak and Tierney have argued (using statistics), such a quantitative methodology has become increasingly popular within IPE over the last 20 years. Maliniak and Tierney 2009, p. 19.
[154] Ragin 1987.
[155] Ragin 2000.
[156] On this distinction, see See Schlosser et. al. 2009, p. 9.
[157] See Ragin 1992a. See Geortz 2009, p. 22.

Advances in the application of QCA now allow for the use of data which are not binary-categorical (i.e. 0 or 1), such that the 'coding' of set membership take place in more granular, or 'fuzzy' membership scores. Fuzzy sets are a way of accounting for social phenomenon using a simple interval scale coding method with a form of calibration based on set membership. Fuzzy set analysis facilitates the precision and comparability of quantitative analysis and at the same time allow the use of substantive knowledge of qualitative analysis to calibrate these measurements.[158] Fuzzy sets thus constitute a bridge between quantitative and qualitative approaches to measurement of social phenomena, in that full membership (coding of 1) and full non-membership are (coding of 0) are qualitative states, not 'measured' or 'counted' data observations.[159] Yet between these two qualitative states of full and partial membership in a set are varying degrees of membership, ranging from 'more out than in but not fully out' (close to 0 but below .5) to 'more in than out but not fully in' (close to 1 but above .5). Coding a 'variable' (i.e. either a causal condition or an outcome) in this way allows for quantitative comparison across cases and at the same time enables fine-grained variation across different causal configurations, capturing not all, but *more* subtle differences in the observation of social phenomena than would otherwise be the case.

There are three principal weaknesses of fsQCA which are germane to this study. The first is what might be called its procedural weakness, and involves the assignment of membership scores to variables (fuzzy-set 'coding'). While there are a number of methods that can be employed for the coding of variables, when the data is not already coded and available from some external source, the fuzzy-set coding that takes place is often performed non-transparently, and is not reported as a procedure. Transparency of the process of coding is important because fsQCA usually involves a qualitative judgment on behalf of the researcher.[160] The second and more substantive weakness of fsQCA is that it assumes a persistent association between causal conditions and outcomes to be a causal one, when in fact this relation of association may not be causal.[161] For lack of a better term, this can be called the 'assumed causality problem.' These

[158] See Rihoux 2008
[159] See Ragin 2000.
[160] Lieberson, for example, has argued that QCA results are very sensitive to the researcher's discriminatory power. See Lieberson 2004. Many who use fsQCA argue that using the method requires a substantive knowledge of the cases under investigation, and indeed this has become a common justification within the literature. See for example Katz et. al. 2005; Rihoux and Ragin 2004; Avdagic 2010.
[161] Seawright has critiqued the use of fsQCA on this basis. See Jason Seawright 2004, pp. 16-17.

weaknesses are compounded by a third – what might be called the 'rough assessment' problem: the fact that, unlike standard statistical methods, fsQCA is a method which does not produce estimations of error.[162] This is a substantial problem for some scholars, since explanation of social phenomena are most commonly understood probabilistically (A causes B 90% of the time), rather than deterministically (A leads to B).[163] In this regard, it might be claimed that while fsQCA can assess the sufficiency and necessity of a causal condition or combination of causal conditions in producing an outcome, it cannot demonstrate the *strength* of these relationships.

The weaknesses of fsQCA highlighted above are surmounted by the complementary use of the other complementary methods used in this study. On the one hand, the detailed within-case analysis involved in process-tracing allows for a procedurally transparent process of coding fuzzy-set membership scores for each variable in each case. For example, a score of .67 for legislative oversight (mostly but not fully in the 'set') can be justified rigorously with reference to empirical evidence. Furthermore, such qualitative judgments are transparent and thus have the status that they can be potentially challenged. On the other hand, the problem of 'assumed causality' is overcome by the fact that causal relationships between explanatory and dependent variables are already established through process-tracing analysis.[164] If and when there is no causal link established between a private sector campaign and the regulatory outcome of interest, the dependent variable is coded as zero in the fsQCA dataset from which across-case analyses are drawn. The 'rough assessment' problem of fsQCA is overcome through the use of quasi-probabilistic estimates of how well a given causal condition or combinations of causal conditions fits a logical test of necessity or sufficiency. These are called 'consistency scores', and these scores are employed in this study, as Chapter 10 demonstrates in detail.[165]

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[162] Wade and Goldstein, for example, have critiqued the fact that QCA disregards confidence-affecting information that both qualitative and statistical analyses typically contain. See Wade and Goldstein 2003.
[163] Lieberson has made this critique against the method of small-N comparative approaches, including QCA. See Lieberson 1992.
[164] The use of fsQCA as a complementary technique is explicitly supported in some of the recent methodological discussions of the method. See Rihoux 2008; Ragin 2006b; Grofman and Schneider 2009.
[165] See Ragin 2006a; Ragin 2008.

Statistical Regression Analysis

While fsQCA facilitates the majority of across-case analysis in the study, there are nevertheless still some advantages of more conventional statistical methods to conduct across-case analysis. On the one hand, regression analysis can offer the researcher an assessment of the statistical significance of a given variable of interest. Despite the sometimes complex mathematics behind regression techniques, often the most valuable information is simply whether a given variable matters, relative to the mean of all other variables in the regression. 'Statistical correlation' can thus be a powerful tool to make inferences about whether a given phenomenon is important, or simply part of the background noise and chaos of any complex collection of social processes. Furthermore, because statistical analysis engages in a computation of the 'net effects' of each explanatory variable of interest, it can decipher an otherwise elusive process of co-variation that might be missed in other methodologies. For example, a general and dispersed effect of one variable may be a statistically significant covariant to the dependent variable of interest when assessing patterns across a large-N sample, but such an effect may be elusive when each case is observed individually. This would be the case when social power relations operate in a diffuse, rather than a direct manner, such as structural power.

Some of the weaknesses of statistical regression analysis have already been highlighted above (such as the problem of equifinality), but also include the demands of a large number of observations, the difficulty of correctly specifying a regression model, and the simplifying assumptions required for many statistical analyses to be meaningful (such as unit homogeneity and independence, etc.).[166] Rather than abandoning regression analysis as an analytical tool, I employ statistical regression analysis selectively, for two specific purposes. First, I employ regression analysis in order to test for the efficacy of the *structural power* hypothesis to explain regulatory outcomes across cases. As described in Chapter 1, structural power is predominantly understood to operate in a diffuse, rather than direct manner, and as such may be difficult to observe effectively through even careful process-tracing.[167] Furthermore, the kinds of indicators for structural power are economic in nature, and thus more easily employed within statistical

[166] See Kittel 2006; de Meur et al 2009; See Ragin 2008, pp. 4-6, 176-182;
[167] Further to this point, the use of regression analysis is appropriate because, as recently pointed out by Posner, structural power is widely understood as a probabilistic explanatory variable. See Posner 2009, p. 682.

analysis because of their nature as standardized variables less subject to the discriminatory power of the researcher (see discussion of explanatory variables below).

Using Mixed Methods and Triangulation

While the study employs a diversity of methods, the objective is not to have different methods compete for an answer to the same question. Rather, it is to draw on different methodological traditions to address the central research question in different ways in order to triangulate a more robust set of answers. As many interventions within social science methodology debates have recognized, methodological choices involve trade-offs.[168] However, the strongest research designs are arguably those which utilize different methods in order to investigate the same, or related, phenomena of interest.[169] By combining process-tracing analysis within cases with both large-N regression analysis and fsQCA, the study seeks to obtain both a rich analytical sense of the mechanisms of private sector influence, and to uncover empirical patterns therein.[170]

Section 2
Constitution and Measurement of the Dependent Variable

This study asks how, whether, and under what conditions private sector campaigns influence regulatory policy outcomes. The empirical outcome this study tries to explain (i.e. the 'dependent variable') can be defined as change in the regulatory policy outcome. This dependent variable is understood in a very particular way: that is, as the difference between the original regulatory policy proposal made by the BCBS and the final regulatory policy outcome. The dependent variable is thus a measure of policy change, and not the characteristics of the policy

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[168] See Collier, Brady and Seawright 2005.
[169] See Collier and Elman 2008; Hedström 2008.
[170] The compatability of FsQCA with other methods is increasingly recognized in recent literature. See for example Verkuilen 2005; Smithson 2005; Grofman and Schneider 2009. For an application in the international politics literature, see Koenig-Archibugi 2004. For an application to the political economy of regulation, see Maggetti 2007.

itself. There are a number of different qualities of any given policy and its change over time that might be considered, but this study focuses on one element that is a central feature of each regulatory policy within the Accord, and also a central feature of banking regulation more generally. This feature is the extent to which a regulatory policy reflects regulatory stringency versus permissiveness. Regulatory stringency is understood to refer to the way in which a financial regulation increases the minimum capital adequacy required for a given activity. If a policy increases required capital adequacy, it represents a more 'stringent' regulation than the status quo. In contrast, regulatory 'permissiveness' is the extent to which a financial regulation decreases required capital adequacy relative to the status quo, and is thus 'permissive' in allowing banks to hold less capital adequacy than would otherwise be the case.

Coding for regulatory policy change in this way also helps to account for the variations in regulatory policymaking. For example, if a given regulatory policy is proposed and then removed from the Accord, this change can be registered. In such an instance, if the original regulatory policy proposal was a stringent one (i.e. if it meant that regulatory capital would increase relative to the status quo), then this change registers as permissive regulatory policy change.[171] This framework for measuring the dependent variable as change also allows for the consideration of regulatory policy change at the agenda-setting level. For example, in instances when private sector groups *proposed* a regulatory policy successfully, and if this regulatory policy decreases regulatory capital requirements for banks, then this change is registered as permissive regulatory policy change.

There are good reasons to operationalize 'permissive regulatory policy change' as a dependent variable. The regulation of capital adequacy is a critical instrument through which banking regulators influence bank behavior.[172] The regulation of banks' capital adequacy is costly for banks, because it involves the reallocation of resources.[173] Because banks themselves bear those costs most directly than regulators do, they have an interest in regulation which is less burdensome to them. As such, banks usually have an interest in more permissive regulatory

[171] Conversely, if the original regulatory policy proposal was a permissive one, and was then removed, this does not constitute permissive regulatory policy change, but rather stringent regulatory policy change. Importantly, this is a rarity and is *not* accounted for in my study.
[172] Lastra 2005, pp. 226-227
[173] See Persaid and Nugée 2007, pp. 209-210; Elliehausen 1998; FSA 2002; Santos 2001, pp. 52-57.

policies relative to more stringent ones.[174] Regulators, on the other hand, face a different set of incentives. Regulators are members of public bureaucracies, are not profit-oriented, and often have an institutional remit of securing the financial system's stability.[175] As such, they usually have a greater inclination toward more stringent regulatory policies than do the banks that they regulate. To be sure, these divergent relative preferences do not mean that regulators will not sometimes decide to design a permissive regulatory policy. If they do, however, it is unlikely to be the case that banks will prefer a *more* stringent policy than what is being proposed by regulators. Indeed, banks would have an incentive to change this regulatory policy in an even more permissive direction. Thus, the typical situation is one of *relative divergence* of preferences, not absolute ones.

Basel II was about more than simply capital adequacy alone. The Accord also concerned issues of supervisory review (Pillar II) and market discipline (Pillar III). However, Pillar I was by far the most central aspect of policy development, and of private sector contention, within the Accord. It is within this Pillar that one finds the most substantive regulatory policies of the Accord, namely, the set of instructions and parameters concerning how the regulation of banking activity is to be conducted within the BCBS. Thus, Pillar I forms the bulk of the Accord's content.[176] It is hardly surprising that contestation centered around Pillar I, since these requirements represent a clear and binding force over banks' behavior through capital requirements. Indeed, as we shall see in subsequent chapters, several private sector campaigns encouraged Pillar I regulatory policies to be 'moved' to Pillar II, precisely because doing so would mean the removal of a costly constraint.

I code the dependent variable on the basis of qualitative criteria, and employ set theory to standardize these values.[177] In terms of fuzzy set analysis, I define the dependent variable as the degree to which a regulatory policy outcome conforms to the membership in the set of 'permissive regulatory policy change' (PRPC) as described above. Full membership (outcome coded as 1) in the set of permissive regulatory policy change is defined as a regulatory policy

[174] The exception to this would be in instances when banks prefer stringent regulatory policies which generate barriers to competition between themselves and competing banks. As this study demonstrates in the context of Basel II, this was a rarity.
[175] See Alexandar Eatwell and Dhumale 2006.
[176] By page count, 81% of the Accord is Pillar I, 7% is Pillar II, and 6% is Pillar III.
[177] For a discussion of how fuzzy set logic provides a set of tools for transforming raw data and concepts into standardized measurements, see Geortz 2009, p. 22.

change that constitutes a clear and unambiguous decrease in the capital requirements associated with the specific form of bank behavior in question as compared to the previous state. When a regulatory policy does not experience any change in its capital requirements, this constitutes non-membership (outcome codes as 0) in the PRPC set. With regard to the various levels of partial (.67 and .33) membership in the set, a four-value fuzzy-set is used. A description of the indicators used in this coding is described in Appendix 2.

Influence: Where and When

As many have pointed out within the political economy literature, private sector influence over policymaking may occur at several different stages of the policymaking process.[178] Considering such different stages of policymaking is an important part of the empirical strategy of this study. Figure 2.0 below illustrates the different stages of transnational regulatory policymaking. Between the initial stage of a regulatory policy proposal (stage 1) and the final regulatory policy proposal (stage 4), there are several different possibilities for private sector groups to exercise influence. One possibility is that private sector groups can take actions (box 2a) which influence a regulatory policy by either eliciting a reaction on behalf of an individual national regulator (box 3b), whose actions may (box 4a) or may not (box 4b) lead to regulatory policy change. Alternatively, private sector groups could take actions (2a) which influence the BCBS as a collective (3a), which then may lead to regulatory policy change (box 4a). For both of these possibilities, the possibility of influence is at the 'negotiation phase', where policies are formed. Another possibility for private sector influence is a campaign tries to influence a regulatory policy proposal before it is even proposed (stage 0), thereby exerting influence at the 'agenda-setting phase' of policymaking. At this stage, private sector groups may take actions (box 0a) which affect the initial regulatory policy proposal (1a). Provided that this proposal is not different from the final regulatory policy itself (i.e. 4a), this scenario is also understood as a form of influence.

[178] Cf. Austin-Smith 1993; Schmidt 2002. More recently it has been explicitly employed to studies of multilateral public policy formation - see Abbott and Snidal 2008

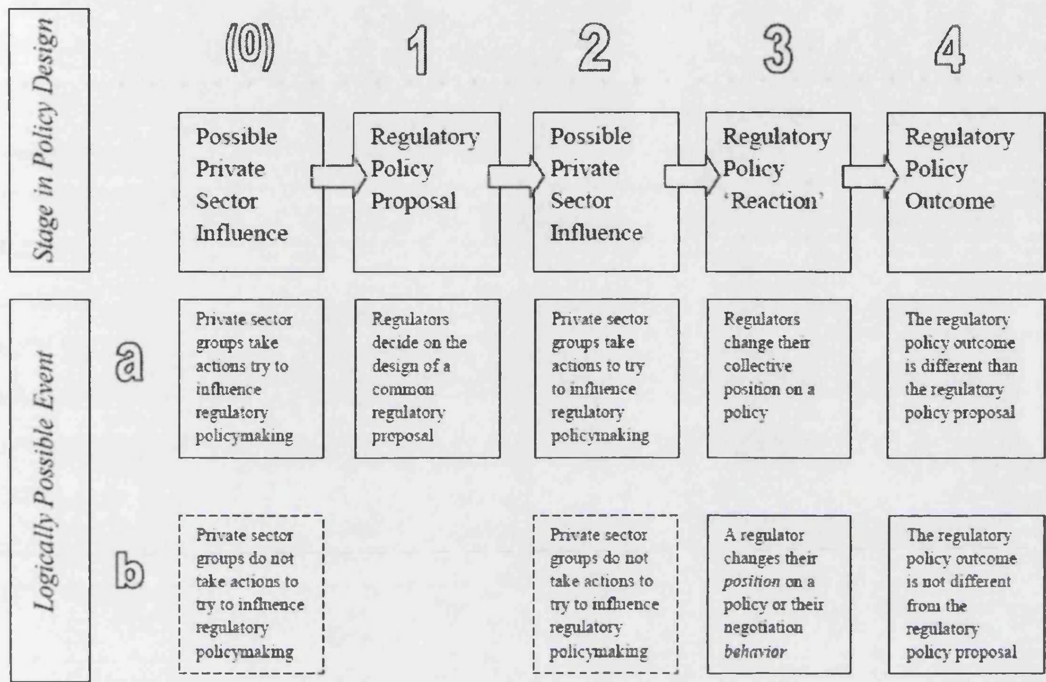


Figure 2.0: Logical possibilities for private sector influence to occur

While private influence may take place at either the agenda-setting phase or the negotiation phase of policymaking, it is not *only* through the *actions* of private sector groups that influence might occur. As row b in Figure 2.0 above connotes, the possibility of structural power influencing outcomes means that influence might occur from the *non-action* of private sector groups as well, i.e. by means of structural power. Such a possibility has important implications for empirical examination, given the fact that non-actions are, by definition, non-observable. The influence of structural power in the negotiation phase (box 2b) is, however, potentially observable through its *effects*, specifically though the observed difference between the regulatory policy proposal (1a) and the final regulatory policy (4a). However, the possibility of structural power influencing the regulatory policy proposal at the agenda-setting phase (0b) is not possible to observe through its effects. This is because there is no clear empirical basis from which to

compare the difference between what the regulatory policy proposal *would have been* had structural power been absent and the actual regulatory policy proposal.

This difficulty of measuring structural power's effects at the agenda-setting phase raises the question of whether or not structural power can even be investigated empirically at all, given that structural power conditions (whatever their relevant dimension) should not be expected to change from the agenda-setting phase to the policymaking phase described above. As such, the investigation of structural power at the policymaking phase might be considered moot – after all, it was already 'exhausted' as a possible causal factor. In other words, if structural power had an effect, we would not know, and if it did not have an effect, it certainly should not be expected to now. However, as Dür has pointed out, structural power need not be considered as an automatic, omnipresent factor affecting policy outcomes, since decision-makers often lack the necessary information with which to decide how costly a given policy might be.[179] Following this line of thinking, some recent empirical studies have investigated the structural power of business in the policymaking process by operationalizing measures of 'signaling' of business disapproval.[180] In these studies, structural power comes to the fore during the policymaking phase, not the agenda-setting phase. In the case of the highly detailed and complex financial regulatory policies under investigation in this study, this possibility should not be discounted. Assuming that structural power operates only or primarily at the agenda-setting stage assumes that BCBS participants have perfect information on the full costs of regulatory policy decisions, and can therefore can adjust their decisions accordingly. I consider such an assumption a strong one to make, especially in light of the significant amount of quantitative studies that the BCBS undertook to understand the likely impact of their proposed policies. As such, I take the effects of structural power as potentially measureable at the policymaking phase in addition to the agenda-setting phase.

Intermediate Dependent Variables

The main intermediate dependent variable in the study indicates whether or not a given national regulator has been influenced or not. This variable 'Regulator Influenced' is a simple

[179] See Dür 2008b: 1223.
[180] Berhagen and Bräuninger 205; Bernhagen 2008, p. 85; Bernhagen 2007

logical OR computation of two other intermediate dependent variables.[181] These two variables assess the way in which regulators may or may not react to private sector campaigns over particular policies. As Chapter 1 outlined (and as is conveyed in box 3b in Figure 2.0 above), there are two dimensions of interest in this respect. On the one hand, private sector groups might influence the *position* of a regulator – meaning the regulator's stance in regard to the policy in terms of their expressed preference. On the other hand, private sector groups might influence the *behavior* of a regulator – meaning that their campaign has a causal effect on how a given regulator acts among other regulators. If a private sector campaign is successful at achieving either, or both, of these proximate objectives, the 'regulator influenced' variable has value.

The changed position of a regulator refers to the fact that a regulators' original position with respect to a given policy changes to a new position, such that this position is now either more permissive or more stringent than before. This is a very difficult factor to assess empirically, because banking regulators often do not express their particular policy preferences very often. However through qualitative analysis of how regulators were reacting to the different claims of different groups, at different times, it is possible to assess in many instances if and how a regulator changed their position with respect to a given policy. Additionally, interviews conducted with private sector groups and the regulators themselves helps to establish evidence toward such inferences, as does the statements of regulators to the financial press at the time. Recognizing this challenge, the study employs a simple variable, 'Change in Regulators' Position' (CRP). This is coded along a four-value fuzzy-set scale, and is detailed in Table 2.2 below.

The *behavior* of a regulator refers to the way in which a given regulator behaves vis-à-vis other regulators. Because Basel II is the product of a transnational negotiation among regulators, an analysis of the process of a given policy's development is a function not only of the positions of the various regulators within the BCBS, but also how they behave in relation to each other. It is well understood, based on substantive empirical evidence, that the modal behavior of regulators on the BCBS tends to be the highly cooperative, deliberative behavior characteristic of highly technical negotiations.[182] However, this mode of engagement is not the only behavior

[181] A 'logical OR' computation takes the highest value in two sets in order to compute the new set.
[182] See, for example, Slaughter 2004, p. 160; Kussin and Kette 2006.

possible in the negotiations. It is also possible for a given regulator to engage in what negotiation theorists have called 'value claiming' negotiation behavior.[183] Value-claiming behavior is exhibited when a regulator tries to claim special concessions in order to maximize the outcomes' alignment with their position irrespective of the wishes of other regulators.[184] Odell has recently provided criteria for operationalizing value-claiming behavior in international negotiation contexts, and offers a list of indicators, which are reproduced in Appendix 2.[185] For the purposes of this study, this concept is operationalized into the variable ''value-claiming behavior' (VCB).

Like the CRP variable, VCB is also difficult to assess empirically. However, a number of sources of qualitative evidence help establish the values for this variable within a given campaign. Semi-structured interviews conducted with the regulators that participated in the BCBS negotiations helps to establish empirical evidence in this regard. Statements that regulators made in speeches conducted during the period of the negotiations, as well as statements made to the financial press at the time also help to establish empirical material that can assess such behavior. Some research on behavioral distinctions in international negotiations is skeptical of the possibility of measuring characteristics like value-claiming empirically.[186] While these challenges with such empirical observation are very real, they are nevertheless reduced in the present study because the modal behavior of the negotiators is generally already known (value-creating behavior). As in all partial equilibrium analysis, deviations from this modal position are easier to assess than assessing the behavior of a negotiator at any given time. The VCB variable is coded along a four value fuzzy-set as described in Table 2.3.

Section 3
Defining and Explaining the Explanatory Variables

This section describes the explanatory variables used in the study. While a variety of measurement techniques are employed, what is important is that many of these explanatory

[183] See Walton and McKersie 1965; Lax and Sebenius 1986.
[184] In Odell's words, it is when a negotiator "insists on an agreement under which one side will gain at the expense of the other". Odell 2001, p. 21.
[185] Odell 2001, pp. 39-52. For a recent application, see Odell 2009, pp. 273-299.
[186] See Dietelhoff and Müller 2005.

variables provide a means to test one or more of the given hypotheses of interest, as described in Chapter 1. Private sector campaigns are composed of all the actions that private sector groups took within a particular context (national and/or transnational) as part of their attempts to influence a regulatory policy outcome. I understand private sector groups to be formal, privately governed organizations which exist to generate positive returns for their owners. These entities are 'groups' in the sense that they are organized agglomerations of individuals, firms, and organizations who exist within a defined institutional setting. In addition, because many of the actions taken in campaigns are by associations, and some even by associations of associations, the term 'groups' seems more appropriate.

I have consulted a wide variety of empirical material in order to assess the content of private sector campaigns, and the vast majority of this information is primary source material. Letters and publicly available documentation created by private sector groups of various kinds provides a rich, though not unlimited, source of empirical material. First and foremost, such documentation gives a relatively good indication of private sector groups' regulatory preferences on a particular policy, and what kind of positions were being taken on such a policy. Available documentation from conferences, including presentations and speeches, is also used. In addition, in a number of instances non-public, internal documentation has been made available to me which has provided valuable information that was not otherwise available, or that corroborated other information. Comments made in the news media by relevant actors has also be a valuable source of empirical material, and accounts of events by other observers in the news media are also used to supplement and triangulate information (though such accounts are not a primary source). Finally, extensive semi-structured, focused interviews were also conducted with both private sector participants and regulators. I travelled to eight different countries to interview 97 different individuals who were intimately involved in the formation of Basel II. Appendix 1 provides a list of interview participants as well as a brief discussion of interview methodology.

Private Sector Mobilization

The first set of explanatory variables assesses the extent to which private sector groups are engaged in active mobilization over a particular policy. I define private sector mobilization as

the extent to which private sector groups organize themselves to communicate opposition toward a given regulatory policy. Attempting to capture the various dimensions of how private sector groups mobilize implies that forms of organization and associability matter in a way that may potentially influence outcomes. A private sector campaign in which firms and/or associations of firms make critical comments on a policy but do nothing more than that is a very different campaign from one in which private sector groups organize working groups to strategize how to influence a policy, engage in regular discussions with their regulators, and offer substantive commentary on the policy's content. Full membership in this set (1) is fulfilled when private sector groups are actively pursuing an organized strategy to seek to change a particular regulatory policy outcome. Full non-membership (0) in this set does not mean that there is no private sector opposition to the policy in question, only that this opposition is articulated in a very basic manner, as a critical comment by a group or groups, as a 'signal' rather than a 'mobilized', substantive set of actions.

The Use of Information in the Campaign

In order to assess the extent to which information plays a role in a given private sector campaign, a specific variable is employed to capture this. Information is understood here not to mean information in the broadest sense of a communicable message or pieces of communicable attributes, but rather in the more specific sense of articulated reasons why a given policy should or should not have certain characteristics. This notion is captured in the variable 'Informational Density of Campaign'. Full membership in this set requires that private sector groups articulated an extensive set of reasons for their position on a policy and these reasons were supported with detailed, structured evidence, such as quantitative data. Capturing the role of information as a resource in this way is very crude; however, it does allow for a basic differentiation of a private sector campaign in which private sector groups simply said 'we don't like policy X and it should be changed', from a private sector campaign in which private sector groups said 'we don't like policy X and our extensive study, attached, of the correct content of policy X supports our case.' In each case study of private sector campaigns, I detail specifically what kind of information private sector groups presented to regulators, and describe their studies when they had them.

Private Sector Coalitions

A second set of explanatory variables is related to the first but seeks to measure not the mobilization of private sector groups, but rather the extent to which mobilization is articulated through coalitions. As established in Chapter 1, a prominent tradition within the business and politics literature is that firms do not only act individually to influence policy, but utilize the coordinative and representational advantages of associability. Coalitions can take a number of different forms, and this study operationalizes two different explanatory variables to capture this diversity. The first of these variables capture private sector coalitions organized at the national level. Membership in this set occurs when there is evidence of at least two of the following phenomena within the context of a given private sector campaign: 1) a variety (i.e. more than 3) individual firms are mobilizing around a particular policy at the same time and articulate the same position; 2) more than one association of private sector groups are mobilizing around a particular policy at the same time and articulate the same position; and 3) the different firms/associations that are mobilizing over a given policy are actively coordinating their strategies together. This criteria is applied equally to private sector coalitions within transnational campaigns and national campaigns.

I also include an additional explanatory variable which assess not the presence or absence of private sector coalitions, but rather particular characteristics of the actors within a campaign when a coalition is present. To take into consideration whether or not banks are organized into coalitions with non-bank private sector groups, I employ the variable 'Non-Bank Allies' (NBA). Membership in this set is fulfilled when, in a given campaign, private sector groups other than banks or banking associations are mobilized around the policy in question in the same way that the banks in the campaign are, i.e. oppositionally and aimed at the same kind of policy change. Because this variable is plural (i.e. allies as opposed to ally), full membership in the set entails the presence of at least two non-bank allies.

Enemies of the Campaign

In order to test the Business Conflict hypothesis, I include a variable that captures dissent within the private sector. Even if a private sector campaign involves a coalition of groups trying to change a policy in a certain way, some private sector groups outside of the coalition may not of the same view, and may *support* the policy in question, for whatever reason. In this guise, the variable 'Enemies of the Campaign' (EC) is assigned full membership when there are a group of private sector firms or an association mobilizing to assert a position in contradistinction to the rest of the campaign. They have to articulate a position which is unambiguously *against* the position of the private sector groups who seek PRPC, and they have to be publically supportive of the regulator's position when the regulator's position is not the same as the oppositional campaign.

Legislative Oversight

In order to test the Legislative Oversight hypothesis, I investigate a number of private sector campaigns where legislative oversight occurred. A legislative oversight hearing is defined as a formal proceeding in which a representative(s) of a country's banking regulatory agency is/are brought before a legislative committee in order to discuss the regulators' position on a particular issue. In the case of this study, that particular issue must be a specific regulatory policy being developed in Basel II. Data for this variable is obtained by first obtaining information about which G10 countries experienced legislative oversight associated with the Basel II Accord, and which did not. On the basis of extensive interviews conducted within the BCBS, it can be concluded that formal legislative oversight only occurred in three countries: Germany, Japan, and the United States. Minutes of legislative hearings in each of these countries' parliamentary finance committees were then consulted for mention of the 'Basel II', 'the Basel Committee, or near variants thereof. When this test yielded a positive result, the minutes were searched in terms of their particular content for mentions of particular regulatory policies. The basic content and tenor of legislative oversight hearings in each country are summarized in Appendix 7. However the within-case analyses in each chapter makes reference to the particular issues as they emerged within a given campaign.

Legislative Oversight is operationalized into two different variables. Supportive Legislative Oversight connotes that the legislative oversight present was *supportive* of the particular private sector campaign in question. Oppositional Legislative Oversight connotes that the legislative oversight was opposed to the campaign (and thus supportive of the regulator's proposed policy and not the arguments of private sector groups). A supportive legislative environment is one where the policy in question is deliberated in a way sympathetic to the private sector campaign in question. This support (or opposition, as the case may be) is indicated by questions posed by legislators that criticizes the regulators' position when the regulator and private sector groups have divergent positions. It may also be indicated by how positively private sector testimony is received in formal hearings. Whether Legislative Oversight is coded in its supportive or oppositional variants is a highly qualitative judgment, and is justified in the context of the qualitative analysis of each campaign in which legislative oversight is present.

Explanatory Variables for Structural Power

As was outlined in Chapter 1, whilst there is a single underlying principle to the notion of structural power, in financial regulatory politics it is conceived of in a highly multi-faceted way. In order to investigate the importance of structural power empirically, I conceptualize two different ways (or 'dimensions') in which structural power can vary within the context of the study, each of which has two associated 'forms' of structural power within it, as denoted in Figure N below.

The first dimension of structural power that is considered are the forms which vary across country. The first of these is the structural power of the state in the international financial system. This is understood not only in terms of the financial sectoral resources that each state possesses, but how much it possesses *in relation to* other states. The second form of structural power which varies across BCBS countries has to do with the internal relations within each state – specifically the structural dependence of the state on finance capital. Following the language of some of the early work on external and internal strength of states,[187] these two forms of structural power can

[187] The language, though in a different meaning, is employed in Krasner 1977; Zysman 1977.

be conceived of as 'external strength' of the state and 'internal strength' of the state, respectively, as in Figure 2.1.

Figure 2.1: The Dimensions and Forms of Structural Power Explored

	Dimension of Structural Power Explored	
	Structural Power Condition Varying by State	*Structural Power Condition Varying by Regulatory Policy*
Form 1	'External' Structural Power of the State in International Finance	Importance to Financialization
Form 2	'Internal' Structural Dependency of the State on Finance Capital	Potential Mobility of the Associated Business Line

The second dimension of structural power considered in the study includes the forms of structural power which vary by regulatory policy. Some regulatory policies are associated with forms of economic activity which may be deemed more structurally important to financialized accumulation. For example, securitization might be understood to be a critical component in financialized accumulation, meaning that there are structural power-based constraints on regulatory policymaking in this area, for example. Other regulatory policies are associated with forms of economic activity which are understood to exercise structural power by means of their mobility. Policies associated with derivatives transactions, for example, might be associated with different kind of structural constraints as those for small business lending.

Section 4
Policies and Case Selection

Now that the dependent and explanatory variables and their measurement have been described, the question remains: how are these variables to be analyzed in relation to each other? As outlined earlier, this study engages in an analysis of different private sector campaigns. Any given campaign is associated with a particular policy that it intends to influence in some way. But what constitutes a policy, and which policies are to be investigated? This section first addresses these questions, and then describes the method used to select the private sector campaigns under analysis.

The Constitution of a Policy

The Basel II Accord consists of 239 pages of detailed regulatory requirements ranging from highly complex mathematical models to explicit instructions about discretionary supervisory interventions. Many aspects of the Accord were qualitative, and many were quantitative. Some aspects of the Accord offered precise instructions, while others offered only general guidance. This diversity and complexity requires a definition of how a discrete aspect of the Accord can be said to constitute a specific regulatory policy. In this study, I adhere to the following broad definition: *For an aspect of Basel II to be a policy, it must refer to a discrete area of bank behavior in some way.* Basel II is composed of three different 'pillars': capital requirements, supervisory review, and market discipline. Within each of these pillars, there are a number of different policies. However for the purposes of this study, only the policies within the first pillar of capital requirements will be investigated. There are several reasons for this. Not only was the first pillar the most important and the most contested, as mentioned earlier, but confining the study to focus on Pillar I policies means that findings are comparable across different policies, as each involve regulatory capital requirements.

Appendix 3 details the constitution of the total population of policies to be included in the study. As this Appendix details, for a policy to be included into the total population of policies, it has to fulfill three criteria. First, it has to be deemed significant by the BCBS. Second, it has to be coherent in terms of its content. Third, it has to be relevant for the study. According to these

criteria, a total of 12 different policies exist within the Accord. Most of these policies involve the more advanced approaches within the Accord, which is commensurate with the study's aim of understanding regulatory policies associated with large banks. These policies are summarized in Table 2.0 below, which details the timeline when each policy was being developed/negotiated.

Table 2.0: Population of Policies and Descriptive Foci

	Name of Policy	Timeline of Policy Design/Contention						
		98	**99**	**00**	**01**	**02**	**03**	**04**
1	Operational risk	■	■	■	■	■	■	■
2	Full internal models	■	■				■	■
3	Commercial real estate		■	■				
4	Internal Ratings approach		■	■				
5	Interest Rate Risk		■	■				
6	W Factor				■			
7	Expected Losses		■	■	■	■	■	■
8	Residential mortgages		■	■	■	■	■	
9	SME Lending		■	■	■	■		
10	HVCRE					■	■	■
11	Securitization					■	■	■
12	Revolving (Credit Cards)					■	■	■

The Constitution of Cases and Addressing Possible Interdependencies

Now that a variety of regulatory policies have been selected for analysis, I must clarify how private sector campaigns – the basic unit or 'case' of analysis – were selected for empirical investigation. At the most basic level, a case is the basic unit of analysis which is subject to comparison.[188] This study defines a case as an instance of private sector campaigning which conforms to a particular configuration of causal conditions at a given time.[189] A private sector campaign is thus understood not only as the actions of private sector groups in the attempt to

[188] See Gerring 2004; Ragin 1992b, p. 1.

[189] I understand cases as configurations here in the same manner described by Ragin 2000, i.e. as "combinations of aspects and conditions" that exist among the set-theoretic categories derived by the researcher. See Ragin 2000, p. 13.

influence outcomes, but also the particular contextual (i.e. macro-institutional, structural) conditions under which they took these actions.

Because cases are understood configurationally, new factors which arise over the course of a private sector campaign mean that a *new* case has emerged. Thus when conditions change within the configuration of private sector actions and their contexts, this new configuration is considered to be a new case.[190] Or, for example, when private sector groups engage in coalitional activity for reasons they hadn't before, or when legislative oversight is initiated, these new conditions change the configuration of causal conditions and (potentially) outcomes, thus constituting a new case.[191] In order to make the coding of extended form cases as transparent as possible, at the end of each chapter, a 'Configuration Table' is provided which offers a summary of the fuzzy-set membership scores to each of the explanatory and dependent variables in the study.

This particular method of constituting cases has the benefit of maximizing configurational diversity, and thus the possible different combinations of causal conditions linked to outcomes. However it also raises other methodological issues that need to be addressed – in particular the fact that cases might be interdependent. While QCA does not rely on the strict 'observational independence' assumption that statistical regression analysis does, interdependencies across cases should nevertheless be avoided. Such interdependencies across cases could arise in two different ways: what I call 'spillover effects' on the one hand, and 'issue linkage' on the other. On the one hand, if there are several campaigns at different times within a given country associated with the same policy, it is possible that earlier campaign success (or failure) influenced later campaign successes (or failures). Consequently, it might be argued that such 'spillover effects' represent an across-case interdependency which could distort across-case

[190] This particular practice has been employed by researchers working in the QCA tradition, for example most recently by Metelits, who has differentiated each of her three country cases into three different periods of time based on the unique configuration of causal conditions that they exhibit. See Metelits 2009, pp. 675-676. This approach of differentiating by cases is also employed when researchers have endeavored to incorporate timing into QCA. See Caren and Panofsky 2005. Carrerra, Dunleavy and Bastow 2009 also operationalize their cases as periods of time. The related method of analytic narratives operationalizes different cases in a similar way, as illustrated in the successive 'cuts' within a narrative, suggesting changes to the configuration of the extended form game used as an analytic device. See Bates et. al. 1998.

[191] Such an approach can be justified in the guise of 'recasing' as described by Ragin, whereby the process of small-N research often uncovers new values of variables, and thus the need to conceptualize different cases. See Ragin 1992c, pp. 223-225. The notion of critical junctures and contingent events in the qualitative methodology literature also support such an approaches' underlying assumptions. See Collier and Collier 1990; Mahoney 2000a.

findings. Such interdependencies are taken into account by marking all such cases with an 'I' in the Configuration Table at the end of each Chapter and then by treating these cases *differently* in subsequent across-case analysis. Specifically, for instances where permissive regulatory policy change took place, but might be dependent on earlier, unsuccessful efforts by private sector groups, I collapse the relevant cases into one single case using the logical OR procedure specified within the QCA literature. This involves taking the highest fuzzy-set value for a given variable over a range of interdependent cases, such that, if private sector groups mobilized at different levels over time, it is their maximal efforts that is taken into consideration. For cases where private sector groups were unsuccessful at achieving permissive regulatory policy change after an earlier successful campaign, I consider these cases as a unique kind of case which I analyse separately – what I call 'after-campaigns'. For both of these approaches, I run a series of test in Chapter 10 to probe whether or not across-case findings are affected by these considerations, and if so, how.

Interdependencies might also exist by means of 'issue linkage', whereby the negotiation of one policy is dependent on the negotiation of another policy. This could distort the true relationship between the explanatory and dependent variables, suggesting that a policy experienced permissive regulatory policy change because of the content and context of private sector campaigns when such policy change was due to (or due *in part* to) issue linkage. The particular character of the Basel II policymaking process minimized the potential for such an interdependency across policies, since most regulatory policies were designed as discrete entities. Moreover, they were developed not only at different points in time, but also by different individuals in different subcommittees within the BCBS. Operational risk, for example, was handled by a Risk Management Group; securitization by a Securitization Sub-Group; the W-Factor was handled by the Capital Group in 2001, while the SME policy was handled by the Capital Group in 2002.[192] Nevertheless, the presence of issue linkage entering into a regulatory policy decision is something that I explored empirically. The extensive interviews I conducted with BCBS participants put emphasis on understanding the reasons for policymaking decisions, and changes to those decisions. Consequently, it is thus possible to ascertain which campaigns

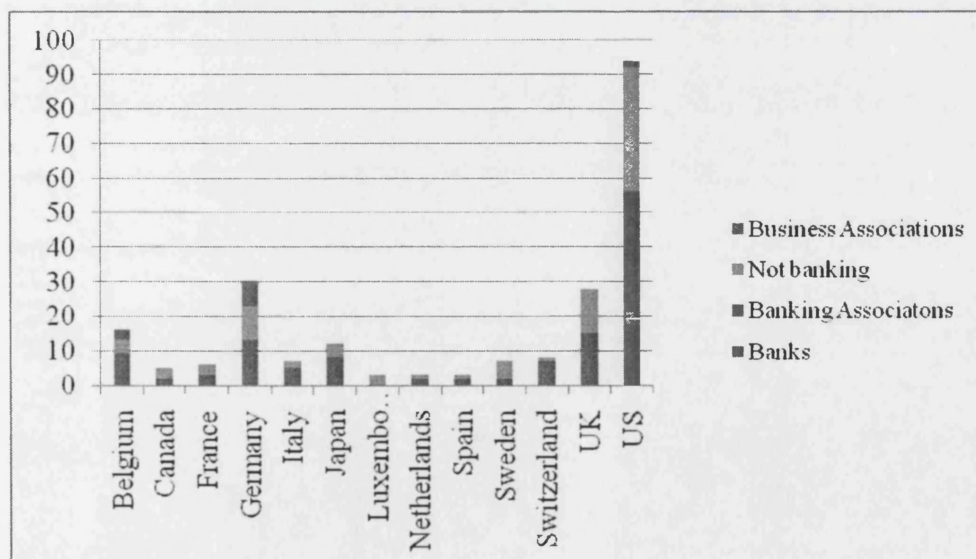
[192] Whilst it is true that many 'sticking points' in the policy formation process were handled by the 'full' BCBS, according to participants in the process, often the difficult negotiation points were handled at lower levels, and were simply approved at the full BCBS level.

were affected by issue-linkage, and how. The extent to which issue-linkage may have affected the success of private sector campaigns is discussed both within the relevant empirical chapters, and also in Chapter 10, which engages in across-case analysis.

The Selection of Campaigns

In order to select campaign activity for analysis, I have employed a variety of deductive and inductive techniques. I first use basic, indicative evidence of where private sector campaign activity took place, in order to arrive at a selection of BCBS countries for focused study. This process involved comparing basic indicators of campaign activity in order to assess both where private sector activity was most extensive and in what ways it differed from country to country. Drawing on the vast archive of BCBS correspondence with private sector groups over the course of Basel II's development, Figure 2.2 below displays the composition of different authors, differentiated by nationality.

Figure 2.2: Campaign Activity in Different G10 Countries



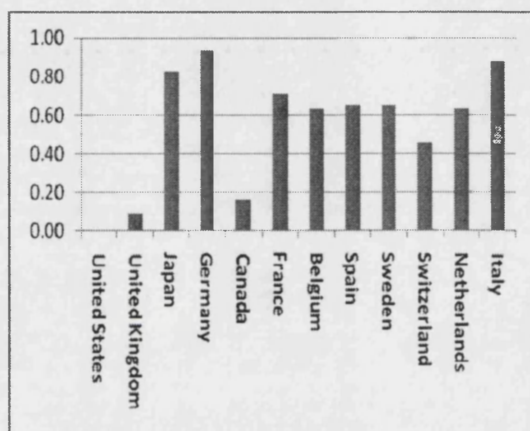
The United States, the United Kingdom and Germany are selected on the basis that there is indicative evidence of substantial private sector campaigns within these countries. This evidence of activity makes these countries ideal for the purpose of process-tracing analysis inasmuch as that method demands empirical material. However, there might be other unknown but potentially important reasons why national private sector campaigns did not leave as extensive paper trail as these countries. In this vein, Canada and Japan are added on the basis that they provide additional institutional variation of potential use to the study (see below). Selecting five countries, and not more, is important from the perspective of empirical manageability, given the importance placed on primary empirical research. An important question, however, remains: to what extent do these selected countries represent a form of selection bias? In particular, does this selection of countries adversely affect the across-country diversity of the national campaigns examined? To answer this question, I consider the across-country variation on a range of different institutional characteristics of each BCBS country, and ask whether or not the sample of countries selected displays any particular selection effects with respect to these different characteristics.

I first consider the extent to which the country in question can be considered a 'liberal market economy' (LME) or a 'coordinated market economy' (CME), based on the characterizations in the 'Varieties of Capitalism' literature. [193] According to this particular institutionalist theory, CMEs are characterized as having more 'bank-based' systems of finance, whereby the position of banks in the entire political economy is more central.[194] It might be the case, therefore, that private sector campaigns in CMEs have different characteristics or have higher rates of success. This is an important source of institutional variation to consider, as the CME-LME distinction comes up repeatedly in discussions of banking regulatory change in particular.[195] I computed a CME score for each BCBS country based on Hall and Gingerich's recent empirical work which aggregates the number of institutional features within a given country which conform to CME features.[196] As Figure 2.3 below illustrates, the CME scores across the BCBS countries is highly variable. However, the countries selected for the study not

[193] See Hall and Soskice 2001a; Hancke', Rhodes and Thatcher 2004.
[194] Hall and Soskice 2001b; See also Cerny 2010, p. 252.
[195] See Wade 2007, pp. 125-27; Froud et. al. 2007, pp. 341-42; Zimmerman 2010 pp. 125-26; Schwartz 153-55.
[196] Hall and Gingerich 2009, p. 458 (Table 2)

only capture this variation, they maximize it, with countries like the US and UK strongly 'liberal' and Germany and Japan strongly 'coordinated'.

Figure 2.3: CME Scores Across the G10



Such a quantitative measure of the CME-LME typology is completely consistent with depictions in the more qualitative literature, especially that which pits the archetypal examples of the Anglo-American banking systems against those of Germany and Japan.[197]

Another source of institutional variation to consider is the cultural and legal-institutional framework within which banks, governments, and regulators operate. As discussed in Chapter 1, one important informal institution highlighted within the literature is the revolving door between banking regulatory agencies and the banking sector itself. Another is the formal, legal 'de jure' independence of the banking regulatory agency from the government. Both of these institutions vary across countries, and are the subjects of considerable introspection across the literature. Barth, Caprio and Levine conducted extensive across-country surveys in 2000 which obtained a quantified representation of these institutions, which are reported in Figures 2.4 and 2.5 below.[198]

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[197] Cf. Lütz and Eberle 2007; Hall and Soskice 2001; Zimmerman 2010.
[198] See Barth Caprio and Levine 2001.

Figure 2.4: Revolving Door Scores

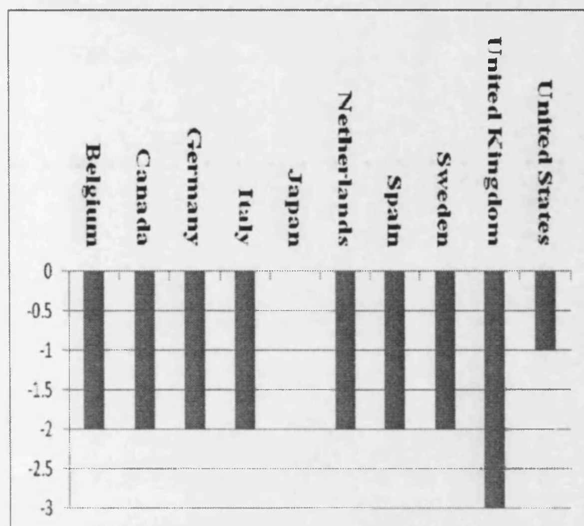
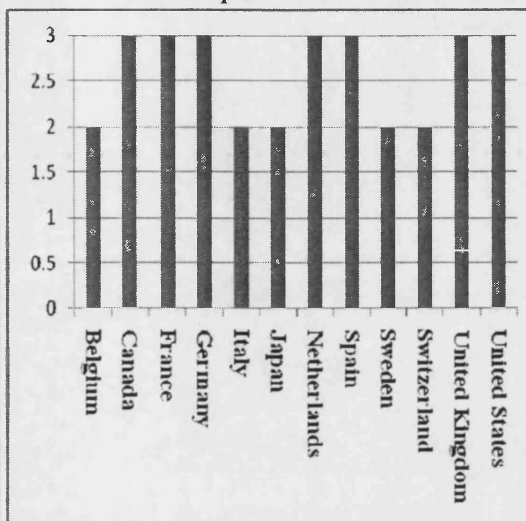


Figure 2.5: De Jure Regulatory Independence Scores



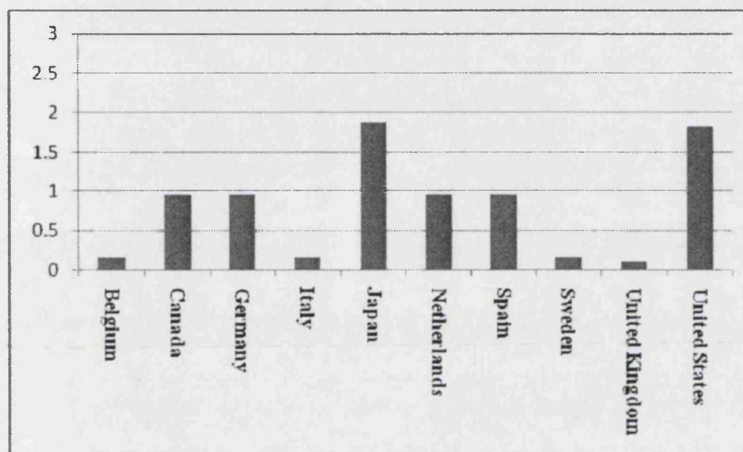
As Figure 2.4 reports, the revolving door scores vary a great deal among BCBS countries (data for France and Switzerland were not available), but this variation is clearly represented within the countries selected for the study. Figure 2.5 illustrates the de jure independence of the regulatory agency from the government of each respective BCBS country, with higher scores indicating more independence. The variation across the BCBS is not considerable in this respect, with most BCBS countries having a high degree of de jure regulatory independence. Once again, however, the variation that does exist is captured in the countries selected for the study. In addition to these forms of variation, I considered the way in which such variation *combines* to construct a common institutional environment, whereby the revolving door and de jure regulatory independence are understood as parts of the same phenomenon of regulatory independence.[199] To consider this dynamic, I performed a factor analysis using a sample of 80 different countries included in the Barth et. al. Specifically, I ran a principle-components factor analysis using both the revolving door and the de jure regulatory independence data to generate a unique factor score for each country.[200] Figure 2.6 below reports the factor scores for each BCBS

[199] This follows the thinking of Barth et. al. 2003 in this respect, though they combine scores additively, not on the basis of factor scores in this instance.

[200] A simple principle factor analysis does not yield different results in terms of relative placements of these countries – only the scale is different.

country (France and Switzerland are dropped from the sample due to a missing revolving door score). These results indicate that there is variation across the BCBS countries, but once again such variation is captured by the BCBS countries included in the study.

Figure 2.6: Factor Scores for the Regulatory Independence of the G10 Countries



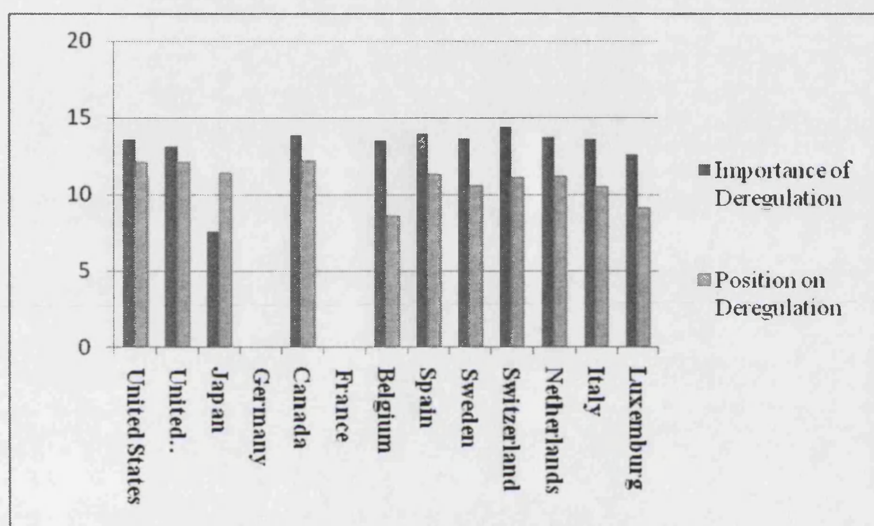
The national political environment is another source of variation across the G10 during the period of the study. As far as formal institutions are concerned, each BCBS country is a Parliamentary system of government, with the exception of the United States. There is also substantial variation among the electoral institutions of each country selected. Japan and Germany are systems of Proportional Representation, while the US, UK and Canada are not; the UK and Canada are first-past-the-post Westminster systems, while the US has a completely different, Presidential system altogether.[201]

A further consideration is the extent to which regulatory policies are politicized in various countries. To consider this dimension of political life in each BCBS country, I utilized Benoit and Laver's survey of policy competition, in which expert surveys were used to score the positions of each of the main political parties in a given country with respect to deregulation. A score of 1 to 20 was used for each party, whereby 1 was used to denote 'favours high levels of

[201] Electoral system diversity is considered in Busch 2008.

state regulation and control of the market' and 20 was used to denote 'favours deregulation of markets at every opportunity'.[202] These values were computed for 'importance' and 'position on' deregulation. Using this data, I calculated an overall value for each BCBS country by multiplying the share of the vote for each party by the score of each party to arrive at a single value. As Figure 2.7 below illustrates, there is not considerable variation on these values (data for France and Germany was not available).

Figure 2.7: Deregulatory Political Environment



Notable outliers include Japan, whose politics placed noticeably less importance to deregulation, and Belgium, whose position on deregulation is less favorable than the other countries. There are, unfortunately, no quantitative scores for Germany (though in substantive grounds it is difficult to believe the position on deregulation is not at the low end of the scale). Using the same dataset from Benoit and Laver's expert surveys, I also calculated the left-right scores (whereby 1 denotes left-wing and 20 denotes right-wing) using the same method above, with results reported in Figure 2.8 below. Figure 2.9 then repeats the analysis for the ruling party for the election year in which the surveys were conducted (all were from 2001-2004). What this analysis illustrates is that the left-right orientation of the electorate across BCBS does not vary, but the left-right orientation of the ruling parties does vary. This variation is, however, fully captured in the countries selected within the study, with Germany being ruled by a left-wing

[202] Benoit, Kenneth, November), p. 4

party, and the United States a right-wing party during the period under investigation, and both the UK and Canada being ruled by slightly right-of-center parties.

Figure 2.8:
Left-Right Political Environment

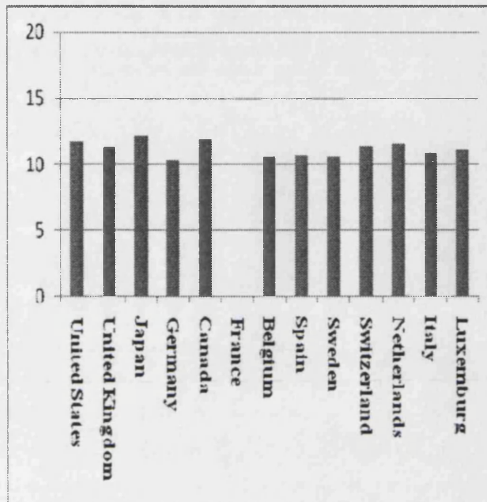
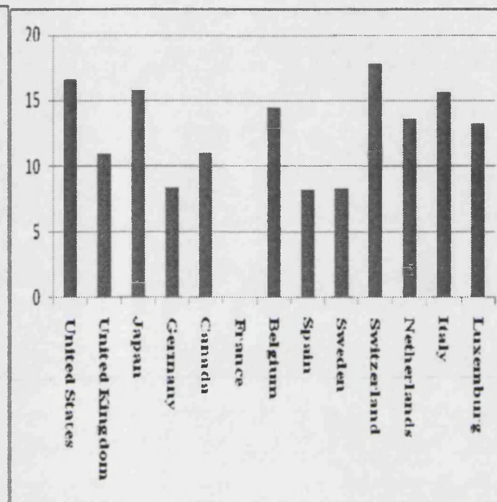


Figure 2.9:
Left-Right Position of Ruling Party



Based on the above analysis of variation across BCBS countries, there is a good basis for selecting the sub-set of countries I have chosen. With this sub-set countries selected, I then engaged in an exploratory process of investigating instances wherein private sector campaigns did and did not take place. As an indicator of private sector campaign activity, I first discerned the basic content of private sector campaigns by investigating not only the detailed written responses of private sector groups that were sent to the BCBS, but also comments made within the financial press, speeches, press releases, and written reports and testimonies given within national legislatures on the regulatory policies in question, and internal documentation. This strategy was inductive in that it literally involved a thoroughgoing exploratory search for evidence of private sector activity. Information was further supplemented through interviews conducted with individuals who were involved both within private sector groups and individuals who were involved within the regulatory agencies concerned.

For transnational campaigns, the process of case selection is identical to that described above, with the exception that country-level information was not available for obvious reasons.[203] Instead of delimiting cases on the basis of whether or not private sector activity was found to take place within a particular country over a particular policy, the delimiter is whether there is evidence of any transnational organization taking place over a given policy. Evidence suggesting the presence of a transnational campaign was obtained from the documentation produced by the Institute of International Finance (IIF) and the International Swaps and Derivatives Association (ISDA), the two 'global peak' associations of financial sector groups during the period under investigation.

As Table 2.1 below illustrates, for some policies campaigns were waged in a variety of countries, while campaigns for other policies were confined to one country. While some campaigns were waged primarily transnationally, others were waged both transnationally and on a national basis.

Table 2.1: Population of Campaigns and Their Associated Policies

		Country					
	Regulatory Policy Within Basel II	USA	Germany	Japan	UK	Canada	Transnational
1	Full Internal Models						■
2	Internal Ratings Approach						■
3	Interest Rate Risk						■
4	W factor						■
5	Operational Risk	■	■	■	■		■
6	Commercial Real Estate		■				
7	SME Lending		■	■	■		
8	HVCRE	■					
9	Residential Mortgages	■	■		■	■	
10	Revolving (Credit Cards)	■					
11	Expected Losses	■	■			■	■
12	Securitization	■	■	■	■	■	■

[203] This point has been confirmed in several interviews, such as 32P, 33P, and 96P.

Explication of Analyses of Private Sector Campaigns

The campaigns under investigation in this study are organized by scale and by chronology. Chapter 3 investigates those campaigns which were primarily transnational in character (with the exception of the transnational expected losses and securitization campaigns, which are examined in later chapters as they interacted with national campaigns taking place). Chapters 4 through 9 examine national private sector campaigns. Here, I organize my analysis chronologically and contextually. For example, the campaigns associated with the expected losses policy and the credit cards policy are grouped together because these policies were both developed at the same time, and involved interactions with regulators in a similar contextual environment.

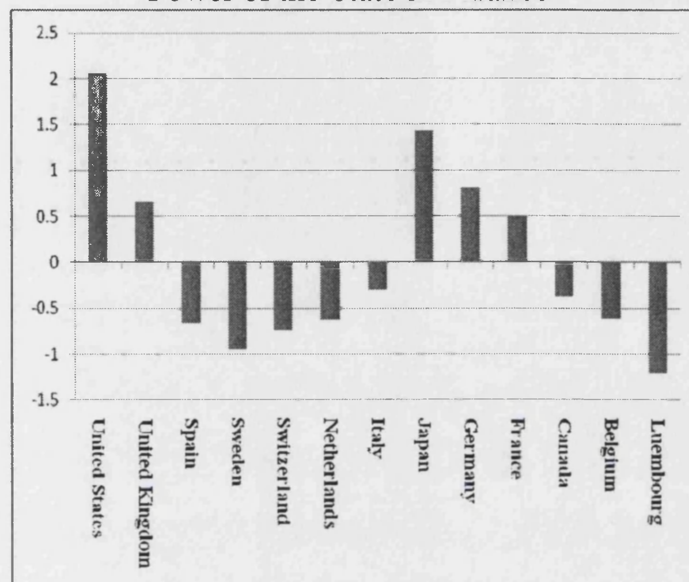
In each empirical chapter, I discuss the main findings and focus my comments on the extent to which cases offer support for particular hypotheses. I do so not only because of the large number of hypotheses evaluated, but because of both the nature of the data involved and the nature of process tracing. The data involved in most of the campaigns analyzed is such that failure is more common than success, which means that there is ample opportunity for *negative* evaluations of hypotheses. The particular strength of process-tracing analysis, however, is in *positively* evaluating hypotheses, i.e. in showing links between the presence of particular conditions/factors and outcomes. To be sure, *negative* findings are just as important, but are more efficiently evaluated through across-case analysis. Because of the use of fsQCA, I leave the examination of across-case relationships to be explored systematically in Chapter 10. This approach also allows me to evaluate the strength of causal mechanisms observed within process tracing analysis, while at the same time leaving open the possibility that complex causal processes that are beyond my immediate observation within each case may play a role in affecting outcomes.

Section 5:
Structural Power Selection Effects

This section analyses whether or not the sample of countries included in the study have characteristics which generate a form of selection bias regarding structural power. Considering such selection bias is important since structural power is a much less readily observable property than other phenomena of interest to the study. In conducting the analysis of such 'structural power selection effects', it is first necessary to establish the parameters of variation among BCBS countries, which necessitates measuring structural power in both of its main state-varying forms, that being the 'relative structural power of the state in finance' and the 'structural dependence of the state on finance capital' (*policy-level* structural power selection affects are addressed at the beginning of Chapter 10). First, I considered the structural power of each BCBS state, considering in particular the relative strength and dominance of different BCBS countries. I employed a variety of data for this purpose from both the World Bank World Development Indicators and data from *The Banker* database. For each BCBS country, this dataset includes the standardized, US dollar-values (current prices) for Gross National Income, the average Tier 1 capital of the largest 10 banks, the average assets of the largest 10 banks, the percentage of Tier 1 capital of the top 100 banks in the world, and a measure of how many of the top 10 banks in a given country are in the *The Banker* top 100 list (each of these values is taken from 2001, the mid-point year of the study). Each of these values is intended to measure the financial sector resources within each BCBS country, and thus each can be understood as an indicator of the structural power resources of the state in question. Since the Structural Power of the State is understood in relational, rather than absolute terms, there is a need to produce a relationally-based indicator which indicates which BCBS countries are strong in this dimension, and which are weak. Consequently, I conducted a statistical factor analysis of the data described above, using a principle-component factoring model.[204] This factor analysis revealed that for each of the quantitative indictors described above, there is a common element or underlying 'factor' common to all variables. Figure 2.10 below reports the predicted factor scores for each BCBS country produced through this analysis.

[204] I only included data from BCBS countries in this dataset since it is the relationships among BCBS members which is relevant to the study, not the structural power of all states in the international system of states.

Figure 2.10: Factor Scores for the 'Relative Structural Power of the State in Finance'

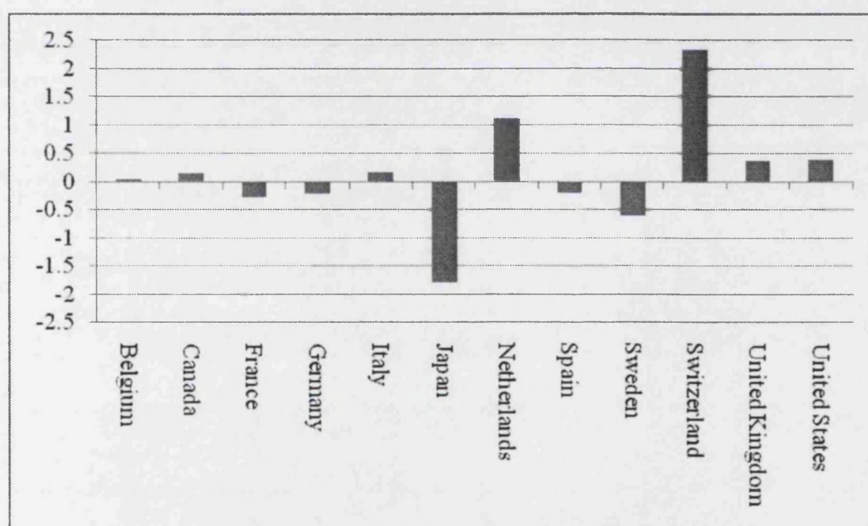


As this data illustrates, there is a substantial degree of variation across BCBS countries when it comes to the relative structural power of the state in finance, with countries like the United Kingdom, Japan and Germany as structurally dominant (above the Y axis), and the United States by far the most structurally powerful, and thus 'externally strong' states. Like other middle powers such as Belgium or Sweden, Canada is considered, in relational terms, to be an 'externally weak' state in financial-structural power terms.

To measure the structural dependence of the state on finance capital, data was gathered indicating the importance of the banking sector in terms of taxation, economic activity, and employment in each BCBS state. More precisely, this data included the percentage of tax revenue that the banking sector contributes to total tax revenue, the percentage of employment in the banking sector as a percentage of total employment, and the average percentage of income of the banking sector as a percentage of GDP, all averaged for the years 1998-2004. Because the structural dependence of the state on finance capital is *not* a relational concept across countries, but rather a relational concept *within* countries, I included data not only from BCBS countries but also for all other comparable countries from which data was available, in order to generate a

more robust factor analysis.[205] These countries were also OECD members: Austria, Czech Republic, Denmark, Finland, Ireland, New Zealand, Norway, and Poland. Luxemburg stands out far above all other states, and is thus excluded on the basis that factor analysis may lead to distorted results in the presence of extreme outliers.[206] In order to construct an indicator of the structural power of finance capital within each state, I conducted a factor analysis of the data described above, using principle-component factoring model to designate a factor score for each BCBS country. All three variables are found to be related to the same underlying single factor. As Figure 2.11 below illustrates, there is a great deal of variation among BCBS countries in terms of their factor scores.[207]

Figure 2.11: Factor Score Values indicating the Structural Dependence of the State on Finance Capital



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[205] Data for all countries except Canada and the United Kingdom were from stat OECD database; data for Canadian bank employment figures were from CBA 2009. Data for the UK was drawn from Cullinane 2005.

[206] It is already very clear that Luxembourg is structurally dependent on finance capital – it is a city state oriented around financial services, with over 80% of the employed population in the banking sector.

[207] Notably, these relative results are not affected by the removal of any one of the three variables in the factor model.

Rather than using these actual factor scores as the basis of measurement in and of themselves, these values are employed in order to aid the general classification of countries (see 2.12 below). The fact that BCBS countries such as France, Germany, Japan, Spain, and Sweden have factor scores below zero indicates that (in relation to all other countries represented in the sample) these states are 'internally strong' in terms of the structural dependence of the state on financial capital. All other states are 'internally weak', because the structural dependence of these states on finance capital is high. Figure 2.12 illustrates the placement of BCBS countries along a 2x2 matrix indicating the array of combinations of internal and external structural power conditions which vary by state.

Figure 2.12: Matrix of External and Internal Structural Power Conditions among G10 Countries

		Internal Structural Power	
		Strong	*Weak*
External Structural Power	*Strong*	Japan Germany France	USA UK France
	Weak	Sweden Spain	Luxemburg Netherlands Switzerland Netherlands Belgium Canada Italy

From the basis of the placement of BCBS countries in this matrix, we can conclude that three out of four of the forms of country-level structural power variation are represented. Externally weak but internally strong states are, however, not represented in the study. This feature is an important consideration for later analysis in Chapter 10, and shall inform the extent to which generalizations regarding structural power will be made.

Because the method used to select private sector campaigns uses indicators of private sector activity, it is possible that the campaigns examined are those in which the structural power dynamics at play were either weak, strong, or biased in some way as a selective distortion of the sample of BCBS countries. To analyze this possibility, I first conducted an empirical test of the extent to which various simple indicators of private sector campaign activity were correlated with various indicators of the structural power discussed above. Against each of these variables, I ran correlation tests for three different indicators of private sector activity in each BCBS country. The first of these was the total number of letters submitted to the BCBS from a given country – the indicator illustrated in Figure 2.2 above. The second was a measure of how many of the regulatory policies investigated in this study were criticized in the written comments of the national banking associations of each BCBS country. The third was a proxy measure of how intensely banking associations engaged in such critique – when over 100 words were written on a given regulatory policy, I counted this policy; otherwise the policy was not counted. I ran simple correlation tests between each of these variables and both of the main structural power variables described above, defining an 80% correlation value as highly correlated. I used every permutation of the structural power variables possible: the raw factor scores, the crisp-set values, continuous fuzzy-set values, and manual fuzzy-set values. None of these values were highly correlated, suggesting that the country selection method was not biased to include or exclude the structural power characteristics of states.[208]

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[208] Indeed, the highest was the raw factor score for the structural power of the state in finance and the number of total letters submitted, at 75%.

Chapter 3

Transnational Private Sector Campaigns

This chapter undertakes a detailed process tracing analysis of regulatory policies targeted by transnational private sector campaigns. I focus on six different private sector campaigns concerning different aspects of the Accord. I construct different policy case narratives for each of these campaigns, and consider the unique configuration of causal conditions within, and outcomes of, each campaign. As we shall discover, there was considerable variation in regulatory policy outcomes. In some cases, private sector groups were successful in their efforts, meaning that they achieved permissive regulatory policy change. In other instances, however, they were unsuccessful, meaning that permissive regulatory policy change failed to occur.

As the first empirical chapter of the study, this chapter helps to establish some of the basic features of Basel II's actual content. In particular, it establishes the fact that the Accord does *not* employ banks' own credit risk internal models, but rather allows banks to use their own credit risk ratings. This point is significant not only because later campaigns examined in subsequent chapters need to be understood in this context, but also because the existing IPE of finance literature has commented on the issue of internal models considerably. Many of the existing accounts of private sector influence reviewed in Chapter 1 have argued that banks have been successful in influencing the Accord by allowing them to use their own internal risk models with which to set levels of regulatory capital.[209] As we shall see below, however, an extensive transnational campaign was waged in the effort to have Basel II allow for the use of full internal models, but the BCBS refused.

Each of the five campaigns examined herein are divided into separate 'policy narratives', in which the content, context, and outcomes of each transnational campaign are analyzed through process tracing. The first policy narrative deals with the private sector campaign to advocate for the use of full internal credit risk models in the Accord. The second policy narrative focuses on a

[209] See Steil and Litan 2006, p. 23; Mattli and Woods p. v; Singer 2010, p. 99; Singer 2009, p. 26

very large and extensive policy which formed the analytical bedrock for most subsequent policies in the Accord: namely, the policy concerning the use of internal ratings for regulatory capital purposes. The third policy narrative focuses on the campaign associated with interest rate the risk policy. The fourth policy case narrative examines the private sector campaign associated with the initial development of the operational risk policy. The fifth policy case narrative concerns a campaign associated with a regulatory policy developed to deal with a very specific form of risk known as 'residual risk' associated with the use of credit derivatives.

Each of these cases provides evidence of the substantial degree of mobilization, information exchange, and coalition-based activity that took place at the transnational level. As I demonstrate, however, the level of success in achieving permissive regulatory policy change was very mixed. Banks and their associations were successful in some cases – but this was often in a very unexpected or circumscribed way. In other cases, they were spectacularly unsuccessful.

Section 1
The Campaign for Full Internal Models: 1998-1999

In 1998, just as the BCBS began to seriously contemplate a revision of the Basel Accord, a transnational private sector campaign emerged to press its vision of a new agreement. This campaign was spearheaded by the Institute of International Finance (IIF), the transnational association of banks that had acted since 1982, following the Latin American debt crisis, as the industry's transnational representative body. The IIF had commented on the BCBS's activities since the early 1990s, and during the development of the Market Risk Amendment from 1995-97, the IIF had made several recommendations to the BCBS that encouraged an ongoing dialogue between bankers and regulators at the transnational level. Once the IIF received indications that the new Accord would attempt to make use of banking industry best practices, it began arguing for a policy position favored by its membership. Namely, it wanted the policy to allow banks with sophisticated internal risk management and measurement systems to calculate their own levels of capital adequacy by using their own internal credit risk models.[210] Complex

[210] This contention had existed within the IIF since at least 1995. See IIF 2007, pp. 61-62. The position was also sometimes floated within the international financial press at the time as well, especially after the Market Risk Amendment. See Financial Times 1998.

credit risk modeling systems had proliferated within the US banking community. In 1997 JPMorgan had published their advanced credit risk methodology, called CreditMetrics, Credit Suisse's Financial Products Division had released CreditRisk+ in the same year, and similar such models were being used within the US banking community especially.[211]

The campaign for full internal models must be understood in its historical context. Interest in banks' own internal credit models had been growing within the BCBS, as were efforts to try to learn from best practices within large complex banking organizations. The Chair of the BCBS at the time, Tom de Swaan of the Netherlands Central Bank, had organized a meeting with the IIF as part of their efforts to learn about the new risk management practices that had been developing in the world's largest banks.[212] Many members of the IIF saw this as a sign of encouragement. Private sector actors viewed the election of Bill McDonough of the New York Federal Reserve Bank as Chair of the BCBS in 1998 as further encouragement, since he indicated his interest in using best practice from the banking industry's risk management systems as part of the effort to rework the Basel Accord.[213]

Of all the members of the BCBS, the Fed was the most enthusiastic about the possibility of using banks' own internal risk management practices for the purposes of banking regulation.[214] There was a sentiment within the Fed that the complexity of financial innovation made "intrusive supervision less meaningful, if not virtually impossible"; indeed, US Agencies were increasingly reliant upon banks' own internal risk management systems when assessing their adequacy.[215] Large banks, such as JP Morgan in the United States, and Credit Suisse in Switzerland, had developed very sophisticated credit risk models, and BCBS staff was tracking their advances in the new science of credit risk management. Within the Federal Reserve Board, the supervisory interest in these methods was particularly strong, and by the mid 1990s there were already research initiatives in place to investigate the use of banks' own credit risk models as part of regulatory practice.[216] As interest in the internal risk management practices of banks

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[211] Crouchy, Galai and Mark 2005, pp. 225-253.
[212] Interview 22R.
[213] Interviews 65R, 95R, 73R, 79R. Citibank hosted an IIF dinner and invited McDonough, who informed participants that the Accord was being revised. See IIF 2007, p. 19.
[214] See Meyer March 1998; Meyer June 1999.
[215] Ferguson 1998; Interview 74R; See Courtis 2000, p. 50.
[216] Interview 36R, 74R, 79R, 82R. See Jones and Mingo 1999. See also Lopez and Saidenberg 1999.

grew, the Fed conducted extensive surveys of bank practices.[217] The UK's new FSA was also paying close attention to innovations in credit risk modeling, and its head of financial supervision announced that when banks demonstrated that their own credit risk modeling methods were sound, they would be credited when their capital ratios were set.[218]

The IIF saw the increased interest in internal bank practices as an opportunity to advocate for its own particular preferences. In the words of one IIF participant in this process, "We had hope. We had hope that they were actually going to go all the way toward recognizing portfolio credit risk modeling ....full internal modeling."[219] IIF members began to try and further persuade the BCBS that credit risk models were advanced enough to be used in an international regulatory framework. The IIF organized through their Working Group on Capital Adequacy, which was composed of those senior credit risk managers in IIF member banks.[220] The group produced a report urging the BCBS to update the regulatory capital rules for credit risk in accordance with banks' own internal credit risk models.[221] The IIF Working Group on Capital Adequacy advocated that the BCBS "move quickly to recognize bank's internal credit risk modeling systems to generate regulatory capital cushions that would be more closely attuned to real risks."[222] They argued to the BCBS that if the Basel framework was not revised in this way, it would lead to distortionary behavior and undermine the credibility of the existing Accord.[223] The move to a full internal models approach to capital adequacy regulation, the IIF argued, would be in the best interests of both regulators and banks.[224] The International Swaps and Derivatives Association (ISDA) argued a similar position at the time, pointing out that prevailing risk-weighting categories in the Basel Accord had been defined by types of counterparties, rather than the exposures' actual credit quality, and that credit risk mitigation, such as the use of derivatives, were only sparsely acknowledged.[225]

[217] See English and Nelson 1998.
[218] Harris 1998, p. 4.
[219] Interview 61P.
[220] IIF 2001b, p. 3.
[221] IIF 1998.
[222] IIF March 2000b, p. 2; IIF 2007, p. 69.
[223] IIF March 1998, p. 37, in IIF 2007, p. 69.
[224] See IIF 2007, p. 19.
[225] ISDA 1998, in ISDA Feb 2000, p. 8.

Regulators' Reaction

While there was consensus within the BCBS that the Accord should be reformed, views on the potential usefulness and viability of using full internal credit risk models for regulatory purposes were mixed. While the Fed was the BCBS participant closest to the IIF position at the time, the US Office of the Comptroller of the Currency (OCC) and especially the Federal Deposit Insurance Corporation (FDIC) were strongly against the idea from the outset. [226] There were also skepticisms within the rest of the BCBS. The German delegates doubted data availability, the comprehensiveness of the models, and their own ability to supervise banks using such models.[227] Because the Fed had the greatest interest in credit risk models, it established a Task Force on Internal Credit Risk Models to assess the potential use of banks' internal credit risk and capital models within the context of banking supervision.[228] After careful study of the issue – involving an intense period of interviewing many US banks – the Fed's own conclusion was that there were still considerable challenges that would need to be addressed before an internal models approach could be employed within the new Basel Accord. Among these were a lack of a common framework for defining credit losses, difficulties in calibrating key model parameters due to data limitations, and problems with the validation of such models.[229]

Other work within the Fed came to strikingly similar conclusions.[230] These views were consistent with the research and views held by UK regulators at the time. Bank of England staff were noting at the time that there were "significant hurdles that will have to be overcome" before banks can use their own systems to set regulatory standards.[231] Similarly, while staff at the Bank of England sympathized with the evolution toward best practice, there was a concern that regulatory capital levels might fall too low as a result of full internal models.[232]

Despite the skepticism concerning the use of internal models, the BCBS decided to conduct a G10-wide study on the issue. The BCBS Models Task Force undertook an extensive

[226] Interviews 95R, 79R, 73R. There were also problems within the predictability of these models. See Wagley 1989, p. 1
[227] Interview 93R
[228] Interview 80R
[229] Federal Reserve Board May 1998, p. 2. See also Meyer June 1999, p. 5. Interview 74R
[230] See English and Nelson 1998; Mingo and Jones 1999
[231] Jackson et. al. 1999.
[232] See Jackson et. al 1999, p. 9.

study wherein 31 senior regulatory officials from the G10 surveyed and analyzed the credit risk modeling practices of the 20 largest banks in the world in 10 different countries. This consultation process involved BCBS regulatory institutions looking into the internal modeling practices of large banks. Although the BCBS had initiated these investigations in response to IIF and ISDA's campaigns, regulators soon found further evidence of deficiency within private sector practices.[233]

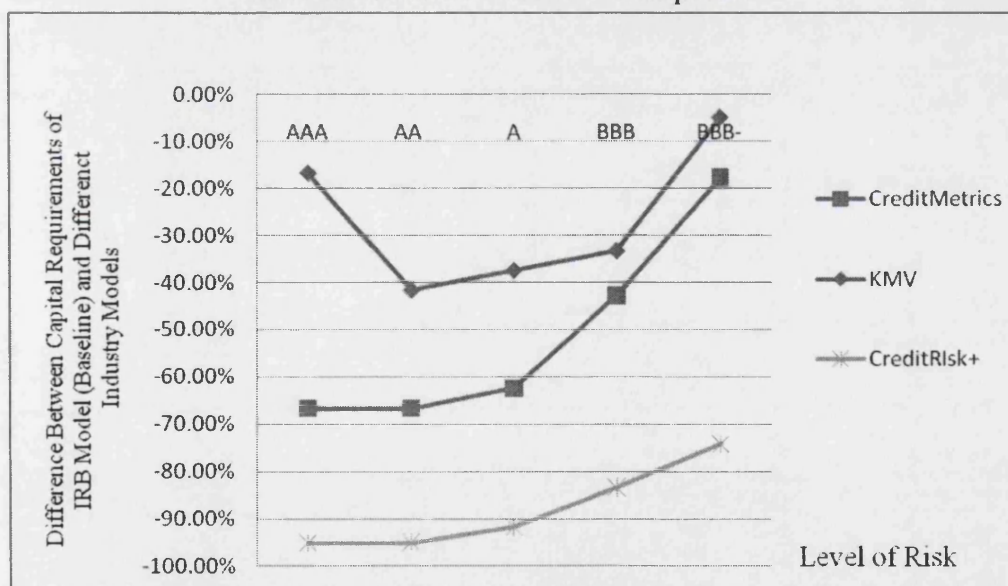
Contrary to the views held within the IIF and the ISDA at the time, the BCBS' Models Task Force concluded that internal credit risk models were not a simple extension of market risk models, for two reasons. First, the Task Force had found that there were significant data limitations within the banks that they surveyed, and thus concluded that the simplifying assumptions and proxy data required for regulatory purposes could have consequential repercussions for bank solvency if they were inaccurate.[234] Second, the Task Force was not convinced that internal credit risk models could be validated based on a common standard. In order to validate bank's models, BCBS regulators would require several years of data for back-testing, spanning several credit cycles.[235] In the words of one BCBS participant, comparing internal models was "like comparing apples and oranges and cauliflower", and after careful study had concluded that "No one in the Committee thought it made the slightest bit of sense".[236]

There was consensus within the BCBS that a full internal models approach should not be employed.[237] The industry arguments were simply not convincing in light of their research. In the words of one BCBS participant referring to the private sector effort, "[t]hey pushed. And we said no."[238] Groups like the IIF and ISDA were clearly disappointed, although some within the banking community thought that the BCBS may reconsider the issue in the future.[239] When the BCBS released its first consultative paper in June 1999, it reiterated its earlier conclusion, namely that there were too many technical difficulties with including full internal credit risk

[233] Interview 79R. Corroborated with Interview 19R.
[234] There simply wasn't enough convincing data on credit risk models' sensitivity to structural assumptions and parameter estimates. See BCBS April 1999, pp. 1-2
[235] BCBS April 1999, pp. 1-2.
[236] Interview 67R
[237] Interviews 92R, 67R, 93R.
[238] Interview 67R
[239] See Ranson 1998, p. 1; Financial Regulator 2000, p. 46; Graham 1999, p. 8.

models in the Accord, including the problem of data availability and model validation.[240] Claes Norgren, the head of the Capital Task Force, stated at the time that the BCBS had excluded such models on the grounds that "these models are not yet developed enough to allow for this kind of use."[241] However, the document also suggested on several occasions in the document that credit risk models might be used in the future.[242] The BCBS Secretariat noted that they commended the private use of such models, and would monitor their progress closely; nevertheless they would not be part of the Basel II Accord.[243] Subsequent – although comparatively modest – attempts were made by private sector groups to encourage the use of full internal credit risk models, and these too were not heeded. The fact that the BCBS never accepted the industry arguments had important consequences, as it meant that even the Advanced IRB approach necessitated higher capital requirements than each of the major internal risk models banks employed at the time, as demonstrated by Figure 3.0 below.

Figure 3.0: Basel II Internal Ratings-Based Approach and Bank Internal Models Compared[244]



[240] BCBS January 2001a, p. 4.
[241] Norgren 1999, pp. 41-42.
[242] See BCBS January 2001a, pp. 4-5, p.
[243] Danielle Nouy, quoted in Deane 1999, p. 46
[244] Data is from Crouchy, Galai and Mark 2005, p. 223.

Section 2
The Campaign for Internal Ratings: 1999-2001

While the BCBS rejected the industry view that full internal models should be used in the Accord to set levels of regulatory capital, it was still enthusiastic about drawing upon the banking industry's best practices.[245] Instead of employing its own internal models within the Accord, the BCBS agreed that it would utilize banks' own internal risk ratings. Work done at the Fed enabled this decision, in which they used the basic logic and mathematics of internal credit risk models to produce a regulatory model that the BCBS could use.[246] It was agreed within the BCBS that, for the most sophisticated banks in the world, the new Accord would enable banks to make their own assessments of risk on a given exposure, an assessment which then served as an input to a model the BCBS designed to calculate a risk-based regulatory capital charge. This gave the BCBS the ability to draw from industry best practice while at the same time maintaining their discretion as regulators. The BCBS Models Task Force sought out to engage with private sector groups organized at the transnational level in order to gain information about best practices within the banking industry.[247]

Extensive Mobilization and Transnational Coalitions

Private sector groups mobilized an extensive transnational campaign in response to the BCBS's proposal, and these efforts were largely led by the IIF. The IIF began these efforts with an internal reorganization. A month after the release of the June 1999 document, the IIF's Board of Directors established a Steering Committee on Regulatory Capital specifically to increase the IIF's involvement in the formation of Basel II.[248] While the IIF Working Group on Capital Adequacy was already in existence, and focused on the technical dimensions of banking regulatory reform proposals, the IIF Board of Directors mandated that the Steering Committee on

[245] Interviews 18R, 67R; 22R, 18R.
[246] Interview 76R; See also Gordy 1998; Gordy 2003
[247] Interviews 18R, 95R
[248] Interview 22P.

Regulatory Capital produce a broader perspective in order to guide the technical work, and develop an overall response to the BCBS's proposals.[249] The IIF had considerable insider-knowledge on their side. The vice-Chair of the Steering Committee was Tom de Swaan, the former Chair of the BCBS, now on the Managing Board of Directors from ABN-AMRO.[250]

The IIF was able to use its position as the peak transnational association of large banks to interact with the BCBS participants on a regular basis during this period. In this vein the BCBS used discussions and data from the IIF as part of their research agenda to investigate the best way to develop an internal ratings-based approach.[251] This process involved informal consultations, when IIF groups would meet with the BCBS or a BCBS sub-committee to discuss specific technical issues, and a more formal process of gathering data, usually with the Models Task Force. The BCBS also consulted bilaterally with 30 large banks across the G10 in order to gather information about banks' internal rating systems, and to assess practices in this area.[252] The Models Task Force analyzed their findings and found that while there was significant diversity in internal ratings practices among banks, as well as open questions about parameter estimations, there were nevertheless some common elements.[253] The Task Force compiled their findings and published them in the explicit effort to receive further industry input on the soundness of the BCBS' analysis.[254]

The IIF sought to influence these efforts by producing a report of internal rating practices for the BCBS Models Task Force in February 2000, outlining the industry's common practices.[255] In addition to surveying their membership and coordinating technical responses to the BCBS' specific queries, the IIF also advocated a specific approach. On the basis of their own expertise and discussions with BCBS members, the IIF formulated a policy proposal for internal ratings in the new Accord. Specifically, the IIF Steering Committee on Regulatory Capital proposed what they called a 'spectrum approach' for internal ratings, whereby more sophisticated banks would be able to advance to calculate their own internal ratings in successive

[249] IIF May 2001, p. 14.
[250] See IIF 2007, p. 20
[251] Interview 53P,
[252] BCBS January 2000a, p. 3.
[253] See BCBS January 2000b, pp. 4, 9, 24, 27.
[254] BCBS January 2000b, p. 3
[255] Internal IIF document, obtained under anonymity.

stages.[256] The IIF also advocated that the risk weighting should be continuous, based on the measurement of expected losses of bank's credit risk exposures, and detailed a set of standards for the supervisory oversight of internal rating systems.[257]

The ISDA also responded with their own proposals to attempt to influence the Models Task Force's work, gathering together a number of its member banks who used their own internal models across a variety of portfolios, and compiled detailed data.[258] Like the IIF, the ISDA also advocated a specific proposal resembling their own preferences, known as an 'index approach' to the use of internal ratings.[259] It was somewhat similar to the IIF's proposal, but generally cruder. While the ISDA didn't have as much informal engagement with the BCBS on the general content of credit risk models, it did engage with the UK FSA which, together with the US regulators and the Bank of France, was conducting the bulk of the technical work within the Models Task Force.[260]

The ISDA and the IIF also worked together. Both groups (which had significantly overlapping memberships at the time) sought to decrease the BCBS' uncertainty on which risk ratings banks would be able to estimate internally. Because of the failed campaign for internal models, there was a concern that the BCBS did not accept the notion of comparability across banks' internal risk management systems. To this end, the IIF and the ISDA launched the Credit Risk Modeling Project, which surveyed the internal risk modeling systems used by some of the largest 25 banks in 10 different countries.[261] The IIF and ISDA met with the BCBS Models Task Force to discuss their empirical findings, which were that risk models across banks yielded directionally similar results (i.e. similar patterns). They advocated specifically that the most significant drivers of risk measures were credit quality, asset value correlations, and loss given default.[262]

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[256] IIF March 2000a, pp. 21-28
[257] IIF March 2000b, pp. 36-39
[258] ISDA 2000, p. 26
[259] In this approach, regulatory capital would be based on different indexed combinations of PD and maturity, all based around a benchmark asset. ISDA 2000, p. 25
[260] See UK Advisory Group January 2000.
[261] See ISDA February 2000; IIF 2007, pp. 69-70. For an empirical analysis, see Crouchy, Galai and Mark 2005, pp. 207-208.
[262] IIF 2007, p. 70

The IIF and the ISDA were not the only transnational association trying to shape the content of Basel II's internal ratings-based approach. A new group composed of risk professionals from major banks in Canada and the United States forged a working group through the Risk Management Association (RMA), based out of Philadelphia. The RMA forged a new group, the 'RMA Capital Working Group' in December 1999 to provide a concerted response to the Basel II proposals. The Capital Group was composed of risk managers large banks, and like the IIF and the ISDA, the RMA Capital Group sought to demonstrate the range of practices within the banking industry.[263] Using data from each of their 11 large member banks, the Capital Group generated a matrix of rating scales which generated risk-weighted capital adequacy curves for use in the Accord, and also advocated for the expanded coverage of ratings (for example to retail exposures).[264] Like the IIF, the Capital Group also argued that the retail section of the Accord could differentiate between different sub-categories of lending, such as credit cards, residential mortgages, consumer credit, and so forth.[265]

Policy Outcome: An Internal Ratings-Based Approach

Unlike the transnational campaign to advocate for the use of full internal models, the campaign for internal ratings can be seen as a success, albeit a partial one. The BCBS regarded the information it received from private sector groups as highly valuable, and helped the Models Task Force to develop some of the technical elements of the Internal Ratings-Based approach within the Accord.[266] The Models Task Force had worked considerably with industry groups at the transnational level, and the published draft in January 2001 demonstrated this joint effort.[267] In general, the IRB approach reflected a general model of credit risk that private sector groups had supported. Yet instead of crude risk buckets, or even a 'matrix' of risk weights, the BCBS exceeded most industry expectations by producing a model in which bank's credit risk capital

[263] Interviews 57P, 60P.
[264] Interview 55P; RMA March 2000, pp. 17-18.
[265] RMA March 2000, pp. 17-18; IIF 2007, p. 76
[266] BCBS May 2000, pp. 1-2; Interviews 77R, 95R.
[267] The BCBS also explicitly acknowledged the assistance from industry consultations at the time on this particular point. BCBS January 2001a, p. 1.

was a *continuous* function of parametric risk drivers, just as the IIF had advocated.[268] This internal ratings-based approach was also differentiated for two different levels of sophistication, namely an 'Advanced IRB' approach, similar to what the IIF had argued for its 'spectrum approach', which was designed for use for the most technically sophisticated banks in the world, and a 'Foundation IRB' approach, for less technically sophisticated banks. The latter approach was not the result of any transnational campaign, but rather due to recognition within the BCBS that some banks, while not extremely sophisticated in their risk modeling practices, could estimate at least some risk parameters.[269]

The transnational campaign for internal ratings cannot be seen as a complete success, however, and the extent of the permissive regulatory policy change should not be exaggerated. On average, the IRB approach would lead to a 5% reduction in capital requirements for credit risk from the Basel I status quo.[270] This modest change reflected the fact that, throughout the process of consultation with the banking community, the BCBS' confidence in banks' own capacities were somewhat diminished. In the words of one BCBS delegate, "the banks were clearly vastly overoptimistic about what their capabilities were."[271] This skepticism limited the transnational campaign's influence in setting the levels of capital requirements associated with different levels of risk. Thus, even though banks would now be permitted to use their own internal ratings to a certain extent, the regulatory model the BCBS employed was actually designed to increase regulatory capital relative to banks' own internal practices. Table 3.0 below illustrates the differences between the Advanced IRB model within Basel II, and the model proposed by the IIF-ISDA mentioned above. These figures are based on comparable levels of externally rated risk (AAA for low risk exposures, CCC for high risk exposures, etc.).

[268] The integration of the IIF's 'spectrum approach' into the internal ratings-based approach of Basel II is celebrated by the IIF as their first central achievement. See IIF 2007, p. 76
[269] Interviews 95R, 73R.
[270] BCBS November 2001a, p. 3 (Table 1). A small number of banks would have increased capital requirements, but the majority would decrease. See BCBS November 2001a, p. 6; See BCBS November 2001b.
[271] Interview 19R.

Table 3.0: Basel II's Advanced Internal Ratings Based Approach and the IIF-ISDA proposal compared[272]

Level of Risk	BCBS	IIF-ISDA
AAA	0.56	0.22
AA	1.12	0.43
A	1.34	0.57
BBB	3.83	1.95
Benchmark	8	4.41
BB	9.87	5.34
B	27.4	17.74
CCC	50	50

As these values illustrate, even though the BCBS pursued the use of internal ratings championed by private sector groups, the BCBS also designed the Accord in such a way as to be noticeably more stringent than private sector proposals. Thus, while the BCBS allowed large and sophisticated banks to estimate their own ratings, the regulatory capital assumptions of the supervisory model used was twice the median estimate that private sector groups had advocated.[273] Such an approach was met with considerable private sector contestation at the time, given the conservatism of the Basel II approach to internal ratings.[274]

Section 3
The Interest Rate Risk Campaign: 1999-2000

Much to the surprise of banking communities around the world, the June 1999 first consultative draft of Basel II proposed the inclusion of an explicit Pillar I capital charge for interest rate risk in the banking book. The proposed regulatory policy would require banks with 'above average' interest rate risks to hold additional regulatory capital.[275] Following earlier work the BCBS had conducted in this area, the regulation was intended to capture the 'outliers' in terms of interest rate risk, thereby minimizing it. Interest rate risk was widely acknowledged

[272] Data obtained from Crouchy, Galai and Mark 2005, p.210, Table 6.4.
[273] See ISDA April 2001; IIF May 2001, pp. 6-7
[274] See IIF May 2001a, p. 43; ISDA April 2001; IIF 2001a, pp. 6-7; RMA 2001, p. i-iii. See also Helk 2001.
[275] BCBS January 2001a, pp. 48-49

within the BCBS as an important driver of financial sector risk. In this guise the BCBS had, first in 1993, and again in 1997, designed standards and recommendations for the management of interest rate risk.[276] With the overhaul of the Basel Accord, it was a natural progression to try to capture this important driver of risk.[277] The majority of the BCBS felt that the interest rate risk policy was an important component of the new Accord, although some felt particularly strongly about the need for the policy.

The Private Sector Campaign

Private sector opposition to the interest rate risk policy was strong and well-coordinated at the transnational level.[278] Internationally-active banks were especially concerned given the complications of simultaneously measuring interest rate risk across a bank's many national subsidiaries. Banking associations such as the Institut International D'Etudes Bancaires (the informal group of top executives of the largest European banks) argued that any general policy toward interest rate risk would not be able to capture the actual risk profile of any individual bank, and would interfere with business management decisions.[279] The IIF was firmly opposed to the policy, and both their Steering Committee on Regulatory Capital and their Working Group on Capital Adequacy made clear to the BCBS in no uncertain terms why they thought the policy was a bad idea.[280] As a consortium of international bankers, the IIF was especially concerned that the interest rate risk policy would undermine international banking practices. They insisted that establishing what exactly constituted an outlier raised profound issues in terms of interest rate differentials between countries. This difficulty was particularly problematic for banks operating in several national locations, they maintained, as it would create distortions and large regulatory costs for such banks.[281] In both written communication to the BCBS as a whole and in exchanges with the RMG, the IIF and its members argued that there should not be any explicit regulatory capital charge under Pillar I of the Accord. Rather, the IIF advocated that interest rate

[276] See BCBS April 1997
[277] Interviews 74R, 77R, 90R
[278] National banking associations in the US and Germany argued against the policy, but there was no real campaign took place, as efforts were focused transnationally. See American Bankers Association March 2000, pp. 1-2
[279] IIDB, January 2000.
[280] IIF March 2000a, p. 25.
[281] See IIF March 2000b, p. 16

risk should be captured under Pillar II, where there would be no explicit capital charge, only supervisory review.[282]

Negotiating a Policy Outcome

As the year 2000 proceeded, the design of a specific Pillar I regulatory capital charge for capturing interest rate risk was proving challenging for the BCBS. In particular, the RMG's staff, even the most advanced experts within the Fed Board, had difficulty discerning the duration of core deposits across countries.[283] As a result, a number of BCBS delegates expressed their growing reservations concerning the interest rate risk policy (specifically, the extent to which core deposits could be measured across institutions), and it was felt that a decision needed to be made in order to proceed. The interest rate risk was thus put on the agenda for the BCBS meeting in Craiga in August 2000, which focused on outstanding issues that needed to be resolved. At this meeting, two BCBS members had developed strong views that the interest rate risk policy would be unacceptable. The first of these BCBS members came from the US delegation. While the Fed was in favor of pursuing the interest rate risk policy, the OCC did not agree, and viewed the interest rate risk policy as something best captured by in-depth supervision of banks.[284] The OCC was generally critical of the quantification of risk, and of trust in supervisory discretion, which may have influenced their decision against the policy as well. Furthermore, thanks to Congressional demands for a regulatory policy beginning in the 1990s, they had years of frustrating experience trying to model interest rate.

The second of these BCBS members was the Japanese delegation. At the time of the Craiga meeting, they communicated that they could not accept the interest rate risk policy. They believed it would especially costly for Japanese banks, which were already under considerable strain at the time. Rather than engaging in value-claiming behavior, the Japanese delegation simply stated their preferences, and referenced their domestic constraint of overhauling an already weak banking system. Indeed, with the US delegation also objecting to the policy, there

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[282] IIF March 2000b, p. 17; IIF March 2000a, p. 25
[283] Interview 77R.
[284] The concern was over the outliers in the banking system, they felt that the regulatory issue could be best dealt with under Pillar II. See Jerry Hawke's later testimony at the House Financial Services Committee February 2003, pp. 24-25

was no need for value-claiming behavior. The rest of the BCBS wanted interest rate risk in Pillar I of the Accord, but did not offer any challenge or counteroffer to either the US or the Japanese delegations. With two negotiation partners disagreeing – both of whom were major economic powers – it was difficult for anyone to resist accommodating their preferences.[285]

The interest rate risk policy was moved from Pillar I to Pillar II, a clear instance of permissive regulatory policy change.[286] Private sector groups were unambiguously pleased with the result, and the decision was heralded as an important, 'sensible' decision of the BCBS and the IIF discontinued its campaign.[287] Despite the fact that permissive regulatory policy change occurred, the IIF's campaign cannot be causally linked to the outcome. The regulatory policy change which occurred was not due to private sector opposition, but rather to objections to the policy made by the US and Japanese BCBS delegations themselves. This case should force us to question the extent of private sector influence, and illustrates that even if a campaign's demands correlate with policy change in the desired direction, this relationship can be spurious. It is of course possible that the Japanese regulators' position was simply a reflection of their banks' preferences – thus demonstrating some support for the Structural Power Hypothesis. The precise motivations of the Japanese regulators is unclear, but accounts from within the BCBS RMG, however, affirmed that it was the US delegations' lack of agreement that was pivotal, rather than the Japanese position.

Section 4
The Transnational Operational Risk Campaign: 1999-2000

One of the most ambitious elements of the BCBS' June 1999 proposal was an explicit capital charge for operational risk.[288] In contrast to credit risk, which involves risks associated with extending and managing credit relations, operational risk is conceptualized as the form of risks related to the potential failure of banks' internal processes, or from external events.[289] The

285 Interviews 90R, 24R, 77R.
286 As Scott has observed, the lack of interest rate risk in Basel II represents a serious omission in the sense that it decreases regulatory capital considerably. See Scott 2005, p. 12.
287 IIF May 2001b, p. 11; ISDA May 2001, p. 49.
288 On the regulatory ambitions of the BCBS in this regard, see Power 2005.
289 Thus, as banks have become larger and more complex operational risk has risen in comparative importance. See Schooner and Taylor 2010, pp. 131-145.

BCBS had already delved into the issue in a previous publication, which underpinned their subsequent work in the creation of Basel II.[290] In the June 1999 draft of Basel II, a proposal for an explicit capital charge for operational risk was advanced, but only in a very basic form. The BCBS delegates knew that this proposal was highly controversial, because the quantification of operational risk had not yet been well-developed by the private sector, and operational risk management was still in its infancy. Yet the BCBS took the position as a Committee that if the banking industry doesn't have a consolidated technique to measure operational risk, then they should be encouraged to find one.[291] Furthermore, putting forth an operational risk capital charge meant that total capital in the G10 banking system would increase, an aim seen as very important to many Continental European members of the BCBS. Making the Accord risk-sensitive would mean, after all, that regulatory capital requirements for credit risk might go down. An explicit capital charge for operational risk would help countervail this tendency.

The specifics of the operational risk policy's design were handled through the BCBS' Risk Management Group (RMG). Reflecting the Fed's interest in this area, it was headed by Roger Cole, a Senior Associate Director at the Division of Banking Supervision Federal Reserve Board.[292] The BCBS RMG was actively seeking industry input on how operational risk was managed within their institutions, and how a capital charge might best be designed. In September 1999 they conducted a survey with G10 banks on their operational loss experiences. In November they held two one day workshops with banks and other industry participants in order to discuss the various issues involved in defining and quantifying operational risk.[293]

The Private Sector Campaign

A broad coalition of transnationally organized private sector groups mobilized to respond to the operational risk policy proposal. The first series of efforts involved the provision of an operational risk definition that the BCBS could use, with private sector groups like the British

[290] See BCBS September 1998a; BCBS September 1998b. Additionally, issues in operational risk were a centerpiece of the International Banking Supervisors Conference held in Sydney in 1998.
[291] Interview 18R.
[292] Previously the RMG had been co-chaired by Christine Cumming as well (from 1997-1999), from the Federal Reserve Bank of New York.
[293] BCBS November 1999.

Banker's association, the Risk Management Association, the ISDA and the IIF working together to develop a common industry definition.[294] Although consensus developed on the definition of operational risk, the concrete form that the operational risk policy should actually take was the subject of greatly heated debate. The vast majority of private sector groups that expressed their views opposed the operational risk policy from the outset. It was widely believed that operational risk management was either better suited to qualitative management techniques, or that it simply could not be measured as a form of risk.

While private sector groups opposed the operational risk policy within a number of countries, it was at the transnational level that a concerted campaign took place.[295] The ISDA was strongly against the use of a Pillar I capital charge, and they argued to the BCBS that banks already manage operational risk through qualitative mechanisms of oversight.[296] Furthermore, they argued, a Pillar I capital charge would divert focus from internal risk controls within banks, and would likely be very costly.[297] The IDSA also used the argument that because operational risk management was still evolving within the industry, any Pillar I capital charge would necessarily lag behind best practice, at an increasing rate as time progressed.[298] Working with their membership (which at the time included 213 of the largest banks in the world), ISDA also systematically analyzed 12 different methodologies through which an operational risk capital charge might be calculated, and offered a critique of each.[299] This critique was much more technically extensive; it drew from a consortium of 21 large banks drawn from Canada, France, Germany, Japan, the Netherlands, South Africa, Switzerland, the United Kingdom, and the United States, to produce an extensive report arguing against the use of a quantitative Pillar I capital charge, and for a qualitative criteria to be established.[300]

The IIF went even further in its critique of the operational risk Pillar I capital charge. In January 2000, it established its own Working Group on Operational Risk, which was composed of 40 large transnationally active banks interested in this policy, with most of them expressing

[294] Interview 55P; Shirreff 1999, p. 8; IIF March 2000a, p. 24
[295] American Bankers Association March 2000, p. 2; ZKA March 2000, pp. 36-42; Interviews 15P, 36P
[296] ISDA February 2000, pp. 40, 46. See also ISDA September 2000.
[297] ISDA February 2000, p. 42
[298] ISDA, February 2000, p. 43
[299] ISDA February 2000, p. 43.
[300]See ISDA October 2000; ISDA September 2000

strong opposition (with some exceptions, as we shall see below).[301] Like the ISDA, the IIF took the position that operational risk should not have a Pillar I capital charge, and that it should be placed in Pillar II of the Accord.[302] The IIF Working Group on Operational Risk engaged directly with the RMG at BCBS meetings, and the RMG was very receptive to industry-wide views at the time, as it sought to use the IIF to gauge operational risk practices within the banking industry.[303]

Within the IIF Working Group on Operational Risk (WGOR), a small number of risk professionals saw that the BCBS's proposal for an operational risk charge as more of an opportunity than a threat. Unlike the rest of the IIF, who bitterly opposed the idea that something like operational risk could be quantified, they had considerable experience within their institutions in such quantification. As such, they voiced their *support* for the policy. How this group reacted provides this case with a unique opportunity to test the Business Conflict hypothesis.

Business Conflict: The International Technical Working Group (ITWG)

Differences of opinion within the IIF resulted in the formation of a new transnational group. One of the individuals from this still unorganized dissident rank suggested forming separate working groups within the WGOR, in order to represent a spectrum of perspectives to the BCBS's proposal.[304] This proposal was strongly resisted by IIF staff.[305] The IIF was, after all, a transnational association which sought to create a transnational-level industry consensus, not to provide multiple and contradictory views.[306] Following this rejection, the dissident experts sought to organize its own working group, separate from the IIF. What soon became known as the International Technical Working Group (ITWG) was an informal group of operational risk experts who met on a frequent basis, often in tandem with IIF and BCBS meetings, to formulate positions, conduct research, and regularly engage with the BCBS RMG. Because it emerged

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[301] Interview 69P.
[302] IIF May 2001a, p. 19
[303] Interview 77R
[304] Many of the operational risk supporters had participated in the ISDA/BBA/RMA/PWC studies carried out in 1997 and 1999, and knew each other from that period.
[305] Interviews 68P, 69P.
[306] Interview 69P.

from within the ranks of the IIF, its membership was highly transnational, comprised of individuals not only from large US banks, but Canadian, German and Dutch banks as well. Initially the ITWG was composed of Royal Bank of Canada, the Canadian Imperial Bank of Commerce, Citigroup, Deutsche Bank, and AMN-AMRO. JPMorgan Chase would soon join, as would several others (all on an informal basis).

Soon after its formation, the ITWG managed to engage directly with the RMG. At a BCBS summit held in Stockholm, the IIF made some general oppositional claims concerning the BCBS RMG proposal, reflecting the strong majority opposition to the policy. Members of the RMG and the ITWG began meeting soon thereafter.

At their next encounter, the ITWG presented a proposal that systematically laid out some of their views. It was clear to the members of the BCBS RMG that it "brought together a group of practitioners that had a lot more knowledge in terms of what they were talking about than the regulators."[307] Since the ITWG was not oppositional, but rather supportive of developing an operational risk capital charge, the ITWG quickly earned the trust of the BCBS RMG, especially Cole.[308] The RMG had good reasons to trust the ITWG as an interlocutor and source of information. Rather than representing their banking organizations as a whole, the individuals of the ITWG presented themselves as risk professionals within their banks. This claim was credible to the RMG, because the ITWG was informal, and thus the senior members of their banks could not impose discipline on their decisions or stances. As one former RMG participant put it, "they weren't going up the line to the top of the house."[309] The ITWG began to engage in dialogue with the BCBS RMG on a regular basis, both in person and through teleconference meetings on specific issues. The ITWG established internal working groups, would present papers to the BCBS RMG, and on occasion would meet with sub-groups of regulators on technical questions.

The ITWG's Contributions

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[307] Interview 77R.
[308] Interviews 77R, 69P, 68P.
[309] Interview 77R.

Once the ITWG began working closely with the RMG, it made a number of large contributions to the development of the operational risk policy. First, the ITWG expanded the definition of operational risk itself in a way that made the operational risk policy more encompassing and thus the capital charge *higher* than it would have been otherwise. While the IIF Working Group on Operational Risk had developed the basis of a definition for operational risk as early as March 2000, neither the ITWG nor the RMG were completely satisfied with its comprehensiveness, or rather lack thereof. As the RMG continued to work with the ITWG, it increasingly discovered the size and content of major operational risk losses within large banking organizations.[310] One of the large operational losses that the ITWG presented to the RMG was the loss associated with litigation. These were especially high in UK-based operations, and even more so in the US. Both the ITWG and the RMG decided that the definition of operational risk had to be expanded to include litigation risk. This inclusion was consequential, since including litigation risk meant potentially increasing the size of the operational risk capital charge by a substantial margin, thus adding to the policy's stringency.[311] The inclusion of litigation risk would appear in the January 2001 draft of Basel II, and remain in the final version.[312]

Secondly, the ITWG contributed the analytical foundations for the advanced methodology for the operational risk policy. A dominant tendency at the time was to conceptualize operational risk, and its mitigation, in terms similar to banks' conceptualization of credit risk. As such, the ITWG often championed what was known as the 'Loss Distribution Approach', which was in many ways modeled after credit risk, but had its intellectual foundations in actuarial models drawn from the vast literature on insurance pricing. This approach was appealing to the Fed, and was also positively regarded by the German and Japanese members of the RMG.[313] In stark contrast to credit risk, BCBS participants had much less experience with this variety of risk, and thus giving more autonomy to the banks themselves did not seem like a bad idea. With some support for this 'internal' approach to operational risk

[310] Interview 77R.
[311] Interview 77R.
[312] BCBS January 2001a, p. 94; BCBS June 2004, p. 137.
[313] As evinced by the extensive survey and referencing of the ITWG in Mori and Harada 2001.

quantification, the RMG gave the ITWG considerable autonomy in developing what became known as the Internal Measurement Approach.[314]

Policy Outcome: An Advanced Operational Risk Approach

In January 2001, the BCBS released the draft of the Basel II operational risk policy. Reflecting private sector views, operational risk was defined as "the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events."[315] While private sector groups had contributed to the making of this definition, this definition notably included litigation risk, increasing the regulatory stringency of the policy considerably. Furthermore, the operational risk policy as a whole was highly stringent, and retained the initial proposal for a Pillar I capital charge. The RMG estimated the average G10 contribution of operational risk to total required capital at approximately 20% of total regulatory capital.[316] This quantity made the operational risk policy by far the most stringent policy in the entire Accord. Because of the efforts of the ITWG, the RMG was able to design a workable operational risk policy which had the support of a number of large banks. The role of the ITWG in this regard, as described above, suggests strong support for the Business Conflict hypothesis.

The Internal Measurement Approach was designed to incentivize banks to develop a more sophisticated system of internal risk management, and reach a level of capital *below* 20% of banks' regulatory capital. This development was seen as "a critical step along the evolutionary path that leads banks to the most sophisticated approaches", however it was accompanied with a regulatory capital floor so that capital remained extremely high.[317] This reflected a widely held concern that regulatory capital should not fall too low as the result of Basel II reform.[318]

The role of private sector groups in the development of the operational risk policy demonstrates evidence in support of the Business Conflict hypothesis. While early private sector

[314] Interview 68P.
[315] BCBS January 2001a, p. 94; BCBS January 2001b, p. 5
[316] BCBS January 2001b.
[317] BCBS January 2001b, p. 8; BCBS January 2001a, p. 96.
[318] BCBS, January 2001b, p. 14; BCBS January 2001a, p. 96. Later in September 2001, the BCBS announced that the level would be set at 75% of the capital requirement under the Standardized Approach to Credit Risk. BCBS September 2001, p. 4.

efforts of the BBA, RMA, ISDA and the IIF may have contributed to the initial definitional basis for operational risk, the specific efforts of the ITWG made the definition more conservative by adding litigation risk. Furthermore, the extensive transnational oppositional mobilization was completely unsuccessful. With a supportive interlocutor in the form of the ITWG, the RMG was able to achieve its objectives while largely ignoring the mobilization of groups like the IIF and the ISDA, who opposed their efforts.

Section 5
The Campaign Over
Residual Risk – The 'W-factor' Policy: 2001

One of the most important new advances in the Basel II Accord as it was being developed was the attempt to recognize banks' risk mitigation strategies, and to reward them for these practices by offering regulatory capital relief. In general, the use of credit derivatives and other collateralized transactions was seen to reduce the credit risk profile of banks. At the same time, there was a desire to deal with the use of derivatives systematically, reflecting in part the fact that they were increasingly used as capital arbitrage techniques.[319] The derivatives market had grown substantially by this time, and given some regulatory experience and future uncertainty with the development of these markets, there was some support for regulatory stringency in this area.

The Continental European BCBS members took a more cautious approach to the use of credit derivatives in comparison with the US and Canadian regulators, who had a longer history of supervision, and consequently more confidence and a liberal attitude toward this form of bank activity.[320] Yet experience with derivatives was no unilateral guarantor of a liberal attitude. The UK FSA had as much supervisory experience as the US Agencies in this area, and yet their perspective was much more cautious. Given uncertainty regarding the evolution of derivative markets, and the fact that banks would likely find clever ways to subvert any regulatory regime around them, it was a member of the UK delegation, Oliver Page of the UK FSA, who argued for

[319] Jackson 1999, p. 25
[320] Interviews 19R, 95R,.

the importance of a general regulatory instrument to add capital requirements to collateralized transactions.

Page put forward the simple but somewhat radical idea that when banks engaged in certain kinds of collateralized guarantees and credit derivative transactions, there should always be a residual capital charge to capture the unaccounted for 'residual' risk: a form of risk that always remained, despite whatever technique banks employed to mitigate credit risk through the use of financial instruments. This risk was captured in a policy called the 'W-factor'.

The W-factor sought to reduce the regulatory benefit that a bank would otherwise receive for its efforts to engage in credit risk mitigation. As such, it sought to encourage banks to monitor the credit quality of the borrower in collateralized transactions, with the perspective that a collateralized transaction always has some risk within it. Page's view was that, despite the benefits of credit risk mitigation instruments, collateralized transactions are never *completely* without risk. When banks were to estimate their probability of default, this figure was to be increased by this 'w-factor', which was set at .15 for most transactions, meaning that there was a 15% regulatory capital add-on for collateralized transactions, recognizing this residual level of risk. The majority of the BCBS was not opposed to the policy, as it helped to increase overall capital.[321] The US delegation, in contrast, opposed this policy from the outset, but let the proposal be released nonetheless.[322] Page was able to push this idea into the second consultative paper of January 2001 because he chaired the Capital Group at the time.

The Private Sector Campaign

When the BCBS announced the W-Factor policy in January 2001, it quickly became a target for condemnation within the private sector, especially among large banks in the US and the UK, but banks in other G10 countries were also opposed as well.[323] It was at the transnational level that the campaign opposing the W-factor was most extensive. This took the form of both the IIF and the IDSA offering sustained critiques of the w-factor, both in their formal letters to

[321] Interviews 88R, 90R
[322] Interviews 88R, 89R.
[323] See Citigroup 2001, pp. 16-18; JP Morgan Chase 2001, pp. 7, 9, 10; BBA and LIBA 2001, p. 85; Japanese Bankers' Association 2001, p. 5

the BCBS, and in their engagements with the BCBS directly as transnational representatives of the industry. The IIF criticized the W-Factor extensively, arguing that it was chosen arbitrarily, and that it should be eliminated altogether. The IIF argued to the BCBS that while residual risks from collateralized transactions did indeed exist, "this does not justify imposition of a standard penalty on all collateralized transactions", and argued for a more fine-grained approach based on the probability of loss. The IIF argued that the indiscriminate regulatory capital charge of the W-factor policy would discourage banks from exercising good risk management.[324] The US-UK based Bond Market Association was against it, and argued that it should be eliminated.[325] However by far the most coordinated transnational associational coalition of opposition to the policy was organized by the International Swaps and Derivatives Association (ISDA), who organized in cooperation with the British Bankers Association (BBA) and the London Investment Bankers' Association (LIBA).[326] This coalition of opposition was partly strategic: there was a widespread understanding at the time that the policy was designed by the UK FSA, a fact that only encouraged UK banks to argue against it.[327] Drawing from the specialist knowledge within the UK banking community, the coalition argued that the W-factor policy mistakenly entangled credit, market, and legal risk into one single measure.[328] The ISDA had recognized that residual risk exists, in a 2000 report to the BCBS, but had discerned a very specific use of the term, and had estimated a regulatory capital charge at 2.5%.[329] Now with a multiplier of 15%, the coalition argued that the w-factor effectively represented a risk-insensitive tax imposed on banks' activities. The ISDA-BBA-LIBA coalition provided an extensive argument that credit risk mitigation contracts did not in fact carry more legal risk than other forms of bank contracting, and that the W-factor would distort the pricing of credit risk in the market, since instruments such as credit default swaps would be made more expensive. The w-factor, the ISDA-BBA-LIBA coalition argued, would lead banks to secure transactions as guarantees, rather than using credit default swaps, which were understood to mitigate risk. This

[324] IIF 2001, pp. 24-25.
[325] Bond Market Association 2001, pp. 6-7
[326] ISDA May 2001, p. 7
[327] Interview 92P.
[328] ISDA May 2001, p. 22
[329] See ISDA, February 2000, p. 36

practice, the coalition argued, would lead to a substantial rise in the cost of credit protection, thus undermining the BCBS's stated goals of minimizing risk in the banking system.[330]

Regulatory Response

A sustained transnational campaign of private sector opposition to the policy had made the W-Factor a favorite target of the financial press, which tended to side in favor of private sector criticism.[331] Despite this criticism, Page of the UK delegation did not find the various industry arguments very persuasive, since their arguments were based on generous assumptions of how risk mitigation actually worked during times of financial stress. Page rejected the view that markets for credit risk protection, such as derivatives like credit default swaps, were highly liquid. He understood collateral to be very difficult for banks to liquidate in times of financial stress, when liquidity in such markets can dry up very quickly.[332]

The US delegation, far from being supportive of the W-factor policy, regarded private sector opposition as simply further confirmation of their own aversion toward the policy.[333] The US delegation knew that the policy would be very costly for US banks: in the words of one BCBS delegate, "industry was beside itself with yet another add on..."[334] Yet it wasn't simply the regulatory costs that the US delegation disliked, but rather also the nature of the policy itself. One delegate saw it as a 'square peg in a round hole' – a crude and badly conceived policy that didn't serve to make credit risk mitigation more risk sensitive.[335] Yet even in addition to being crude, it also made the credit risk mitigation section of the Accord more complex.[336] The US delegation had even stated publicly that they were hesitant about the W-factor shortly after the policy proposal was released.[337] Privately, US delegates, particularly the Fed, had always been highly critical of it, but they had not voiced their objections in prior deliberations in Basel. Now

[330] ISDA May 2001, p. 25.
[331] This point was recognized also by Wood 2005.
[332] As indicated in text of JP Morgan Chase 2001, p. 12
[333] Interviews 39R, 40R.
[334] Interview 70R.
[335] Interviews 88R, 73R
[336] Interview 73R.
[337] See Board of Governors of the Federal Reserve System et. al., January 2001, p. 14

with the policy universally condemned by banks and associations all over the world, their stance within the BCBS was strengthened.[338]

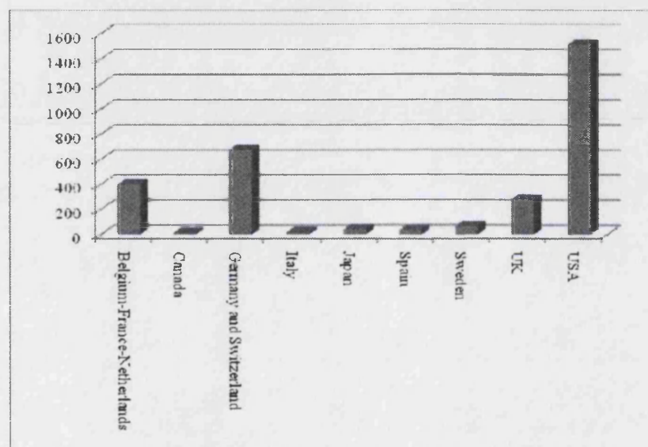
At the September 2001 meeting of the BCBS in Basel, the BCBS decided it needed to make a decision as to whether or not to keep, adjust or drop the W-factor policy. It was evident to all concerned that the W-factor policy should be dropped; in the words of one BCBS delegate, the policy "couldn't withstand this wave of resistance."[339] Yet Page was adamant that it should remain in the Accord. Page himself was under pressure from Bill McDonough, the Chair of the Basel Committee at the time, to rid Basel II of the W-Factor, given the level of criticism. Page was not convinced by his colleagues that the policy should be changed; however, he understood the need for compromise within the BCBS. As the Chair of the Capital Group, he was able to push through the policy in the first place. Yet he also saw the opportunity for issue-linkage: if he gave up the W-factor, he could gain something else in return. An informal traded compromise was reached: Page would concede to the W-factor's removal, while he would gain assurances from the rest of the BCBS that his concern over the pro-cyclical aspects of the Accord would be addressed in future deliberations.[340] It was thus agreed that the W-factor would be effectively removed from the risk calculations, and would be left a matter for national supervisory discretion, in Pillar II of the Accord.[341] This compromise represented an instance of permissive regulatory policy change. A regulatory policy proposal which represented a considerable increase in regulatory capital disappeared over the course of just one meeting.

Private sector groups played a role in encouraging this outcome, but a circumscribed one. The transnational campaign aimed at convincing the UK FSA to change its position was unsuccessful. The US delegates' position did not change either, since they were opposed to the policy from the beginning. The only thing that changed between January 2001 and September 2001 was an extensive transnational campaign by private sector groups to critique the policy. This campaign strengthened the oppositional stance of the US delegation, including the Chair of the BCBS, in their negotiation position relative to Page. This case thus offers some support to the Mobilization hypothesis, as extensive opposition and organization proved decisive in securing

[338] Interviews 39R, 40R.
[339] Interview 93R.
[340] Interview 19R.
[341] See BCBS September 2001, p. 2.

the private sector's desired outcome. It is thus tempting to conclude that structural power played a role here; however, structural power was a constant factor during this period, and thus cannot be considered catalytic.[342] Nevertheless, this case provides support for the Transnational Pathway hypothesis, since private sector groups contributed to permissive regulatory policy change. While it is tempting to suggest that a national-level pathway was at work in this case, there is no evidence that any particular US lobbying activity led to any change by US regulators, since they themselves were already convinced. However, it is possible that given the importance of derivatives for the US in particular (see Figure 3.1) that structural power was at work in convincing them of their original position in the first place.

Figure 3.1: Derivatives Turnover in Different National Markets (in millions of contracts)[343]



This being said, it seems more plausible that structural power was at work in the removal of the W-factor policy in a more transnational fashion. As has been established in a number of literatures, derivatives were a critical component of the international financial system at the time.[344] Other evidence suggests that the W-factor may have been dealt with under significant structural constraints. In 2001 BCBS countries had 90.5% of the world share of premium traded

[342] On the structural importance of credit derivatives in this period, see Wigan 2009.
[343] Source: World Federation of Exchanges - http://www.world-exchanges.org/statistics/annual/2001/futures-and-options-contract-volume
[344] Dodd 2005; Wigan 2010; Bienefeld 2007, pp. 23-24.

derivatives contracts within their markets.[345] However, they only had 71% of the world *volume* of derivatives contracts, and such contract volume is the better indicator since the W-factor had to do with residual risk associated with contracts.[346] Because the W-factor involved a regulatory cost on transactions, it is conceivable that derivatives markets could have migrated outside the BCBS in some fashion, or at least that this could have been conceived to do so.

Conclusion

This chapter has analyzed five different transnationally organized private sector campaigns. As we have seen, there was substantial variation in the dependent variable of interest, that is, permissive regulatory policy change (PRPC). Only three private sector campaigns were associated with permissive regulatory policy change, and one of these (the campaign over the interest rate risk policy) did not offer any causal evidence linking the content of the campaign to the permissive regulatory policy change that occurred. Taken together, these cases stand in contrast to the 'regulatory capture' hypothesis widely employed within the IPE of finance literature. Rather than 'capturing' the BCBS, private sector groups succeeded in influencing the content of the Accord only occasionally, and often in very circumscribed ways.

The first case demonstrated that a transnationally mobilized campaign which advocated for full internal models was unsuccessful in achieving permissive regulatory policy change. While full internal models were rejected, the use of banks' own internal ratings was, however, accepted. Though this cannot be causally associated with private sector efforts, I have coded the outcome in the Configuration Table below as .33 for reasons of caution, so that later across-case analysis in Chapter 10 does not consider this as a case of clear-cut failure.

The second case examined the campaign associated with the use of banks' own internal ratings, and was associated with permissive regulatory policy change. Although the extent of the permissive regulatory policy change in this case was circumscribed, there is sufficient evidence that the specific information that private sector groups provided to the BCBS Models Task Force

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[345] Calculated from data from the World Federation of Exchanges, Table VI.3 - Futures and Options Total Premium Traded (Year 2001) http://www.world-exchanges.org/statistics/annual/2001/futures-and-options-total-premium-traded

[346] This is calculated by taking the sum of all futures and options contracts for 2001, based on data from World Federation of Exchanges, Table VI.1 Futures and Options Contract Volume (Year 2001), http://www.world-exchanges.org/statistics/annual/2001/futures-and-options-contract-volume.

can be said to have influenced this policy. As we have seen, this information was the result of mobilization and was coordinated through important coalitional efforts at the transnational level: thus the Mobilization, Coalitions, and Information Network hypotheses received support from this case, as each of these factors was important in achieving permissive regulatory policy change.

The third case investigated the private sector campaign against the interest rate risk policy. As we have seen, while there were some efforts to mobilize in opposition to this policy, and the policy did experience permissive regulatory policy change, private sector activity cannot be causally associated with this change. Instead, permissive regulatory policy change was associated with the internal dynamics among regulators within the BCBS – thus in the Configuration Table below I have coded PRPC as 0 in order not to distort later fsQCA.

The fourth case examined in this chapter, concerning the operational risk policy, demonstrated support for the Business Conflict hypothesis. We have seen that despite a substantial degree of private sector mobilization, and the use of information within this campaign, the best efforts of the campaign were unable to achieve permissive regulatory policy change. This failure can be attributed to the instrumental role of the ITWG, an informal group which went against the tide of criticism to work with the BCBS to generate what was one of the most stringent regulatory policies in the entire Accord.

The case which examined the 'W-Factor' demonstrated support for the Mobilization and Structural Power hypotheses. Rather than convincing any particular member of the BCBS through information or some other means, private sector mobilization in opposition contributed to permissive regulatory policy change in that it facilitated the BCBS to persuade the UKFSA to abandon its policy proposal. As we have seen, there were considerable structural constraints at work that may have played an important role in both the US' initial position and the eventual UK position.

Because each of the campaigns examined in this chapter were transnationally organized, this chapter offered an opportunity to test the Transnational Pathway hypothesis. As we have seen, this hypothesis received support in only two of the six campaigns examined here. This variegated result does not suggest that this particular pathway of influence should be challenged

outright. Indeed, we have seen that in two cases private sector groups played an important role in influencing instances of permissive regulatory policy change. These two cases, it must be pointed out however, cannot be easily described as a situation of regulatory capture. In the internal ratings campaign, the BCBS actively solicited information from private sector groups. While this information was subsequently provided, the BCBS still utilized stringent measures within the policy, as we have seen. In the case of the W-factor, the campaign did not persuade any regulator to change their position, but rather affected the negotiation dynamic within the BCBS. The valuable information contained within this chapter provides the basis to conduct an across-case analysis of the aforementioned transnationally organized campaigns and their outcomes. The Configuration Table below summarizes the fuzzy-set scores associated with the main explanatory variables of interest, and thus provides the basis for fsQCA in Chapter 10.

Configuration for Transnational Campaigns Examined in Chapter 3

	Permissive Regulatory Policy Change	Mobilization	Coalition	Information	Non-Bank Allies	Transnational Enemies
Full Internal Credit Models	.33	1	1	.33	0	0
Internal Ratings	.67	1	1	1	0	0
Interest Rate Risk	1*	.33	1	.33	0	0
Operational Risk	0	1	.67	1	0	1
W-Factor	1	1	1	.33	0	0

Chapter 4

The German Commercial Real Estate Campaign

This focused empirical chapter engages in detailed process tracing analysis of private sector campaigns associated with a small and very specific policy in Basel II – the regulatory policy toward commercial real estate in the Standardized Approach of the Accord. These campaigns took place only in one country: Germany. And while it ultimately concerned one single risk weight, and led only to a footnote in the final Accord, the campaigns over the commercial real estate policy nearly jeopardized the entire Accord.

This chapter is divided into two sections. Section 1 describes the development of the commercial real estate policy between February 1999 and June 1999, and the private sector campaign that emerged to alter them. Importantly, this case demonstrates that the influence private sector groups successfully exercised was over German delegates' *behavior* within the BCBS, and not over their *position* concerning this regulatory policy. Section 2 describes the second private sector campaign against Basel's evolving commercial real estate policy, which occurred between July 1999 and January 2000. The private sector campaign during this phase was much more extensive, and enjoyed the benefits of stronger mobilization, a national coalition, and legislative oversight. It also demonstrates, however, that private sector influence is a more complex process than commonly assumed, since the campaign examined herein did not affect the position of the regulators, but only their behavior.

Section 1
Beginning with Disagreement

In early 1999, as the Basel Committee on Banking Supervision (BCBS) was set to release the first draft of its new Accord, an unexpected event occurred. A unique debate arose,

concerning the treatment of commercial real estate in the new Accord. Shortly before the release of the first draft of Basel II, the German delegation within the BCBS began arguing against the proposed treatment for commercial real estate. While the draft Accord assigned residential mortgage lending a 50% risk-weight, commercial real estate – widely believed to be one of the more volatile loan portfolios – was assigned a 100% risk weight. This provision seemed sensible enough to the US delegates, since commercial real estate lending by banks had contributed to a series of banking crises within their country, especially in the early 1990s.[347] Such a memory had generated an inherent distrust among regulators of the volatility of mortgage lending, especially commercial real estate lending. As the BCBS Chairman and head of the New York Federal Reserve, Bill McDonough, put it during this period, "[t]he ability of banks to make bad real estate loans is legendary."[348] Indeed, the skepticism toward the German delegations' claims were widespread.[349]

Conversely, based on their experience as supervisors, the German delegates viewed the majority of commercial real estate lending activity as fundamentally safe, and certainly not deserving of a 100% risk weight. Furthermore, given that the existing EU regulations had already set commercial real estate lending to 50%, German observers feared that Basel's provisions would negatively affect the German banking system, and the German economy generally. The German delegates argued that the German commercial mortgage lending market was unique, and as such deserved a special exception.

Private Sector Interests Brought in to the Negotiation

At the BCBS level, it was not possible for the German delegation to convince their international colleagues that commercial real estate lending in Germany should receive a special low risk weighting. As the issue was reaching a critical point in the negotiations, the BaKred made a decision to draw private sector attention to what was occurring in the BCBS. It decided

[347] See Duebel 2002.
[348] William McDonough, quoted in Coyle 1999.
[349] Interview 18R.

to *inform* the German banking community of the German regulators' dilemma within the BCBS, and to solicit help in securing a negotiated agreement.[350] Prior to this point, private sector groups were not aware of the specific details the BCBS deliberations.[351] The President of the BaKred, Jochen Sanio, approached the Verband der Deutscher Hypothekenbanken (VdH, the German Association of Mortgage Banks), informing them of the situation. Specifically, he asked the VdH for concrete empirical material that would back up the Germans' negotiating position. As the association representing the largest mortgage banks in Germany, it regarded the policy as potentially exercising a direct and negative impact on its members; consequently, the VdH quickly prepared a response. Through its membership in the Central Credit Committee (ZKA), the German association of peak national banking associations, the VdH had already commissioned a study in 1996 that backed up their position, and they used this research as part of the information they sent to the German delegation.[352]

Backed up by the VdH, the German delegation argued at the BCBS that the historically low default rate of commercial mortgage lending justified a 50%, not a 100% capital charge. In other words, a bank issuing a commercial real estate loan should hold aside not 8% of its capital in conjunction with a given loan, but 4%, according to the 8% level of overall capital adequacy. Using the data provided by the VdH, the German delegation was able to supplement their historical argument with an empirical one, using bank level data that strengthened their position. Thus, the German delegation made the case to the rest of the BCBS that because commercial real estate lending in Germany was limited to 60% of the value of the given property, this special characteristic made for a stable, reliable issuance of credit, and they demonstrated empirically the low default rates within these markets.

The empirical evidence that the German delegation provided did not convince the rest of the BCBS. The Japanese, Swedish and UK regulators shared the US' experience of highly volatility real estate markets, and supported US concerns.[353] By all accounts, however, it was the US BCBS delegation that was at the time particularly opposed.[354] In response to US resistance, the German delegation arranged for a special bilateral meeting between German and US

[350] Interview 93P.
[351] Interview 93P.
[352] See Hagen and Holter 2002.
[353] See Financial Times 1999; Walker 1999; Corroborated in interviews 18R, 19R, 70R.
[354] For a succinct summary, see The Economist May 1999.

delegates. Technical experts on real estate markets were brought from both delegations, but they failed to resolve differences, and the US delegation remained unconvinced.[355]

Escalation, Deadlock, and Delay

> The German and US delegations were at loggerheads, and this standoff encouraged the German delegation to take tough value-claiming stances in the broader BCBS negotiation. As later attested by Sanio in parliamentary testimony, this was the first time in the 25-year history of the BCBS that a country has threatened to veto a policy decision.[356]

Both the Bundesbank and the BaFin, along with the VDH and ZKA, proceeded to successfully raise their concerns with their contacts within the Ministry of Finance. This development did not go unnoticed by the US delegation, who read comments by Kaio Koch-Weser, the Secretary of State for the Ministry of Finance, in the German financial press.[357] The US delegation also knew that the German mortgage banks were now involved with the issue, and some rightly believed that this involvement was due to Sanio's own recruitment efforts.[358] At this point, however, the dynamic had taken on its own momentum within Germany.

The US delegation indicated that they would not accept the German position on commercial real estate. There were two reasons for the US position. The first was skepticism regarding the German position's factual basis. Although German empirical claims had been questioned from the outset, the US delegation had by now found increasing evidence to support their suspicion. Compounding American skepticism in this regard was the politicization of commercial real estate issue in Germany, which led the Fed to believe that the data they were receiving from the Germans was potentially tainted. The second reason why the US delegation refused the German position was their concern regarding the consequences of exceptionalism in the political economy of real estate. While they were well aware of the influence of mortgage

[355] Interview 70R.
[356] Bundestag December 1999, p. 15.
[357] Interview 89R.
[358] Interview 70R.

banks in Germany, the Fed didn't want US banks to push for any 'national exceptionalism' clauses within in the US.[359]

The entire draft of the new Accord was delayed due to the controversy surrounding the commercial real estate policy, and the 9 April 1999 deadline passed without the release of a draft. It was unclear how long the delay would last. McDonough wrote to BCBS members indicating that publication would be delayed indefinitely.[360] The planned 9 April London press conference was cancelled.[361]

Continuing Foment

The deadlock in negotiations served both to increase private sector mobilization within Germany, and to consolidate and strengthen the German delegation's value-claiming behavior in the negotiation. The VdH was now communicating regularly with not only the Bundesbank, BaFin, and the Ministry of Finance, but also the BdB, whose President, Martin Kohlhaussen, now spoke out publically for the "support and enforcement of the justified German interests," and praised the German delegation "for not accepting the American foray." [362] While there had previously been some hesitation in regard to how 'hard' to fight for the commercial real estate policy within the German delegation, it was now believed that there was no going back: the policy had achieved national significance.[363]

The delay in the Accord's release and the German delegation's particular position affected social relations within the BCBS. The German delegation was criticized within the BCBS for leaking details of the negotiations to its own domestic banks, and US-German tension even spilled over into other BIS functions.[364] In such a context, the BCBS Secretariat was careful to underplay the significance of the difficulties, but as one anonymous BCBS member put it at

[359] Interview 90R; 65R.
[360] Graham April 1999.
[361] See Wall Street Journal 1999; Seiberg April 1999.
[362] Frankfurter Allgemeine 1999; Boerzen-Zeitung April 1999.
[363] Interview 90R.
[364] This is the account of Financial Times Banking editor at the time. See Graham May 1999b; see also Shirreff 1999.

the time, "[we] are going to keep working on it, but we don't want to put a word like 'soon' on it."[365]

Continued Value-Claiming

The Chairman of the US Federal Reserve Board, Alan Greenspan, vaguely asserted at the time that the delay was being caused by "politics".[366] Despite continued skepticism concerning German claims, empirical or otherwise, the German delegation's value-claiming behavior, particularly its noted political constraints, meant that their demands had to be addressed, and urgently if the new Basel Accord was to proceed. The Fed gathered a great deal of data to support the US position; however, by this point the German delegation was making its case not simply by asserting factual claims, but (in one US regulators' words), "by pounding on the table."[367] Sanio was resourceful and unapologetic concerning the German position; the Bundesbank now fully supported him, and he reportedly made the claim that given such strong pressure from German politicians, the German delegation was likely to walk away from Basel II altogether.[368]

The June Compromise

With the commercial real estate risk weightings still highly contentious and unresolved, the issue went to sub-meetings of the US, UK and German delegates, in which there was "very heated discussion and debates and dialogue".[369] In a minor concession the German delegation dropped the issue of a special risk-weighting of Pfandbriefe.[370] By June 1999, a compromise position was reached. What did the US get from this exchange? According to one member of the Fed at the time, "What we got was formal movement in the process."[371] According to another member of the US delegation from the OCC, "we wanted the Germans to stay and we had to find

[365] Graham April 1999.
[366] Alan Greenspan, quoted in Rehm 1999.
[367] Interview 39R.
[368] Interview 88R; 70R.
[369] Anonymous us regulator fed.
[370] Interview 21R. Pfandbriefe were very significant – economically and politically – but it did not represent an immediate threat; Interview 93P.
[371] Interview 39R.

out a combination on that issue".[372] Remarkably, the compromise achieved at the time was to allow the draft Accord to be released, *despite the issue's lack of resolution of* at the technical level. The US delegation – and indeed the rest of the BCBS – committed to allowing exceptional treatment to commercial real estate, but only under certain specified conditions. However, at the time those conditions were unclear; all parties committed to address the issue *after* the release of the Accord for public consultation. What did the German delegation achieve? On the issue of commercial real estate lending, the draft stated:

> In view of the experience in numerous countries that commercial property lending has been a recurring cause of troubled assets in the banking industry over the past few decades, the Committee holds to the view that mortgages on commercial real estate do not, in principle, justify other than a 100% weighting of the loans secured.[373]

The compromise – at least to hold the German BCBS delegates over for the meantime – was contained in the word 'in principle.' Over the subsequent months, the US and German delegates would negotiate the substantive meaning of this abstraction. In the meantime, the German delegation could walk away as victors to their domestic banking associations – especially to their specialized mortgage banks, the *Hypothekenbanken*, their national association the VdH.

Section 2
The Second Commercial Real Estate Campaign

Despite the June 1999 compromise, the commercial real estate issue was far from settled. The VdH found the compromise acceptable for the time being, but nevertheless continued to engage in new forms of mobilization for the full regulatory policy changes that they wanted.[374] US-German differences persisted. In one former BCBS member's view, the commercial real estate issue was the most difficult of all conflicts throughout the period. "It was hard...and I think they all had their views on this – each feeling that they knew how this should be done and that the other one's solution would be intolerable in their local banking environment."[375] The US

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[372] Interview 29R.
[373] BCBS June 1999, p. 31.
[374] Boerzen-Zeitung June 1999; Interview 39P.
[375] Interview 18R.

delegation wasn't simply concerned over Germany's very particular national interest being represented within the new Accord; they were remained skeptical of the German delegation's factual position.[376]

German private sector groups were continuing to advocate for permissive regulatory policy change. They redoubled their efforts to establish a credible empirical basis for private sector demands. By September 1999, the VdH, with extensive support from the ZKA, had completed an extensive survey of covered loan loss rates in real estate from 1988 to 1998 to support the German delegation's position.[377] The expanded participation of all of the member associations of the ZKA allowed the data the VdH needed to be pooled more widely than before. While the VdH had the largest mortgage banks in their membership, now their data extended coverage to 80% of the German mortgage loan market, and covering from 1988 to 1998.[378] The average losses for first mortgages was found to be .04% over a ten-year period – an extremely low figure. Reflecting the continuing divide on the issue, such figures did not satisfy the rest of the BCBS Credit Risk Subgroup, who continued to doubt the data's merits.[379]

In light of the Ministry of Finance and Bundesbank's acknowledgment of US-German conflict over commercial real estate, the (opposition) CDU/CSU faction of the Parliamentary Finance Committee asked to put the issue of Basel II onto the agenda of the Bundestag, specifically the Parliamentary Finance Committee. Legislative oversight had begun. This first hearing in December 1999 sought to oversee the process of negotiation over Basel II, and the Bundesbank and BaKred's specific actions over key issues. Sanio stated to the Committee that "There is a struggle for finding a compromise concerning this problem for nine months now", and added that the US had staged an unprecedented press campaign against the German position, with leading articles in the *Economist*.[380] Various members of the Parliamentary Finance Committee asked if a declaration from them would help the German negotiating position. While Sanio welcomed the idea, the senior member of the Ministry of Finance stated it was too early,

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[376] Interviews 29R, 87R.
[377] See Hagen and Holter 2002.
[378] See Hagen and Holter 2002, pp. 33-34.
[379] See VdH 2000, p. 53.
[380] 15 December 1999, p. 15.

and there was still some room for negotiation.[381] The ZKA would continue to press the German regulatory authorities on the commercial real estate policy.[382]

The VdH were not satisfied with the situation, and decided to intensify their efforts at securing change. As they wanted to ensure that their empirics were taken seriously by the rest of the BCBS, the VdH decided to complement the study of the ZKA with yet another. In an attempt to assure the BCBS of the legitimacy and objectivity of their data, they hired the consultancy firm *Empirica* to conduct a survey of VdH member data. Empirica disaggregated data from four VdH members and tried to capture the fact that existing loss rates in the German mortgage market were due to German reunification.

The ZKA wrote to the BCBS as a whole in March 2000, and argued that strict lending and valuation rules in force in Germany justified the 50% exceptional treatment they were demanded.[383] With legislative oversight now underway in Germany, the ZKA had been communicating their concerns to the Parliamentary Finance Committee, and informed them of their study's results concerning probabilities of default in the German real estate sector, which in turn gave further support to the German position.[384] By April 2000, the negotiations on CRE were still proving difficult since, as reported by Sanio at the time, "the US is not willing to give in at all."[385] During the next Parliamentary Finance Committee hearing, Sanio now asked explicitly for a common decision of the Parliament in order to strengthen the German delegation.[386] The head of the Parliamentary Finance Committee welcomed the request, and asked the entire German parliament to agree on it.[387] While issues such as external-internal ratings and the potential fate of German SMEs were now also on the agenda, the issue of commercial real estate had especially strong salience, because it was clear that the German delegation's position was not advancing.[388]

For the Bundestag, the issue of commercial real estate lending was intimately related to the real economy in Germany, and the prospects of small and medium-sized enterprises, since it

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[381] 15 December 1999, pp. 18-19.
[382] ZKA march 2000, p. 13.
[383] See ZKA March 2000, p. 13.
[384] See Bundestag June 2000, p. 3.
[385] Bundestag April 2000, p. 17
[386] Bundestag April 2000, pp. 17-18.
[387] Bundestag April 2000, p. 18.
[388] Bundestag April 2000, p. 24.

was believed that the low interest rate lending practices in Germany offered distinct advantages to this important cornerstone of its economy.[389] In June, as part of a position taken within the Bundestag by all major parties, a demand was made on the German regulatory authorities to ensure the protection of German commercial real estate, specifically that the ratings for commercial real estate lending must not exceed a 50% weighting.[390] The resolution was interpreted as greatly strengthening the German delegation's position in the international negotiation. In the words of the Chair of the Parliamentary Finance Committee, the resolution was "intended to strengthen the negotiation position of Germany and Europe toward the American representative delegation in the BCBS"[391] The slightly more skeptical Bundesbank felt that its hands were now completely tied, and it had to argue more aggressively on the commercial real estate issue.[392] The VdH were delighted that the German delegates now enjoyed an extra strength in negotiations at the BCBS level.[393]

The rest of the BCBS was very surprised that a national parliament had made an explicit set of demands on their regulatory authorities.[394] There had already been veto threats posed by the German delegation, and substantial intervention by the German Ministry of Finance, but the current level of political intervention was especially strong. Claes Norgren of the Swedish FSA and Chairman of the Capital Task Force arranged a meeting in Craiga (just outside of Stockholm) to resolve this and other issues (including the interest rate risk and operational risk policies described in Chapter 3). The US, UK, Japanese, French and German members of the BCBS met in August 2000. As one BCBS participant recalls:

> What had to happen was politically Jochen had to get what he needed...I was really of the view that they should not have got it. But that would have tanked the whole thing. That would have been the breaking point. Germany would have never signed onto this.[395]

With the need for a resolution especially pressing, Bill McDonough instructed one of his senior staff for the BCBS delegation, Darryl Hendricks, to work with Sanio to reach a technical solution. It was decided that the 50% weighting would remain – at national discretion – but

[389] Bundestag June 2000, p. 3
[390] See Bundestag June 2000, p. 1.
[391] See Bundestag September 2000, p. 15.
[392] Interview 90R
[393] Interview 93P.
[394] Interview 90R
[395] Interview 70R

subject to a series of 'hard tests' to prove that the risk in commercial lending was in fact justifying the exception. A substantial amount of work went into designing these parameters, and the discussion went from a profoundly political one to a thoroughly technical one. Thankfully for the German delegation, the Japanese delegates of the BCBS – who were initially against the idea of the German's proposal – now began to take interest in the issue, and Japanese support facilitated the German delegation's continued value-claiming.[396] The US was trying its best to fashion a 'hard test' for the commercial real estate exception rule, but it was well understood that the German delegates to the BCBS had a much stronger negotiating position.[397] For those involved in the working group , the explicit reference to the preferences of the German members of Parliament made the discussion very difficult.[398] Remaining differences between the German and US delegations were resolved through intervention by the BCBS Secretariat.[399] This invention led to the final closure of the German commercial real estate exception rule.

The solution finally reached was intended to satisfy the Germans and the US. In the end, it was a footnote that ultimately resolved almost a year and a half of tumult for the BCBS. This footnote specified that in some specific cases, mortgage loans could attain a 50% risk weight, as the Germans had initially demanded. Reflecting the German preferences the parameters of this 'hard test' were especially suited to economic conditions within German mortgage markets. As the US didn't want to use this supervisory discretion, they included the stipulation that states which invoked the exceptional treatment clause had to publicly demonstrate that the strict conditions required to do so had been met. The US Agencies also made it clear to their own industries that they would not allow the exceptional treatment that this footnote outlined.[400] The footnote – later accompanied by an entire internal BCBS document[401] – would remain in the new Basel Accord in each subsequent draft, until its final completion in 2004.[402] For the VdH, their worst fears were averted, and they viewed the compromise at the BCBS as a victory.[403] The German delegation was also able to report the positive results of the German Parliament's

[396] Interview 90R
[397] Interview 21R; Bundestag November 2000, p. 47.
[398] Interview 8R.
[399] Interview 21R
[400] See Board of Governors of the Federal Reserve System et. al. 2001, p. 2.
[401] This document is not available to the public, and its title is BS0090.
[402] See BCBS January 2001a, p. 11; BCBS April 2003, p. 20; BCBS June 2004, p. 20.
[403] See VdH 2001, p. 3.

actions back to the Parliamentary Finance Committee, and indeed that they were able to achieve even more than they had initially thought possible.[404]

Conclusion

This chapter undertook process tracing analysis of Basel II's commercial real estate policy, which witnessed two different national private sector campaigns. I demonstrated how a permissive regulatory policy change came about, and highlighted the complex yet important role played by private sector groups. We saw that German BCBS delegates' oppositional position concerning the commercial real estate policy *preceded* private sector opposition, and that the latter was in fact the product of German regulators' agitation. Confronted with considerable resistance from the rest of the BCBS, the German delegation (specifically BaKred) came to the German Association of Mortgage Banks (VdH) for assistance, who provided German regulators with data to use in the negotiation. Yet once a private sector campaign became mobilized, and had the German government on its side, the rest of the BCBS' skepticism concerning the factual basis for the German delegate's concerns grew – especially the United States. Under these conditions, the German delegation engaged in value-claiming behavior, which secured a commitment – but no concrete policy change – on the commercial real estate policy.

The second commercial real estate campaign found that, when issues were still unresolved six months later, private sector groups in Germany, now organized more as a national coalition, providing the German delegation with data and securing a strong constraint on regulators in the form of legislative constraint. While private sector mobilization did not change the *position* of the German regulators, such mobilization did affect their *behavior*, as it offered them a credible constraint on the negotiation with the rest of the BCBS, which in turn eventually secured them the desired outcome. This case offers support for the Information Network, Legislative Oversight, and Coalitions hypotheses. Yet while private sector groups played an important role in securing permissive regulatory policy change, the success of their campaign was contingent on the fact that regulators themselves *asked* for information, and even *asked their legislature* for a more formal constraint in the supranational negotiation. Thus it is important to

[404] See Bundestag September 2000, p. 15.

underscore the fact that private sector campaigning was a contingent part of a larger process, rather than the main driving force behind permissive regulatory policy change. A crucial finding of this case nevertheless is that private sector groups did not influence the *position* of their regulator, but rather their *behavior* within the BCBS. In this sense, the National Carrier Hypothesis has been supported, but only in a very particular way. The Configuration Table below illustrates the fuzzy-set scores for the campaigns of this chapter. These values offer a valuable source of configurational diversity that will contribute to systematic across-case analysis in Chapter 10. These fuzzy-set scores provide part of the data which can assess the extent to which the hypotheses of interest to the study may be conditionally supported or challenged on the basis of patterns found across the entire range of cases in the study.

Configuration Table for Campaigns and Their Outcomes Examined in Chapter 4

Policy	Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive)	Legislative Oversight (Oppositional)
CRE 1	DE		0.33	1	0	1	0.67	0.67	0.67	0	0	0.33	0
CRE 2	DE	*1*	1	1	0	1	1	1	1	0	0	1	0

Chapter 5

The SME Campaigns

This chapter analyses private sector campaigns concerning the effects of Basel II on lending to small and medium-sized enterprises (SMEs). The concern among many private sector groups was that Basel II's approach toward risk-based capital adequacy standards would impede lending to SMEs. In contrast to the campaigns in most other chapters in which private sector campaigns have been organized around *reacting* to specific regulatory policies produced by the BCBS, in this chapter a different dynamic is at work. The campaigns investigated in this chapter analyze efforts by private sector groups to institute a *new* regulatory policy within the Accord which would specifically protect lending to SMEs. While very modest campaigns existed in the UK and Japan, the private sector campaigns in Germany represented some of the most extensive and complex efforts of private sector groups to influence the Accord.

This chapter engages in detailed process-tracing analysis to explore the relationship between the content and context of these campaigns, as well as their associated outcomes. I find significant empirical evidence linking private sector campaigning to permissive regulatory policy change, but only under very specific conditions. A diverse coalition of private sector groups including large and small banks, banking sector organizations, and business and crafts associations mobilized to generate legislative oversight over German regulators. This influence, as we shall discover below, involved a dynamic process, which took years to yield permissive regulatory policy change.

Section 1 describes the private sector campaigns which emerged in response to Basel II's perceived adverse effects on SME lending. I primarily explore campaigns waged in the United Kingdom and Japan. I argue that Japanese regulators were not influenced by this campaign as it lacked industry support beyond the Shingiin banks. Section 2 then analyses the SME campaign which emerged in Germany in 1999 and 2000. I demonstrate that this extensive campaign, which enjoyed the benefit of legislative oversight on its side, *failed* to influence the German regulators.

Section 3 then describes the German private sector campaign of 2001 and 2002. Under the conditions of this campaign, private sector groups successfully exploited a substantial degree of legislative oversight as a means of disciplining their regulators into meeting their preferences. While this concerted strategy was successful in influencing the German regulators, it was not immediately successful in generating permissive regulatory policy change at the BCBS level, since other members resisted German efforts. However, continued value-claiming behavior by the German delegates at the BCBS level ensured an outcome that was commensurate with private sector demands. Section 4 briefly sets out the reactive private sector campaign which took place in Germany in 2003 designed to change the SME policy in an even more permissive direction.

Section 1
SME Campaigns in the UK and Japan

United Kingdom

After the release of the January 2001 draft of the Basel II Accord, the British Banker's Association and the London Investment Bankers' Associations wrote that the content of the Accord would require 'further development' in order to deal with the treatment of the SME exposures of banks.[405] The sentiment within the BBA and LIBA was that the Foundation IRB portion of the Accord would severely affect SME financing because of its contentious definition of a retail portfolio. These groups provided a number of technical suggestions concerning how this perceived problem could be handled, and laid these proposals out for their regulators.[406] Beyond this basic level of engagement, however, campaign proposals and organizing more generally in the UK was not extensive.[407] While the BBA and the LIBA formed a coalition to work on the issue, they did not forge linkages with any other private sector groups. They did not

[405] BBA and LIBA 2001, p. 3
[406] BBA and LIBA 2001, pp. 16-17.
[407] Interview 92P.

seek to raise the policy within the national legislature, and indeed they only raised the issue briefly with the UK FSA and the Bank of England, the UK's BCBS delegates.[408]

Japan

Private sector groups in Japan mobilized to oppose Basel II's potential discriminatory effects on SME lending. While there are two main providers of SME finance in Japan, the Regional Banks and the Shingiin banks, only the latter mobilized over this issue.[409] Shingiin banks were regional, generally smaller, cooperative banks which engaged in relatively simple financial transactions.[410] The National Association of Shingiin Banks argued that Basel II's risk weighting system was wholly inappropriate for Japanese SME financing. Specifically, they did not maintain detailed financial documentation concerning their lending businesses, which made Basel II approaches unworkable. Furthermore, they argued, Japanese SME lending practices assess risk on the basis of the personal qualifications of the SME manager, and collateral provided by real estate and personal guarantees; consequently, Shingiin banks can reschedule lending practices fairly easily.[411]

The Shingiin banks were able to capitalize on a legislative environment conducive to their concerns. While there were no legislative hearings focused on Basel II only, the legislative environment in which Basel II entered was extremely contentious. Representatives of the Diet sometimes spoke of the BCBS in extremely negative terms, often seeing the 1988 Accord as a touchstone for foolish diplomacy.[412] Since the late 1990s there were ongoing fears within Japan that bank lending to SMEs was declining.[413] Given the context of concern with SME financing in Japan at the time, it did not take long for the issue to arise in the Diet. Toshimasa Yamada, an LDP Member of Parliament from Hiroshima, had conducted private hearings with CEOs of small

[408] Interview 92P.
[409] See Second Association of Regional Banks 2001; Regional Banks Association of Japan 2001.
[410] Whereas regional banks in Japan held about 18% of the countries' assets, the Shingiin banks held about 7.5%.Figures are calculated by author based on 2002 data by Van Rixtel 2003, p. 9
[411] National Association of Shingiin Banks 2001, p. 2.
[412] See Diet February 2001; Diet March 2001.
[413] As Walter has pointed out, there was a political concern within the ruling LDP party of Japan to protect the SME sector in the face of financial regulatory change. See Walter 2006, p. 418 ; See also Hards 1998.

Japanese banks and discovered that they were very concerned about Basel II.[414] Accordingly, Yamada raised the issue in a hearing of the Diet Committee on Economy and Industry, at a legislative oversight hearing of Shoichi Tagaki, the Director General of the JFSA's Supervisory Division.[415] Yamada argued to the Committee that what the JFSA was trying to do would negatively impact SME finance in Japan, and that the capital adequacy standards for small Japanese banks should be lowered to less than 4% of total capital adequacy.[416] Yamada strongly criticized the FSA for not recognizing the reality on the ground for small bankers and businesspeople. He charged that small Japanese banks in the countryside would suffer under Basel II, and that it should not be applied to small financial institutions.[417] Takagi flatly disagreed, however, stating that in fact CEOs of small banks have a diversity of opinions on the issue, and that capital adequacy of small banks were already far too low by international standards.

Despite the JFSAs resistance, the issue of SME finance and Basel II was frequently discussed in the Diet at the time, in venues such as the Budget Committee, the Finance Committee, and the Committee on Economy and Industry.[418] The National Association of Shingiin Banks. Capitalizing on this high level of political interests, banks continued their campaigns, even approaching the JFSA directly with their critique, arguing that the JFSA should do more to differentiate between large and small banks.[419] After being told by the JFSA that this would not happen, the President of the National Association of Shingiin Banks, Yukihiko Nagano, testified before the Diet, strongly arguing that Basel II would adversely affect SME lending in the country.[420] While Nagano did not testify again, the link between Basel II and adverse consequences to small Japanese banks and SMEs was brought up in several Diet Committee settings.[421]

[414] It is unclear whether banks came to him, or vice versa.
[415] Diet November 2001.
[416] Diet November 2001.
[417] Diet November 2001.
[418] See Diet February 2002a; Diet February 2002b; Diet March 2002.
[419] As told by Nagano in Diet March 2002.
[420] This was particularly critical, he argued to the Diet, because there is no longer any cooperation between Japanese government ministries regarding SME finance.
[421] Diet October 2002; Diet November 2002.

Despite considerable legislative attention, Shingiin banks' campaign did not persuade the JFSA to change its position. Even in heated discussions on Basel II and SMEs within the BCBS, the Japanese delegation took either a very neutral or muted position.[422] This case suggests that private sector mobilization in the presence of legislative oversight is not sufficient to either influence regulators or generate permissive regulatory policy change. As such this case challenges the efficacy of the Legislative Oversight hypothesis.

Section 2
The First German SME Campaign
June 1999-December 2000

Shortly after the release of the June 1999 draft of the Accord, concern began surfacing among German banks that the new revised Basel Accord might interfere with the system of bank-based financing of the German SME sector. A central concern was that Basel II's reliance on external ratings might penalize the system of bank-based financing in Germany, and that its specific risk-sensitive approach would not accommodate the particularities of German bank lending to SMEs.[423] By 2000, there was widespread concern regarding the potential increase in the cost of credit to SMEs. This concern elicited the attention not only of the financial sector in its various guises, but also of non-financial firms.

A strong national coalition began to develop in Germany. Within the ZKA, it was believed that the issue of SME sensitivity had to be addressed, and the smaller banking associations, the BVR and DSGV, actively participated in this campaign. The National Federation of Industry (Bundesverband der deutscher Industrie, or BDI) targeted the Accord's higher credit costs for German industry, given the relative paucity of external rating coverage in Germany, in stark contrast to the USA.[424] They joined the banking associations in arguing for the use of banks' own internal ratings.[425] The head crafts association of Germany, the Zentralverband der Deutschen Handwerks (ZDH) also became involved, as they too feared forthcoming damage

[422] Interviews 19R, 24R, 35R, 89R, 90R, 95R.
[423] Germany actually experienced an expansion in external ratings coverage since 1999. See Sinclair 2005, pp. 133-135. Corroborated in Interview 7P
[424] BDI September 1999; Interview 4P.
[425] BDI October 1999.

to lines of credit to small enterprises. The Federation of German Industry and Commerce, the DIHK, increasingly pressed for reform of Basel II in order to protect the fate of German SMEs.[426] All of these business associations communicated their concerns not only to the Bundesbank and BaKred, but also to members of the Bundestag.[427]

German business associations like the BDI, ZDH, and DIHK on the fact that SME promotion was seen as the foundation for German economic recovery and innovation at the time.[428]After oversight hearings of the BaKred and Bundesbank began (see Chapter 4 on the commercial real estate campaign), in which members of the ZKA were also formally represented, the Bundestag drew up an all-party resolution which instructed the German BCBS delegates to achieve positive results for the German SME sector. The Bundestag cited the need for the German delegation to "avoid disadvantages and burden for the economy of the Mittelstand."[429] The motion framed these objectives in terms of the importance of the SME sector for the German economy; however, the commercial real estate policy was the more immediate concern at the time (see Chapter 4), and consequently the SME issue did not receive full attention.

Despite the fact that German private sector groups had some a supportive legislative environment on their side, eliciting support from the Bundestag, the BaKred and the Bundesbank were proving resistant to pressure. During Parliamentary oversight hearings on Basel II, the ZKA proposed a new, compensatory policy to be inserted into the Accord to protect SMEs.[430] The BaFin and Bundesbank flatly rejected this idea.[431] The BaKred and Bundesbank focused on other developments within the BCBS negotiations, and argued to both MPs and the ZKA that there was no real threat to the German SME sector from Basel II.[432] While the German regulators were well aware of the criticisms lodged by private sector groups, the notion of adjusting an international financial agreement to ensure sector-specific protection for a class of firms was not seriously considered a legitimate priority. [433] German regulators regarded such a proposal as an

[426] Interviews 5P, 6P.
[427] Interviews 5P, 6P, 14P
[428] See Ryner 2003, p. 213
[429] Bundestag June 2000, p. 1
[430] See Bundestag April 2000.
[431] See Bundestag April 2000.
[432] Bundestag November 2000, pp. 54-55.
[433] Interview 90R

inappropriate response to these regulators' overall concerns with financial stability and risk management.[434] The private sector campaigns over the SME issue had succeeded in putting the issue on the political agenda in Germany; however, they had failed to alter the position of the German regulators. No regulatory policy change occurred as a result, and the January 2001 draft of the Accord did not contain an SME policy.

Section 3
The 2001-2002 German SME Campaign

After the release of the January 2001 draft of Basel II, German private sector groups were even more concerned with its potential consequences to the SME sector, specifically the potential increase in the cost of credit lending to SMEs.[435] German banks and banking associations met with the Bundestag and BaKred bilaterally to express their concerns, and did not feel satisfied with their regulators' reactions.[436] Consequently, they embarked on an explicit strategy to increase political pressure on the Bundesbank and the BaKred by raising the profile of their concerns.[437] The ZKA was similarly displeased with the level of response they received within the Bundestag; consequently, they sought to raise the profile of their SME concerns by targeting the members of the Bundestag and discussing their concerns with the Ministry of Finance.[438]

The ZKA soon became the central organ of an extensive national coalition of groups opposed to the Accord's lack of special adjustments for SME lending. Public-sector banks such as the German Bank for Reconstruction and Development (Kreditanstalt für Wiederaufbau, or KfW) provided data and analysis for this campaign. They had begun early research into the

[434] Interview 90R
[435] Interview 12P.
[436] Interview, 7P, 12P.
[437] Interview 12P.
[438] When the BaKred and Bundestag were brought in for oversight hearings, the Committee was relatively uncritical of the non-actions taken on SME issues. See Bundestag November 2000, p. 47.

potential effects of Basel II on credit allocation to SMEs, and circulated these studies widely – including to the Ministry of Finance.[439]

German business associations continued to mobilize, but now diversified their tactics. The DIHK arranged communiqués and meetings with their local members; they spoke to representatives of both the BaKred and Bundesbank; they communicated with the Ministry of Finance; and they used their well-developed network within the German parliament to make their views known and provide MPs with information on the issue.[440] The ZDH, as the national representative of the crafts sector in Germany, was particularly strategic in their approach. They sought to maximize the politicization of Basel II to their advantage as much as possible by not only speaking with the Ministry of Finance, the BaKred, and the Bundesbank, but also holding press conferences on the issue, making many oral statements during hearings on the issue, and organizing meetings with German members of Parliament.[441] The ZDH also acted as a central distribution point for the German Craft Chambers (its member organizations), and actively encouraged its regional members to spread and politicize the issue across Germany.[442] A key element of the ZDH's strategy was its deployment of the national symbolism surrounding the German 'Mittelstand' (which translates roughly into both 'SME' and 'middle class' in German), by speaking to journalists and promoting articles in German daily newspapers such as *Das Bild* and other periodicals that set public opinion among the working class and small businesspeople – and which were also read by German parliamentarians as a gauge of public opinion.[443]

The national bank and business associations within Germany worked together through a strongly-networked, informal national coalition of opposition. Business associations such as the BDI, DIHK, and ZDH exchanged information with the ZKA.[444] Individual members of the ZKA such as the BVR and the DSGV also provided support for business associations' efforts directly, and at the same time encouraged these groups' members to speak to their politicians at the

[439] Interview 7P.
[440] Interviews 5P, 6P
[441] ZDH July 2001; Interview 14P.
[442] As evinced by internal ZDH documentation. See ZDH October 1999.
[443] Interview 14P; ZDH February 2001, p. 4
[444] Several members of the ZKA even joined committees within the ZDH in order to encourage a consolidated effort. Interviews 11P, 12P, 14P; ZDH February 2001 p. 4.

regional level.[445] The ZDH and ZKA worked together in their various engagements communicating their concerns to the Ministry of Finance, the BaKred and the Bundesbank.[446] Private sector groups in this network also reached out to other business associations, such as the Central Committee of Electricians (ZVE, Zentralverband des Elektrohandwerks).[447] The large private banking association within Germany, the Bundesverband der Deutscher Banken (BdB), typically focused on other aspects of Basel II, also began to speak out on the SME issue, and worked with the Bundesverband deutscher Industrie (BDI) to coordinate their response.[448]

After this extensive campaign of mobilization and coalition-building, the Bundestag's position became much more focused on the SME issue. Not only did the above groups contact individual German MPs, but MPs were also beginning to contact the ZKA for information on an informal and confidential basis.[449] The Executive branch also raised its concerns, and the Federal Ministry of the Economy, for example, had signaled that it would fight for the financial security of the Mittelstand.[450]

National Regulators' Response

Despite the best efforts of private sector groups, the German regulatory authorities remained unresponsive[451] For example, the BDI worked with the KfW to organize a major, high-profile conference Basel II's effects on SME financing, even inviting the Bundesbank as a speaker.[452] Reflecting the different views at the time, the Vice President of the BDI argued that the cost of credit to German businesses would surely increase under Basel II,[453] while the member of the Bundesbank Board argued that increased regulatory capital would not affect credit pricing.[454] Both the Bundesbank and the BaFin continued to *acknowledge* concerns

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[445] Interviews 12P,13P.
[446] ZDH February 2001, p. 4; ZDH July 2001.
[447] ZDH July 2001.
[448] Interview 24R.
[449] Interview 12P.
[450] See Rogowsky 2001, p. 5. The BDI was highly skeptical of this position, however. See Von Wartenberg February 2001, p. 7.
[451] Interview 21R.
[452] See Von Wartenberg February 2001.
[453] See BDI February 2001.
[454] See Stark 2001.

regarding SME lending, while simultaneously insisting that the gains already made within the Accord, such as the recognition of internal ratings, were positive for SMEs.[455]

Although the BaKred and Bundesbank were regularly involved in hearings on the issue at the Parliamentary Finance Committee, their reluctant stance on the SME issue continued. Sanio continued to insist that the Mittelstand would not be threatened by Basel II, and even argued before a hearing of the Parliamentary Finance Committee that German banks might experience windfall profits thanks to Basel II provisions.[456] Though a representative of the BdB actively rejected this assertion,[457] Sanio suggested in response that if bank lending decreased following ratification of the Accord, it might reflect banks' strategic use of the Accord as an occasion to restructure lending practices.[458] The KfW argued that, on the basis of their research, the credit situation would surely deteriorate for German SMEs. [459] However both Hoffman and Sanio rejected the KfW study's credibility, asserting it was based on too many assumptions and inappropriate empirical analysis.[460]

Nevertheless, the more the Parliamentary Finance Committee learned about the Basel II situation, the more their concern grew. Several members of the Committee traveled to New York and Washington to investigate the situation there.[461] The CDU/CSU members of the Committee advocated further and more extensive public hearings on the issue. Most significantly, however, the Chair of the Parliamentary Finance Committee decided to produce an all-party resolution to address the concerns that private sector groups had brought to the fore.[462] The Parliamentary resolution was unambiguously in line with what private sector demands.[463] The document advocated that the final structure of credit risk in Basel II lead to an *increase* in credit to German

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[455] Bundestag March 2001; see also See BaKred May 2001a..
[456] Bundestag May 2001a, p. 45
[457] Bundestag May 2001a, p. 48
[458] Bundestag May 2001a, p. 47
[459] Bundestag May 2001a, p. 49
[460] Bundestag May 2001a, p. 50
[461] See Bundestag June 2001, pp. 66-67.
[462] Bundestag May 2001a, pp. 51-52.
[463] Some individuals involved suggested that this list of demands was actually written by private sector groups. This corroborates with some evidence in the Parliamentary record. See Munestag May 2001a, p. 52.

firms, and mandated German BCBS delegates to ensure a positive overall outcome for the German SME sector.[464]

Negotiating the German SME Demands at Basel

While in previous BCBS deliberations the German delegation had expressed their preferences to *avoid disadvantage* to the German SME sector, they had expressed this preference in early discussions concerning the use of internal and external ratings. Now, following a concerted German private sector campaign and the supportive legislative attention, the May 2001 resolution of the Bundestag gave the German delegation a clear mandate to advocate explicitly for a special, separate treatment that would protect SME lending within the Basel II framework.[465] The German delegation stated in no uncertain terms to the rest of the BCBS that there *must be* an explicit policy developed regarding the treatment of SME lending.

The case was made among their BCBS colleagues, and formally in an open letter to the entire BCBS. The Bundesbank and BaKred argued for the superior credit quality of German SMEs, emphasizing repeatedly how important the sector was to the German economy.[466] Their open letter to the rest of the BCBS, it might be noted, bears the exact same day as the Bundestag motion on the subject; moreover, in the letter the BaFin and Bundesbank noted, "we expect the German Parliament...to take an active stand on central issues...in the near future."[467] Indeed, the German delegates at the time perceived the SME issue to be a very serious political demand by their Parliament, and recognized that they were operating under significant political constraints.[468] The German delegation's preferences were expressed as demands that had to be accommodated for the Basel II negotiations to move forward.[469]

The reaction to the German delegation's value-claiming behavior was neither well-received nor easily resolved. Many BCBS members were well aware of the legislative situation

[464] Bundestag May 2001b, p. 1.
[465] Corroborated with accounts from Interviews 70R, 35R, 29R. In the words of one BCBS participant, "it was percolating. And then it sort of ramped up." Interview 7R.
[466] They argued that from their supervisory perspective, "there is [sic] no grounds for any reservation against the prospect of a continued good credit quality of the Mittelstand." See BaKred May 2001b, pp. 4-5.
[467] BaKred May 2001b, p. 1.
[468] Interviews 90R, 21R, 24R.
[469] Interviews 39R, 40R.

in Germany, and saw the German delegation's behavior during the negotiations as fundamentally politically motivated.[470] While BCBS members such as Switzerland, Italy, and France were somewhat sympathetic to the concerns of the German delegation (each of these regulators supervised banks with substantial SME portfolios as well), none of them actively advocated for any changes to the Accord. Among the non-German BCBS members, the US delegation was the most skeptical.[471] Nevertheless, the value-claiming behavior of the German delegation was taken very seriously: the Fed representatives working on Basel II issues took the German SME demands back to their Board.[472]

The rest of the BCBS decided that the German SME demand needed to be addressed and that, in some form, and it would require the lowering of capital for SME lending compared to the earlier proposals. The BCBS announced this decision publicly in July 2001.[473] Despite this public commitment, a specific SME policy had yet to be designed, which led to great debate within the BCBS, as some members had also expressed skepticism regarding banks' ability to identify whether or not SME exposures should be included as part of the retail portfolio or the corporate portfolio.[474]

A further stumbling block was the aforementioned intransigent opposition of the US delegation. To pacify American concerns, the German delegation invited staff from the Fed to Germany to conduct an audit of banks' portfolios. In so doing, the German delegation hoped to demonstrate the good quality of German SME lending - yet the US delegation had their initially skeptical views justified by the visit.[475]

The German Campaign Continues

German private sector groups were pleased that the issue was on the BCBS agenda, but were disappointed with the lack of a concrete SME policy that satisfied their regulatory

[470] Interviews 18R, 70R, 87R, 89R.
[471] Interviews 70R, 78R, 87R.
[472] Interviews 39R, 40R.
[473] See BCBS June 2001. After this decision, Sanio pleaded back in Germany that this should quell fears within Germany and should lead to a "calming of the emotions." Sanio July 2001.
[474] BCBS 2001, p. 6.
[475] Interview 70R.

preferences. They continued their oppositional campaign, maintaining contact with German MPs and the Ministry of Finance. Some of these efforts were highly strategic: for example, to generate additional political leverage, the ZDH strategized to organize their concerns at the Hamburg Chamber of Commerce as this was the riding of Jochen Hofmann, the MP responsible for economic and financial affairs within the Office of the Chancellor.[476] In an election year, such strategies appeared to have paid off remarkably well. In September, the SPD-Green coalition published their own new resolution designed to compete with the all-party resolution released earlier in May.[477] Two weeks later, the National Minister of the Economy, Werner Müller made the Federal Government's dissatisfaction even more clear to the German press, stating the Federal Governments grave dissatisfaction with the Accord.[478] One week later, an even more significant gesture was made. The German Chancellor, Gerhard Schröder, threatened publicly to veto the translation of Basel II into European law unless significant changes were made.[479] The Bundesbank followed Schroeder's veto threat by stepping up their concerns regarding SME sensitivity within the BCBS.[480]

The rest of the BCBS were well aware of politicized nature of the SME issue in Germany. There were members of the BCBS who were literate in the German language, and who read German news periodicals which commented widely on the politicization of the SME issue.[481] Many were found it odd and surprising that the German banking and business community could affect the formation of the Accord so profoundly and unexpectedly.[482]

Sanio flew to Washington for a special meeting with the Fed to meet the new head of the Fed's BCBS delegation, Vice-Chairman of the Federal Reserve Board Roger Ferguson, Jr., to work out an informal agreement on the issue.[483] Although the BCBS had previously debated the classification of SME portfolios, the German delegation's concerns effectively now settled the issue, and the BCBS ultimately resolved that regulators could use their national discretion to

[476] ZDH July 2001.
[477] Bundestag September 2001.
[478] Bundestag October 2001.
[479] This was, significantly, in speech before the BVR. See Engelen 2002, p. 97. Schroder also made this remark regarding a veto while on a diplomatic trip to India and China See Ehrlich and Lebert 2001.
[480] See Börsen-Zeitung October 2001.
[481] Engelen 2002, pp. 97-98.
[482] Interviews mcD
[483] Ferguson became vice-president of the Federal Reserve Board on 26 July 2001.

define what SME exposures could go into the retail portfolio.[484] At the full BCBS meeting in Basel in December, the BCBS agreed that credit to the SME sector must not be impeded, and announced publicly that it would make specific initiatives to address the issue.[485]

Continued Mobilization

German private sector groups continued to mobilize extensively, eager for specifics concerning Basel II's SME policy. Private sector groups such as the ZKA, ZDH, BDI and DIHK continued to contact Members of Parliament with their concerns, and the issue was now more salient than ever. Legislative oversight hearings within the Bundestag continued, and even the Party of Democratic Socialism proposed their own set of Basel II proposals.[486] The Office of the Chancellor established a Chancellor's Roundtable on Basel II, inviting members of the peak national private sector associations to participate.[487] By the Spring of 2002, Basel II was still a heavily politicized issue in Germany.[488] Symbolic of the level of concern within Germany on the issue, BCBS Chair McDonough came to Germany twice to address the situation, once before an audience of bankers, and another time to meet with Schröder directly.[489] By late June, the government was holding press conferences on Basel II issues, the Chancellor's Round Table on Basel II was still in operation, the Parliamentary Finance Committee was continuing its oversight hearings on the Accord.[490]

Regulatory Policy Outcome

Throughout 2002, the SME issue was taken very seriously within the BCBS, both at the full Committee level and at the working group level. With public commitment from the rest of the BCBS, the German delegation encouraged the discussion to center on a risk-weight

[484] Internal Documentation November 2001.
[485] BCBS December 2001, p. 1.
[486] Bundestag January 2002.
[487] Inteview 25R. See Bundestag April 2002.
[488] See for example Initiativkreis Wirtschaft and Friedrich-Ebert Stiftung 2002.
[489] Interviews 65R, 90R.
[490] See Bundestag July 2002

adjustment that explicitly took the size of firms into account in the Accord. It was decided that the risk weightings would depend on business size, a solution that could be easily worked on within the existing proposals.[491] In July the BCBS finally agreed upon a concrete SME policy.[492]

The policy constituted a series of targeted changes and exceptions to the risk-weight curves within the Accord. These changes allowed banks to require up to 20% less regulatory capital for most SME borrowers, and to set aside an average of 10% less regulatory capital against loans to SMEs compared with loans to large corporations. For the corporate portfolio, an explicit 'firm-size adjustment' was made to directly alter the risk-weight curve for SME lending deemed in the corporate category. Even more significantly, that the BCBS decided that banks that managed small-business related exposures "in a manner similar to retail exposures" would be permitted to apply these exposures to the retail IRB risk weight curves, provided that their total exposure was less than 1 Million Euros.[493] Other technical elements of the risk parameters within the IRB approaches in the Accord were changed, such that the factor of maturity within risk calculations now included special preferential treatment for small firms.[494]

These changes represented a clear instance of permissive regulatory policy change. As Fabi, Laviola and Reedtz have argued, the BCBS "reduced the capital charges for almost all risk levels and provide[d] better treatment of credit risk in the case of SMEs."[495] The German private sector campaign had accomplished its goal. A complex coalition had mobilized extensively, and had generated legislative oversight to successful obtain its goal of permissive regulatory policy change. Despite this remarkable success, however, some private sector groups were still not yet satisfied.

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[491] This 'firm-size adjustment' would adjust regulatory capital to the revenue of a firm, and as such was a simple add-on to the existing elements of the Accord. See Bundestag December, p. 16.
[492] See BCBS July 2002.
[493] See BCBS July 2002; Imeson 2002.
[494] See BCBS July 2002.
[495] See Fabi et. al. 2005, p. 521. See also Bates 2003.

Section 4
The 2003 German SME Campaign

The significant permissive regulatory policy change of July 2002 was unambiguously welcomed by engaged private sector groups.[496] Indeed, by the next meeting of the Parliamentary Finance Committee, groups such as the BdB stated that the crucial changes necessary for German SMEs had been achieved[497]; the DSGV asserted that the Basel II proposals were now economically feasible; the DIHK reported the positive results to its members;[498] and the VdH stated that because of the national discretion achieved in the July 2002 compromise, they would not request further improvement in the area.[499]

Not all private sector groups were completely satisfied with the SME policy, however, and some groups wanted more permissive regulatory policy change. In particular, the business associations that had aligned themselves in coalition with the banking associations of Germany felt that further changes were needed. A plethora of groups, new and old, urged further changes, and targeted the Bundestag in doing so.[500]

Neither the Bundestag nor the BaFin responded to these demands. Indeed, the Secretary of the Parliamentary Finance Committee noted in an internal communiqué that the SME issue was now largely resolved, and the BaFin and Bundesbank could now refrain from making special demands in this regard.[501] A broad-based national coalition was more difficult to build, especially with the German banking associations who had been largely appeased; moreover, the German regulators could argue – both to the Bundestag and to the private sector – that they had achieved what had been asked of them. Indeed, the German BCBS delegates continued to use the past achievements on the SME issue as defense against further domestic criticisms of Basel II.[502] Indeed, in future engagements within the Bundestag, Sanio actually stated that what was

[496] See Euroweek 2002. See Bundestag January 2003a, pp. 168-169.
[497] Bundestag January 2003b, p. 40
[498] Bundestag January 2003b, p. 47
[499] Bundestag January 2003, p. 41. However later the VdH tried to argue that private investors should be treated like SMEs, under certain conditions. See VDH March 2003, p. 58.
[500] See Bundestag January 2003b, p. 49; ZDH July 2003; BDI July 2003; Bundestag January 2003, p. 43
[501] According to internal Bundestag memos. See Bundestag January 2003a, p. 168.
[502] See Meister May 2003, pp. 23, 29; BCBS May 2003, pp. 23, 29.

achieved at that point for German SMEs was actually beyond the scope of what was risk-equitable.[503]

Although German business associations continued to mobilize in pursuit of further gains, they were not successful. Legislative oversight over the Basel II negotiations continued, but further attempts to make demands on German delegates did not work. For example, in July 2003, members of the CDU-CSU faction within the Parliamentary Finance Committee wanted to institute another all-party motion, send it to the Ministry of Finance, and have it represent a new set of negotiation demands for the German BCBS delegation. The SPD and Green members of the Parliamentary Finance Committee disagreed, arguing that they shouldn't simply represent the demands of banks with no real justification.[504]

Conclusion

This chapter has investigated the private sector campaigns concerning bank lending to small and medium sized enterprises (SMEs). I first explored private sector campaigns in the UK and Japan. While these campaigns were relatively modest, the Japanese campaign did have the benefit of legislative oversight on its side. However both campaigns failed to influence either their regulators or the content of the Accord itself. I then described the extensive efforts of private sector groups in Germany. While in their first campaign of 1999 and 2000, private sector groups were unsuccessful in their efforts, by 2001 they had mobilized considerably into a national coalition which had strong legislative oversight on its side. I have demonstrated that this particular set of conditions was instrumental in changing both the position and the behavior of the German regulators. At the same time, value-claiming behavior within the BCBS did not lead to instantaneous permissive regulatory policy change in the form of an SME policy. German private sector groups continued their mobilization, however, and with continued legislative attention to the issue they ensured an outcome that was commensurate with their preferences. These cases show support – though not unequivocal support – for the Legislative Oversight and Coalitions hypotheses especially, since these two conditions were shown to be vital to the success of private sector efforts.

[503] Bundestag May 2003, p. 53.
[504] See Bundestag July 2003, pp. 39-41.

The final case examined, the German SME campaign of 2003, illustrates the contingency of legislative oversight under particular conditions. While private sector groups such as business associations and crafts associations wanted further changes to Basel II to accommodate SME lending, these changes were not forthcoming. The fact that mobilization and the national coalition were much less robust than in earlier efforts may suggest that private sector influence may be contingent on a particular recipe of conditions. Such variation among causal configurations and outcomes is summarized in the configuration table below, and will be valuable for later fsQCA analysis in Chapter 10, including notation indicating possible interdependencies which will also be considered in across-case analysis.

Configuration Table for Private Sector Campaigns and their Outcomes in Chapter 5.

Policy	Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive)	Legislative Oversight (Oppositional)
SMEs	UK		0	0	0	0	0.33	0.33	0.67	0	0	0	0
SMEs	NI		0	0	0	0	0.67	0	0	0	0	1	0
SMEs 2000	DE		0	0	0	0	1	0.67	0.33	0.67	0	0.67	0
SMEs 2001-2002	DE	/	1	1	1	1	1	1	0.67	1	0	1	0
SMEs 2003	DE	/	0	0	0	0	0.33	0.33	0	1	0.67	0.67	0.33

Chapter 6

The National Operational Risk Campaigns

This chapter analyses the nationally organized private sector campaigns that targeted the Basel II Accord's operational risk policy from 2001 to 2004. While campaign activity existed in the UK and Germany, it was in the US that private sector opposition was most extensively organized. These campaigns, and the macro-institutional environment in which they occurred, are arguably the most complex in the study. Much like the SME campaigns examined in Chapter 5, the efforts by private sector groups to influence the operational risk policy in the US were dynamic, in that they evolved alongside the policy itself. This evolution in turn affected the behavior of private sector groups in important ways, often leading to divisions within the US banking community concerning whether they should oppose or support the operational risk policy. This chapter traces the evolution of this business conflict, and analyses its consequences on regulatory policy outcomes.

The operational risk policy is critical to subsequent chapters which focus on other private sector campaigns organized in the US, because that the campaigns targeting operational risk were fundamental to the generation of legislative oversight in the US in 2003 and 2004. The main empirical finding this chapter provides is that in the presence of business conflict, legislative oversight is ineffectual in either influencing regulators or generating permissive regulatory policy change.

This chapter is divided into four different sections. Section 1 begins by describing the variety of reactive private sector campaigns that took place in different countries after the release of the January 2001 operational risk policy, and demonstrates that it was in the United States where private sector campaigns were most extensive. It then details the complex campaign that took place in the US in 2001. The result of this private sector campaign was a substantive degree

of permissive regulatory policy change. However, these changes did not simply result from private sector demands upon regulators, but rather represent a strategic set of changes made by the Fed in a unique and highly constrained environment.

Section 2 describes the private sector campaign that took place in 2002, in which certain strongly oppositional private sector groups argued against the operational risk policy. This section explores the simultaneous growth of business conflict in the US banking community and the Congressional interest in the policy. While some regulatory policy change did take place during this period, it does not constitute permissive regulatory policy change.

Section 3 details the private sector campaign which took place from January 2003 to June 2003, during the period in which legislative oversight was strongly focused on the operational risk policy, and when private sector groups mobilized substantial resources to advocate for permissive regulatory policy change. Despite the advantages of an ideal environment due to legislative oversight, the private sector campaign was unsuccessful. Section 4 then outlines the private sector campaign which took place from July 2003 until June 2004. Despite considerable efforts, this one too was unsuccessful in achieving permissive regulatory policy change.

Section 1
Private Sector Campaigns across Countries

One of the most contentious policies of the Basel II Accord was the policy designed for operational risk in the January 2001 draft of the Accord. As was described within Chapter 3, the operational risk policy, as it then existed, represented a substantial increase in the regulatory capital requirements of banks. It was highly conservative, constituting the most stringent policy in the entire Accord. It is therefore perhaps not surprising that it was almost universally criticized by private sector groups across the G10.

Private sector campaigns were organized against the operational risk policy in the UK, Germany, and the United States. In the UK, the banking community opposed several aspects of the policy, but such opposition was muted, as British bankers were generally willing to work

with the BCBS' proposals.[505] The British Bankers' Association and London Bankers' Association criticized the 'poorly constructed and oversight charge' as wrong-headed and overly focused on quantification, but advocated for further changes, rather than abolition.[506] The issue came up in their various engagements with the Bank of England and the UKFSA, but was not a major issue.[507] Within the German banking community, the operational risk policy was criticized, but private sector groups did not mobilize extensively over the policy, and it was not very contentious.[508] The ZKA regarded the operational risk policy of the BCBS as highly problematic, criticizing the 20% figure as arbitrary, highly exaggerated, and against the aim of establishing risk-sensitivity in the new Accord.[509] It offered a substantive criticism of the BCBS' operational risk policy, but ultimately believed the policy to be too open and ambiguous to engender a sustained campaign of opposition.[510] The policy was criticized by other private sector groups in Germany as well, but a sustained campaign failed to develop.[511]

In contrast to the situation in the UK and Germany, the private sector campaign within the United States following the January 2001 draft of the Accord was extensive. Part of the reason for this difference was because of the nature of many US banks and the business lines that they had. Banks that engaged in custodial services – the managing and processing of financial assets – effectively concentrate operational risk. As Appendix 5 points out, 6 out of the 10 largest custodial services were conducted by US firms, with some firms concentrating this kind of activity acutely. Additionally, private sector campaigns were most extensive in the US because US regulators were stewarding the development of the policy itself. While the operational risk provisions were discussed and negotiated at the international (i.e. BCBS) level, the bulk of the technical work and stewardship of the process was headed by the US Fed, especially individuals at the Fed Board and the Federal Reserve Bank of Boston.

The US Private Sector Campaign

505 LIBA and BBA, 2001, p. 6.
506 LIBA and BBA, 2001, p. 6.
507 The reasons for this are unknown. Interview 92P.
508 Interviews 12P, 91P, 90R, 21R.
509 ZKA 2001, p. 5.
510 ZKA 2001, pp. 95-10; Interviews 12P, 90R.
511 Interview 17P

The reactive private sector campaign which emerged in the United States following the publication of the January 2001 draft of Basel II was highly complex. Three different camps emerged – each with their own unique views on the policy. The first group, the majority of large US banks, maintained that the 20% charge for operational risk was not only misguided but arbitrary, and grossly overstated the amount of capital that was actually needed for operational risk.[512] With such widespread concern among such important actors, the main US banking associations, such as the American Bankers' Association, the Risk Management Association, and the Financial Services Roundtable, also represented this view at the time.[513] The operational risk policy was seen by this 'oppositional majority' as not only ill-conceived, but an instrument for the BCBS to increase levels of regulatory capital in order to compensate for possible deductions in the regulatory capital in other parts of the Accord.

The second group was a small group of bankers who, in general, supported the policy. Most of these bankers had been involved in the ITWG (see Chapter 3), and thus already had extensive interaction with the RMG at the international level. In engagements at the national level, when the US Agencies held high-level meetings with US banks, this group of bankers asserted their support for the policy as a whole. While they shared some of their colleagues' criticisms that the policy was *too* stringent, they strongly agreed with the spirit of the policy, especially its mandated Pillar I regulatory capital charge. This 'supportive minority' group was, as this moniker suggests, very small, but it drew bankers from very large institutions, such as Citigroup, JPMorgan Chase, and KeyCorp. Importantly, each of these banks were much more advanced than their peers in terms of operational risk management, and thus the policy could enhance their comparative advantage.[514] Because of these banks' involvement in the ITWG, the high costs associated with the operational risk policy were also less surprising to them.

A third group of banks represented what might be called the 'radical opposition.' This small group of banks was very strongly opposed to the operational risk Pillar I capital charge, because of their involvement in particular kind of banking services. There were four large banks,

[512] See Wachovia 2001, p. 4; Washington Mutual 2001, p. 3; Bank of America, pp. 11-12; MBNA 2001, pp. 2, 11-13; Capital One 2001, p. 4; PNC 2001, p. 2. Other smaller US banks also opposed the policy at the time, such as Southside Bank. See Southside Bank 2001, p. 6

[513] FSR 2001, p. 1.

[514] Citigroup 2001; JP Morgan Chase 2001, pp. 22-26 of 2001; See Congress June 2003b, p. 4.

often referred to as 'processing banks', in the United States which engaged primarily or substantially in custodial services: State Street, Mellon Bank, Northern Trust, and Bank of New York. Credit Suisse First Boston, a Swiss Bank with substantial operations in the USA, also had significant custodial services, and also strongly opposed the operational risk policy for similar reasons. Such banks effectively concentrated operational risks, since they managed assets for other banks, pension funds, and other financial institutions (see Appendix 5).

The senior management and regulatory affairs departments of two of these banks, State Street and Mellon, wanted the operational risk capital charge to constitute their primary critique in their formal and informal responses to Basel II.[515] Through discussions with their retained consultant in Washington, Federal Financial Analytics, they organized themselves into a new private sector group, named the Financial Guardian Group, which opposed the policy on their behalf through an office and staff in Washington, D.C., and led by Karen Shaw Petrou, a well-known advocate for financial services firms in the Capitol.[516] Both State Street and Mellon would engage with the US Agencies on a bilateral basis concerning this policy; however, the groundwork and high-profile interactions were handled by the FGG, which could be much more vociferous.

Private sector groups in each of these different groups – the oppositional majority, the supportive group, and the radical opposition – communicated their concerns directly to the US Agencies, principally to the Fed Board, the Boston Fed, and to the OCC, both formally and informally. Indeed, the US regulators began holding meetings with large US banks to inform them of the ongoing work concerning the policy.[517] During such meetings, the divisions within the US banking community were evident. The vast majority of bankers argued in opposition to the policy, maintaining it should be included in Pillar II instead of Pillar I, that is, without a regulatory capital charge. In this regard, the majoritarian opposition and the radical opposition were united. Yet the bankers from Citi, JPMC and KeyCorp argued otherwise – and found

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[515] See, for example, FGG 2001, p. 10.
[516] Interview 97P
[517] Interviews 37R, 38R, 49R, 66R, 57P, 53P.

themselves isolated with respect to the need for a Pillar I charge.[518] Where there was unity was that the charge was too high.

Regulators' Reactions

The US regulators knew that the operational risk policy would be controversial, and communicated to the US banking community that open issues remained, and that more work was needed to define types of loss and collect relevant data.[519] There were, however, divisions among the US regulators with respect to the policy. The Fed and the FDIC strongly supported it. The OCC, however, was not. Several OCC staff, as well as the Comptroller himself, didn't agree that operational risk could be modeled like credit risk modeling, saw operational risk as fundamentally different, and quantification was treated with skepticism.[520] Yet despite the fact that the OCC "argued until [they were] blue in the face that it should be a Pillar II requirement",[521] the rest of the BCBS was supportive of the policy.[522] Comptroller Hawke couldn't disagree more, and raised his concerns repeatedly in BCBS discussions.[523]

A Change in the Policy

In September 2001, the RMG announced a number of important changes to the policy that reflected the banking industry's concerns.[524] These changes included a mild redefinition of operational risk, which now excluded 'direct and indirect' losses and systemic risk,[525] as well as the announcement of a framework to allow banks to mitigate against the operational risk capital charges by providing evidence of their investments in insurance instruments.[526] More substantively, however, the RMG reduced the proposed capital charge for the advanced approach

[518] Interview 53P. This is also reflected in the comments f the ABA at the time. See ABA 2001, p. 12.
[519] See Board of Governors of the Federal Reserve System, et. al., p. 6.
[520] Interviews 66R, 68R, 87R, 49R. See also later testimony of Hawke, in Congress February 2003, p. 23.
[521] Congress February 2003, p. 34
[522] See Norgren 2002, p. 3
[523] Quote is from Congress June 2003b, pp. 32-33; see also Hawke September 2002, p. 1
[524] The RMG had been conducting extensive research with industry groups, including the ITWG and IIF, but also with many US banks on an individual basis. The most active banks within the ITWG were US banks.
[525] See BCBS September 2001, p. 2
[526] See BCBS September 2001

to operational risk from 20% to 12% - a substantial reduction in regulatory capital requirements. The RMG explicitly cited industry arguments in favor of this reduction.[527] Feedback from banks had already indicated to the RMG that a 20% value might be too high, and that the figure might be lowered.[528] The RMG's own research suggested a mean value of 15.3%, and a median value of 12.8%.[529]

In addition to these changes, the RMG also began to develop a new approach which retained a Pillar I capital charge, but had a significant qualitative component to it, and utilized bank's own internal risk measurement systems, called the 'Advanced Measurement Approach' (AMA).[530] This approach was effectively a more ambitious approach to operational risk regulation than the earlier Internal Measurement Approach, in that it proposed to give banks even more autonomy in the regulation of their own internal activities. The 'supportive group' contributed toward this change by providing extensive data to the Fed, which had persuaded them that banks' own operational loss data was improving rapidly.[531] The opposition to the operational risk policy also played a role. As BCBS delegates from both the Fed and the OCC would later claim (under testimony), these changes were made partly in response to industry criticism of the crude operational risk formulas in the other approaches.[532] Another part of the motivation for the Fed, however, was to keep the OCC on board, as there was a concern that their dissent might cause problems.[533] The policy was thus the result not of private sector opposition alone, but rather of private sector opposition *coupled with* regulator opposition. As one member of the RMG recounted, "It provided a tent that a whole lot of the participants could get under. It was inclusive."[534]

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[527] See BCBS September 2001, p. 4.
[528] See BCBS, June 2001
[529] See BCBS September 2001, pp. 24-26.
[530] See BCBS September 2001, pp. 5-6, 16-20.
[531] Interviews 38R, 37R; 66R.
[532] See Congress June 2003a, p. 21; Congress February 2003, p. 6; Interview 29R.
[533] Interviews 77R, 49R.
[534] Interview 77R.

Section 2
The 2002 US Campaign

In 2002, a new campaign configuration formed surrounding the operational risk policy. Most private sector groups who had engaged in the 2001 campaign saw the changes which had occurred as extremely positive. Large US banks, as well as the RMA, for example, found they now had less to critique.[535] The 'supportive group' supported the policy even more than before, especially about the AMA.[536] The 'radical opposition', however, while viewing the policy changes as steps in the right direction, still regarded it as fundamentally misguided. They chose to mobilize extensively in opposition to the policy. The Financial Guardian Group tried to attract new members from the other members of the radical opposition of custodian banks in the US that stood to be similarly hurt by the policy, but were unsuccessful.[537]

Given their relative isolation in their 2002 campaign, the Financial Guardian Group sought to intensify and diversify their strategy, and wrote to, and met with, a variety of US regulatory agencies at various levels to make their criticisms.[538] The Fed in particular remained unconvinced of their claims, and saw the policy as useful, both for its own purposes and within the BCBS in terms of boosting overall levels of capital.[539]

Facing a resistant Fed, the FGG focused on Congress, and hired the professional lobbying firm Hogan and Hartson to take their issue to Capitol Hill by targeting key Congressional members with tailor-made messages rousing concern on the operational risk policy in Basel II.[540] Among these was Representative Barney Frank, Ranking Member of the House Financial Services Committee at the time, and a representative of Massachusetts's 7th District, where State

[535] Martin 2002. Interviews 80P, 81P.
[536] Jameson 2002; Interview 68P.
[537] Interviews 54P, 69P
[538] FGG March 2002; Petrou May 2002.
[538] FGG March 2002; Petrou May 2002. See also Congress February 2003, p. 51; Interview 57P; Ferguson February 2003.
[539] See Congress February 2003, p. 11; Ferguson February 2003; Confirmed in interviews 38R, 66R, 37R. Interviews 53P, 65R, 95R.
[540] Interview 97R.

Street was based.[541] State Street was one of Frank's top 10 largest contributors (the 10th) in the 2002 electoral cycle, with a donation of $3250.[542]

The Financial Guardian Group framed their opposition to the operational risk policy in national competitiveness terms. At a Full House Financial Services Committee hearing in May 2002, Petrou used an invitation to speak on the European Financial Services Action Plan to cite Basel II, and the operational risk policy in particular, as a competitive distortion damaging to US interests, that the Pillar I charge "arises in the EU", and that it would potentially put US national competitiveness and financial safety at risk[543] This strategy raised several Congressional Representatives' attention, and when asked what could be done about the situation, Petrou replied that Congress should look into the issue if the US regulators would not change their position.[544]

Regulators' Response

The Fed continued to resist any change to the operational risk policy Pillar I capital charge, even in an environment where the FGG was highly mobilized and legislative oversight was on the horizon. It did, however, chose to change one aspect of the policy. Specifically, the Fed proposed within the RMG to abandon the regulatory capital floor that they had established for the advanced approaches to operational risk back in 2000.[545] This meant that regulatory capital requirements for operational risk, while still high, could now fall lower than where they had been set previously (though see below). While later statements by the Fed suggested this decision was made at the behest of the US banking community,[546] there are other reasons to attribute this decision to another factor which was unrelated to private sector efforts. In particular, the decision to remove the AMA capital floor was actually made because of another policy decision within the Accord at the time – the imposition of a regulatory capital floor for the entire Accord. Leaving a capital floor for operational risk was considered incommensurate with

541 Interviews 43R, 57P, 52P, 57P.
542 Source: OpenSecrets.org
543 Petrou May 2002, p. 21.
544 Petrou May 2002, pp. 23, 29.
545 BCBS July 2002.
546 See Ferguson 2003; This position was be corroborated Interview 49R. See also Zwaniecki 2002.

this new policy.[547] Although the decision to remove the capital floor would potentially decrease capital requirements for operational risk, the difference would now simply move to the Accord's overall capital calculation instead. This was seen as an important part of the compromise between the US Fed, who strongly championed the AMA, and the rest of the BCBS (in particular continental European members), who were more skeptical of it and saw a strong need to use operational risk policy as a means of maintaining overall capital. Because this change cannot be attributable to private sector actions I have coded the dependent variable .33 (out but not fully out) in the Configuration Table at the end of this chapter.

This decision helped to further secure the further support of the non-FGG banking community, as well as the continued support of the OCC.[548] More isolated than ever, The FGG continued their ambitious efforts to change the operational risk policy to a Pillar II treatment, and continued their strategy of lobbying Members of Congress, soon convincing several high-ranking members of Congress.[549] Not only Representative Frank, but now also Chairman of the House Financial Services Committee Michael Oxley accepted the plausibility of the argument that the US financial industry would be at a competitive disadvantage, and that it represented an international compromise, rather than a policy well-suited to US financial institutions.[550] The more the House Financial Services Committee and its staff investigated the issue of Basel II, the more it found grounds for concern: banks had various other concerns as well, the OCC and the Fed did not appear to be in agreement in regard to the operational risk policy, and when they investigated the issue by calling informal hearings, Fed staff and House staff were in conflict.[551]

Section 3
The January-June 2003 US Campaign

After having successfully lobbied Congress for formal hearings on Basel II, the Financial Guardian Group was in a very strong position to utilize the legislative oversight over the Fed.

[547] Interview 65R. This policy was to be in place for at least the first two years of its implementation, but also laid out the option for it to be extended.
[548] See Martin 2002; RMA Capital Group June 2003, p. 29; Hawke 2002, p. 1.
[549] See Maloney 2002, p. 2.
[550] Oxley and Frank 2002.
[551] Oxley and Frank 2002, pp. 1-2; Interview 43R, 71P, 89R.

The operational risk policy was very negatively represented in the February 2003 hearings. Every single member of the Committee that spoke was critical of the policy, especially of whether or not there should be an explicit Pillar I capital charge. Perhaps not surprisingly, Ferguson was the target of the criticism, especially from Ranking Member Frank.[552] He House Committee focused on the differences between the Fed and the OCC and, interestingly, the OCC seemed to embrace these differences. While Ferguson was relatively defensive regarding the issue of the Accords' 'complexity', Hawke actively criticized its complexity.[553] The same was true over their comments on the operational risk policy: Ferguson defended the operational risk capital charge, and Hawke criticized it.[554] The members of the Financial Guardian Group were, not surprisingly, very pleased with the result.

The radical opposition to the operational risk policy was extremely well represented through in the first hearing though three different congressional testimonies. Petrou of the Financial Guardian Group, as well as David Spina, the CEO of State Street produced particularly critical testimony, as did a representative (from Credit Suisse) from the Financial Services Roundtable.[555] In the 2003 June hearings, the radical opposition launched further critiques of the policy, and of the US regulators in handling it. These hearings featured testimonies not only Petrou of the Financial Guardian Group and Ervin of Credit Suisse First Boston, but now also the CEO of Mellon. Aside from having the radical opposition well-represented in testimony, the subsequent discussion also went very much in the Financial Guardian Group's favor.[556] State Street did not testify at the June 2003 hearing, but had attempted to capitalize on the environment of legislative oversight at the time, by having Representative Frank acting as an intermediary in their discussions with the Fed – a strategy which failed.[557]

Despite this barrage of criticism to the operational risk policy, however, the radical opposition did not have allies in the rest of the banking community. Following the continued development of the AMA, for example, the Financial Services Roundtable had become

[552] See Congress June 2003b, p. 35. See also
[553] See Congress February 2003, pp. 17-18.
[554] See Hawke March 2003, pp. 7-8.
[555] Congress February 2003, pp. 5, 39; Spina February 2003. See also Ervin 2003, pp. 9-10. Credit Suisse was the single largest contributor to House Financial Services Committee Chairman Oxley's 2002 electoral cycle. Source: Opensecrets.org.
[556] See Congress June 2003b, p. 46; Congress June 2003a, p. 51
[557] See Congress June 2003b, p. 37.

fundamentally split on the Pillar 1 versus Pillar II point (a point that was, notably, cited during the June Congressional hearings).[558] The RMA was also no longer oppositional to the policy, and they even established a new working group in the spring to address the technicalities regarding implementation, rather than substantive policy change.[559] This position reflected the fact that many banks had seen the operational risk policy change in light of their input, as discussed above. These divisions also emerged in the context of the Congressional hearings. In the Senate hearing, the CEO of the RMA offered explicit support for the policy.[560] Likewise in his written submission to the House Committee, the CFO of KeyCorp enthusiastically supported the AMA, and objected to the reasons for placing operational risk in Pillar II.[561]

The Response of the Regulators

Despite the barrage of criticism from the radical opposition, even amidst a highly critical legislative environment, the Fed remained resolute in its stance throughout 2003.[562] Business conflict provided a way for Ferguson to defend the Fed's position. While being criticized in Congress on operational risk, Ferguson was also able to invoke the fact that, two weeks prior the New York Fed and the RMG had together hosted a conference on the policy, a conference full of supporters of the AMA that showcased the advances that had been made in operational risk quantification since the policy was first proposed.[563] While the OCC had an opportunity to use its considerable negotiation leverage over the Fed to insist on policy changes closer to its own preferences, it chose not to, because it saw the AMA as only satisfying its own concerns, and it saw the need for compromise at the BCBS level as essential.[564] The FDIC, on the other hand, saw the operational risk policy as something that increased capital, and therefore in a very positive light. The fact that the private sector campaign had been entirely unsuccessful in generating permissive regulatory policy change despite these conditions challenges the Legislative Oversight hypothesis. The fact that the FGG's campaign pit them squarely against

[558] Congress June 2003b, p. 43; see also FSR July 2003, pp. 3, 11.
[559] RMA June 2003; Interview 56P.
[560] Congress 2003a, p. 47.
[561] Congress 2003a, p. 115.
[562] See Ferguson April 2003.
[563] See also Congress June 2003a, pp. 20, 59.
[564] Interview 49R; 29R.

dominant tendencies within the US banking community offers support for the Business Conflict hypothesis.

Section 4
The July 2003-June 2004 US Campaign

After the June 2003 hearings on Basel II, a new campaign configuration emerged, once again led by the FGG. The FGG, as well as State Street and Mellon individually, continued to write to the RMG and make arguments about the need to move to a Pillar II treatment of the policy.[565] The FGG was now also joined, however by other banks, such as Lehman Brothers and Merrill Lynch, as well as their association, the Securities Industry Association, in the call to move to Pillar II treatment.[566] The FGG continued to engage with the US regulators in this environment, writing to and meeting with OCC and Fed Staff, and gaining new support from Congress as well.[567]

Despite the best efforts of the radical opposition, business conflict continued to permeate the issue of operational risk, as CEOs of banks fought in public periodicals at the time, and the issue remained one of division within the Financial Services Roundtable.[568] Meanwhile, supporters of the policy simply became more vocal, with the CFO of Citigroup and the Head of Corporate Operational Risk at JPMC both praising the policy in the financial press at the time.[569] Thus substantial players in the US banking industry resisted further changes, even while processing banks and others – including the large investment banks wanted a move to Pillar II.

Regulators' Response

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[565] The FGG also argued that the BIS's own Committee on the Global Financial System supported their claims. See FGG July 2003; State Street August 2003, p. 1; Mellon 2003.
[566] Lehman Brothers 2003; Merrill Lynch 2003; Securities Industry Association 2003.
[567] See Petrou March 2004; Santorum 2003; House Committee on Financial Services November 2003, pp. 4-5.
[567] House Committee on Financial Services November 2003, pp. 4-5.
[568] See Boraks 2003; FSR Nov 2003, pp. 2, 5.
[569] See Garver December 2003; Bielski 2003; JPMC November 2003, pp. 48-49. Corroborated by interviews 68P, 83P.

While the regulators listened to the ongoing criticisms of the operational risk policy, they did not heed them. They remained unresponsive to the radical opposition – even though by early spring an additional Congressional hearing was planned on Basel II, signifying further legislative oversight.[570] The Pillar I operational risk capital charge remained in the Accord, and the oppositional campaign of the radical opposition was unsuccessful. Like the earlier campaign, this case suggests strong supportive evidence for the Business Conflict hypothesis, since the campaign featured deep divisions within the US banking community and permissive regulatory policy change did not occur. Not even the voice and substantially powerful investment banking community could affect change under these circumstances.

Conclusion

This chapter has explored private sector campaigns organized at the national level which were associated with the operational risk policy – by far the most stringent policy in the entire Accord. The US private sector campaigns over the operational risk policy detail a number of patterns. On the one hand, these campaigns call in to question the disciplining power of legislative oversight in ensuring the success of a private sector campaign aimed at liberalizing regulatory policy change. Not only was legislative oversight fully present during the campaigns examined in 2003 and 2004, but the policy received more supportive attention from legislators than any other in the US at the time, and yet these campaigns were unsuccessful. Each of these campaigns, however, was also associated with private sector divisions with respect to the policy – 'enemies' of the campaign, or 'business conflict'.

The only campaign that successfully led to permissive regulatory policy change was US the campaign in 2001 (Section 1) which occurred in the *absence* of any legislative oversight. This campaign featured private sector mobilization, coalitions, and the use of information, and as such each of these associated hypotheses receive support. While private sector groups had an important role in influencing this permissive regulatory policy change, this influence does not reflect a simple case of 'regulatory capture'. Private sector groups offered useful data to the Fed, which increased the confidence that the operational risk policy could undergo permissive

[570] Congress June 2004, pp. 9-10, 17.

regulatory policy change. But these changes also occurred in the context of differences of view among the US regulatory community. In particular, the permissive regulatory policy change was designed to assuage the OCC's concerns, not just those of industry. This unique context will be considered in the across-case analysis of Chapter 10.

Configuration Table for Private Sector Campaigns
and their Outcomes Explored in Chapter 6

	Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive	Legislative Oversight (Oppositional)
Op Risk 2001	UK		0	0	0	0	.67	.67	0	0	0	0	0
Op Risk 2001	DE		0	0	0	0	.67	.67	.67	.67	0	0	0
Op Risk 2001	US		1	1	1	0.33	1	1	1	0	0.33	0	0
Op Risk 2002	US	/	0.33	0	0	0	0.67	0.33	0.67	0	0.33	0.67	0
Op Risk Jan-Jun 2003	US	/	0	0	0	.33	1	0.33	0.33	0	.67	1	0
OpRisk Jul-Jun 2004	US	/	0	0	0	0	1	1	0.33	0	1	1	0

Chapter 7

The Real Estate Campaigns

This chapter focuses on private sector campaigns surrounding Basel IIs regulatory policies concerning real estate lending. As such, contention over the content of these policies inflamed a variety of oppositional groups not only from the banking community, but also from other institutions and associations involved in real estate, such as homebuilders' associations, insurance associations, and real estate professional organizations. The cases in this chapter also underscore the importance of business conflict dynamics: at various moments, coalitions developed and broke apart, and some private sector groups supported policies which others thought reprehensible. The focus of this chapter is on campaigns that took place in the United States, where private sector efforts were most extensive.

Section 1 describes the US-based private sector campaign against a stringent regulatory policy targeting 'high volatility' commercial real estate (HVCRE) lending. As we shall see, this campaign involved extensive mobilization among a wide coalition of actors, and took place in an environment of legislative oversight, and was successful in generating permissive regulatory policy change. A second HVCRE campaign, which took place under similar conditions, failed entirely, and is described briefly in Section 2 – suggesting caution in the generalizability of findings across cases.

Section 3 describes the private sector campaigns waged against the Basel II regulatory policy for residential mortgages, a policy which was highly permissive, but which in 2003 became more stringent due to BCBS concerns. While private sector campaigns opposed this policy in the United Kingdom, Germany, and Canada, opposition was by far the most extensive in the United States. Private sector groups of all kinds united to launch an extensive campaign,

but one which was, ultimately, entirely unsuccessful in generating permissive regulatory policy change. I demonstrate that this failure was due largely to business conflict, as small banks and mortgage insurance firms' activism countervailed the demands of large banks, and in so doing buttressed the US regulators' stringent policy position.

Section 1
The High Volatility Commercial Real Estate Campaign 2002-2003

In 2000, as part of the BCBS' efforts to capture a greater diversity of credit risks in Basel II, the BCBS introduced a new category of lending into the Accord to recognize 'specialized lending.'[571] Specialized lending was a necessary category, it was decided, because unlike 'normal' corporate lending exposures, it had special emergent properties of risk, often because loans defaulted in clusters and in ways not normally acknowledged in many credit risk models.[572] While there were a number of concerns regarding specialized lending, of particular interest was the treatment of a specific kind of commercial real estate (CRE) – CRE lending that exhibited high loss volatility. The Swedish and UK members of the BCBS were highly supportive of this initiative, but its particular champion was the US, which saw CRE lending to be highly cyclical and in need of a stringent policy (see also Chapter 4).[573]

Reflecting the concern with CRE lending, a subcommittee was organized to deal with the issue, and while representatives from the Bundesbank and the UK FSA participated, the Fed took up most of the technical work.[574] Proceeding from their research findings in October 2002, the BCBS formally released its proposal for what it called 'high volatility commercial real estate' (HVCRE) lending – commercial real estate that had high Asset Value Correlations (AVCs).[575] The HVCRE policy stated that classes of bank lending designated as HVCRE exposures were required to use a strict 'supervisory slotting approach' for the calculation of the regulatory

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[571] Interview 77R.
[572] See BCBS October 2001, p. 1.
[573] Interview 77R; Case 2003, pp. 5, 52.
[574] Paucity of data on high-volatility commercial real estate was a serious problem within the BCBS. The Fed had some data in this area, but nothing of good quality that was over several credit cycles. See Case 2003, p. 1.
[575] See BCBS October 2002, p. 50.

capital. What this meant that even the most sophisticated banks using advanced internal-ratings based approaches had to classify their CRE exposures using BCBS methodology into categories ranging from 100% capital adequacy to 625%.[576]

Private Sector Reactions

Private sector reactions to the HVCRE policy varied considerably. In Japan and the UK, there was no attention paid to the policy. In Germany and Canada, campaigns did not take place, because there was the belief that these countries did not have HVCRE, and therefore would not be subject to such a policy.[577] In the United States, however, the reaction to the HVCRE policy was vociferous, and an extensive campaign was mobilized.

The US HVCRE Campaign

Banks argued to the US regulators that the risk weights for HVCRE lending were far too high, and that the assumptions underlying it were outdated. Large US banks were among the first to mobilize in opposition to the HVCRE policy. They planned to coordinate a collective response using data collected through the RMA's Capital Group, which quickly began conducting surveys within their own group and concluded that the risk weights for the HVCRE supervisory slots were far too high and reflected an overly conservative bias far out of line with the actual risk management techniques employed in the industry.[578] They thus advocated allowing sophisticated banks to estimate their own risk weights, and thus exempting them from the 'supervisory slotting approach' of the HVCRE policy.[579]

The second group which mobilized in opposition to the policy was the real estate industry, organized as the Real Estate Roundtable. The Roundtable reflected a diverse membership, including large real estate development firms, as well as national associations such as the National Association of Realtors, and American Resort Development. Much like the Capital Group, the Roundtable argued that since the early 1990s, commercial real estate had

[576] See BCBS October 2002, p. 46. Regarding the high risk weights for the HVCRE policy, much of the intuition on this policy was based on Esaki, L'Heureux, and Snyderman 1999. The Fed decided however to set the average LGD assumption for the HVCRE policy to be 1½ times the assumption in this paper.
[577] Interviews 60P, 61P, 93P.
[578] See RMA March 2003, p. 14.
[579] RMA March 2003, p. 14.

become safer, and the high specialized lending charges were thus unjustified, given improved market information, scrutiny, and underwriting standards.[580] While staff at the Roundtable engaged in technical debates with the Fed, they also contacted members of Congress with their concerns.[581]

The third private sector group that mobilized was a collection of regional US banks with extensive portfolios in the American Southeast. These banks believed they would be quite severely impacted by the policy since many of them had substantial CRE exposures. As Appendix 6 illustrates, CRE lending for such regional banks constituted a substantial percentage of their lending activity; in some Southeastern banks, over 25% of their total portfolios were committed to CRE lending. While Southeastern regional banks were small banks in comparison to the large banks in the Capital Group, they enjoyed strong relationships with local politicians, and willingly exploited these connections. Particularly entrepreneurial in this respect was one of the larger 'small' regional Southeastern banks, Colonial BancGroup, which made direct contact with Congressman Spencer Bacchus of Alabama's 6th District, where Colonial was based, who was also incidentally the Chair of the House Subcommittee on Domestic and International Monetary Policy, Trade and Technology.[582] Bachus' 2002 electoral funding drive also had Southeastern regional banks at its core (Colonial was the second largest contributor to his campaign, and Regions and Wachovia were tied for 4th place).[583]

Although Fed staff had met with Colonial to try to assuage their concerns, the bank testified strongly and vociferously against the HVCRE policy before the House Financial Services Committee. Colonial's Executive Vice President and Chief Operating Officer, Sarah Moore, argued before the House Committee that Basel II would give large US banks an unwarranted competitive advantage over smaller US banks, and that the policy would lead to a serious decline in real estate lending as a whole, and urged Congress to rein in the US regulators.[584] Ferguson defended the Fed's position before Congress, and noted that while he and Fed staff were well aware of the banking community's arguments, the Fed had rejected them on

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[580] See Real Estate Roundtable March 2003b, p. 2.
[581] Real Estate Roundtable March 2003a.
[582] Colonial BancGroup was the holding company for Colonial Bank, an Alabama-based bank with exposure in the South East (Florida, Alabama, Georgia, Tennessee, Texas and Nevada). See Congress February 2003, p. 47.
[583] Based on data from OpenSecrets.org – profile: 'Spencer Bachus' 2002 electoral cycle, 'Top Contributors'.
[584] Colonial February 2003, p. 2.

the basis of empirical evidence.[585] Hawke of the OCC, however, distanced himself from the Fed's position, suggesting that there may be reason to be less cautious with CRE lending than in the past; Ferguson was thus forced to disavow the position of a fellow regulator.[586]

Regulators' Response

In this highly oppositional context, the Fed remained convinced that the HVCRE policy should be kept as initially designed. In fact, the lack of empirical data that private sector groups were able to provide to support their claims further entrenched their position. The OCC, however, was of a different view. OCC staff members were also concerned with the risk associated with certain forms of CRE lending, but had become convinced of private sector arguments against the HVCRE policy.[587] The argument that lending and underwriting standards had improved was convincing, as was the argument that the HVCRE policy would carry large costs.[588] The environment of legislative oversight at the time meant that the Fed was under considerable scrutiny from Congress, and its bargaining power within the US delegation had declined.

In this context, the Fed responded by agreeing to change the HVCRE policy to make it less stringent. Banks that qualified for internal credit risk modeling approaches for commercial real estate lending (i.e. the largest and most sophisticated banks) would now be allowed to estimate their own HVCRE risk parameters.[589] This was indeed exactly what the RMA Capital Group had argued.[590] While they were still subject to the relatively stringent model provided by the Accord, this change would allow large US banks to obtain lower regulatory capital charges than they would otherwise be subject to. Such a dramatic change of the HVCRE policy was not controversial within the BCBS, and it was made easily since the Fed had taken complete ownership of the design of the policy. Furthermore, the decision removed the basis for large US banks' opposition, and the Capital Group welcomed this change, and subsequently ceased

[585] Congress February 2003, pp. 30-31.
[586] Congress February 2003, p. 31. There is no evidence which suggests the OCC was under pressure from the Bush Administration at the time, and interviews conducted with OCC staff at the time suggest that the concerns were internal to the OCC itself.
[587] Interview 71R, 87R. See also Hawke's comments in Congress 2003, p. 30.
[588] Interview 87R.
[589] See BCBS April 2003, pp. 51-52.
[590] See RMA March 2003, pp. 1-2; Interview 44P; 71R.

mobilizing in opposition to the policy.[591] The same was not true for the US real estate community, or Southeastern banks, however, who launched a new campaign against the newly changed policy – with new allies at their side.

Section 2
The Second HVCRE Campaign: June 2003-June 2004

A new campaign against the HVCRE policy emerged, and based itself on the publicizing the long-standing fear that Basel II will disadvantage small US banks – a concern that the Fed took seriously, given the perceived political power of small regional banks across the country.[592] Instead of changing the policy further, however, the Fed simply indicated that it would interpret the HVCRE very loosely – with only Asset Development and Construction (AD&C) loans being considered, as opposed to the whole panoply of loans that were previously considered.[593] This strategy succeeded in managing some of the concerns of the US Congress and of the policy's private sector critics, but such assuagement was short-lived.[594]

The real estate industry relied upon its contact within Congress as part of their strategy to advocate for change, focusing on particular on Richard Shelby, the Chairman of the Senate Committee on Banking, Housing and Urban Affairs about their concerns.[595] Colonial was a top contributor to Shelby's 2002 electoral campaign, having donated $35,999 in individual and PAC contributions.[596] Other groups mobilized as well in this context, such as the NAR, the NAHB, and the Mortgage Bankers' Association – all advocating that the HVCRE policy be removed altogether.[597] The NAR and the NAH were both major contributors to Congressman Bachus and

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[591] See RMA July 2003, p. 5; Wachovia p. 15.
[592] Interview 77R, 87R. On the power of real estate lobbyists in the US, see Burbank et. al. 2008, p. 190.
See Burbank et. al. 2008, p. 190.
[593] See Case 2003, pp. 39, 45-46.
[594] See Greenspan May 2002, p. 1; Ferguson June 2003, p. 2; See also Real Estate Roundtable July 2003, p. 2; Corroborated by confidential internal documentation.
[595] See Real Estate Roundtable June 2003, p. 2; Ferguson July 2003.
[596] Source: Opensecrets.org.
[597] See Colonial November 2003, p. 10; RER and CMSA November 2003, p. 4.
[597] National Association of Realtors October 2003, pp 4-5; RER and CMSA November 2003, p. 4.
[597] Financial Services Roundtable November 2003, p. 8; National Association of Home Builders November 2003, pp. 4-5.

Congressman Franks' 2002 electoral campaigns.[598] Some Southeastern banks such as SunTrust began soliciting proposals from outside data purveyors in the commercial real estate industry in order to bolster their case, and they were joined in their condemnation by a chorus of other Southeastern banks.[599] This organized opposition had legislative oversight squarely on its side, as in November 2003 11 members of Congress wrote to the US regulators stating that the HVCRE policy needed to be eliminated – explicitly citing the very arguments that Southeastern banks had been making at the time.[600]

Regulators' Response

Despite the unity of this oppositional campaign, and the fact that it had legislative oversight on its side, the US regulators did not change their position with respect the policy. The OCC and the Fed did not clash again over the policy, as they believed that what remained was prudential. As such, the private sector campaign that took place from July 2003-June 2004 had no effect on the HVCRE policy, which remained in the Accord as designed in the spring of 2003.

Section 3
Campaigns over Residential Mortgage Lending

Since the beginning of Basel II negotiations, the BCBS had aimed to differentiate risk-based capital adequacy requirements for banks' residential mortgage lending. It had been widely acknowledged within the BCBS that residential mortgage lending not only constituted a distinct form of bank lending and risk, but that it was also a politically sensitive policy area, and therefore had to be treated carefully.[601] As such, the Basel II policy toward residential mortgage lending was already designed as a highly permissive regulatory policy at the BCBS level – suggesting some evidence for the Structural Power hypothesis at the agenda-setting stage of

[598] In that they were top 10 contributors. Source: Opensecrets.org.
[599] See SunTrust July 2003, p. 3; Zions November 2003, p. 4; Synovus October 2003, p. 3; Colonial BancGroup November 2003, pp. 7-10.

[600] Congress November 2003, p. 6.
[601] Interview 90R; See also Calem and LaCour-Little 2001.

policy development (this is analyzed in Chapter 10, Section 2).[602] Because the residential mortgage policy was permissive from the outset, private sector groups did not campaign against it; in 2003, however, this situation changed.

After conducting more research into banks' LGD estimates, the BCBS' Models Task Force began to lose confidence in banks' own estimation abilities (for a description of PDs and LGDs, see Appendix 4).[603] Because mortgage activity was understood to be cyclical in nature, and because residential mortgages were such a large part of banks' portfolios, the BCBS decided, uncontentiously, to institute a 10% floor for residential mortgage lending, below which banks' LGD estimates could not fall.[604] This was seen as a natural thing to do given predicted falls in capital, even though there was full awareness that this stringent policy change would prove to be a very costly constraint for many banks.[605]

Private Sector Reactions

Across the G10, reactions to the BCBS' residential mortgage policies were mixed. On the one hand, regulatory capital levels were sure to decline as a result of the policy, and thus it was cautiously welcomed. On the other hand, the compensatory feature of a 10% LGD floor was generally viewed very negatively.

Transnational mobilization against the residential mortgage policy was almost non-existent – a silence not surprising given that the fact that international banking does not typically deal with retail lending activity, of which residential mortgage lending is the main component.[606]

In the UK, banks and their associations opposed the 10% LGD floor, but did not mobilize substantially on the issue. The British Bankers' Association and the London Investment Bankers' Association argued that the 10% LGD floor was unnecessary, and that it should be moved to

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[602] This also included changes to the Standardized Approach as well. See BCBS January 2001, pp. 11; BCBS April 2003, pp. 11-12.
[603] See UK Advisory Group February 2003, p. 4; Interview 74R.
[604] BCBS May 2003, pp. 24-25; Interviews 74R; 90R.
[605] BCBS May 2003, pp. 24-25.
[606] See the minor comments in IIF July 2003, p. 11, p. 31; ISDA and BMA July 2003.

Pillar II of the Accord to reduce capital requirements.[607] The BBA addressed the Bank of England and the FSA on their concerns, but the issue was not a priority, and the UK regulators gave them indications that the BCBS considered this policy to be highly important. [608] The Bank of England was seen as particularly supportive of the 10% LGD floor, and as such the BBA and LIBA did not raise the issue again, and even stated formally to the FSA that the residential mortgage policy was satisfactory.[609]

In Germany, the Zentraler Kreditauschuss and the German Association of Mortgage Banks also offered criticism, but they did not offer detailed analysis, other than proclaiming it to be too onerous.[610] Most residential mortgage lending in Germany was handled by smaller savings and cooperative banks, and these banks stood to benefit on the whole from the existing permissive regulatory policy change. Furthermore, because retail mortgage lending in Germany was considered by German regulators and banks to be generally very low risk activity, it was also a low margin business for banks, and therefore not a central issue. [611] The issue was not debated in the Bundestag.[612]

In Canada, the residential mortgage policy of Basel II was contentious, and banks there mobilized in opposition. The Canadian Bankers' Association offered an extended critique of the 10% LGD floor, and offered an alternative policy proposal. They argued to the OSFI and the BCBS that the 10% LGD floor was an example of "cumulative conservatism", and had no economic basis.[613] Alternatively, the Canadian Bankers' Association proposed a special exemption to the 10% LGD floor, whereby national regulators could exempt their own banks from this feature of the residential mortgage policy of Basel II.[614] They offered a technical argument, based on quantitative data, that such exemptions would be economically sound and would improve the risk sensitivity of the Accord.[615] They framed such a proposal as being able to reflect the diversity in the historical dynamics of housing markets and the legal environments that surround them.

[607] BBA and LIBA July 2003, p. 10.
[608] Interview 92P.
[609] BBA, ISDA, LIBA 2003.
[610] ZKA July 2003, p. 33; VdH 2003.
[611] See Manning 2002.
[612] Interviews 12P, 13P.
[613] CBA 2003, p. 8
[614] CBA 2003, pp. 8-10.
[615] CBA 2003, pp. 8-10.

When they raised their concerns and their alternative proposal to the OSFI, Canadian banks also argued that their residential mortgage exposures were extremely different from the higher risk activity of the US markets.[616] The OSFI listened to these arguments, but responded that it would not represent these views at the BCBS level. The 10% LGD floor, they stated, was "absolutely non-negotiable," and the OSFI simply could not win such a struggle within the BCBS. The reason, the OSFI stated, was simple: there was no way that the US delegates would change this policy.[617] As we shall see below, the US delegation had strong incentives to keep the 10% LGD floor in place.

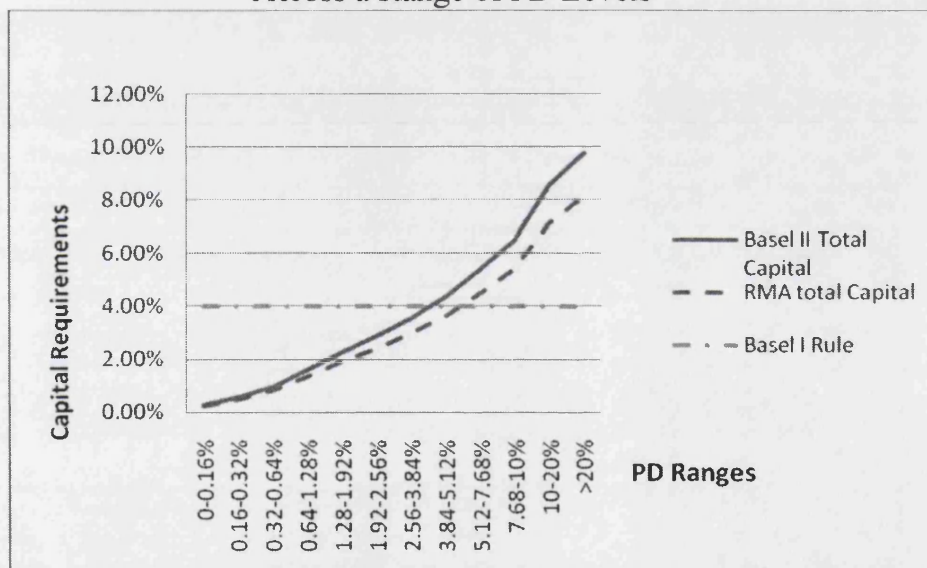
The US Campaign: Widespread, But Not Universal, Critique

A diverse collection of US private sector groups mobilized to argue against the 10% LGD floor. Large US banks such as US Bancorp, JP Morgan Chase, Washington Mutual, Fleet, Wells Fargo and Citigroup were all particularly vocal about what they perceived to be the irrational and arbitrary stringency of the policy, as were industry associations such as the ABA and the Financial Services Roundtable.[618] Very strong opposition was offered by a group calling itself the Consumer Mortgage Coalition, a Washington-based advocacy group organized by the mortgage banking divisions of JPMorgan Chase, Citigroup, and Wells Fargo.[619] The 10% LGD floor was critiqued as "artificial and not justified on economic grounds", "distort[ing] economic incentives", as "fatally burdensome" to US banks; that it would discourage lending to borrowers, and would discourage best practice risk management.[620] Regarding the latter claim, private sector groups argued that Basel II should allow for banks to estimate their LGDs *below* 10% *if* they could demonstrate that they had invested in private mortgage insurance – a case they made in written comments and in interactions with regulators.[621]

[616] CBA 2003; Interview 61P.
[617] Interview 61P.
[618] JPMC July 2003, p. 7; US Bancorp November 2003, p. 5; Fleet July 2003, p. 3; ABA July 2003, p. 3; FSR November 2003, p. 9; See Institutional Investor 2003.
[619] These were Chase Manhattan Mortgage Corporation, CitiMortgage, Inc., and Wells Fargo Home Mortgage, respectively. See Consumer Mortgage Coalition July 2003, p. 3.
[620] Quotes are from Citigroup July 2003, p. 5; Consumer Mortgage Coalition July 2003, p. 2; Washington Mutual November 2003, p. 15; Wells Fargo August 2003, p. 10; Washington Mutual July 2003, p. 15.
[621] See, for example, US Bancorp November 2003, p. 5. See also FOIA November 2003a; FOIA November 2003b, p. 4.

US private sector groups also put forth a critique of the underlying assumptions of the residential mortgage model itself. The RMA Capital Group formulated an empirical critique of the policy as a whole based on data from seven of its largest banks to demonstrate how these banks estimated their own risks from retail mortgage lending. This analysis demonstrated that while the Basel II model was not far removed from banks' existing internal practices, as levels of risk increased the outcomes of the model exhibited more regulatory stringency, as demonstrated in Figure 7.0 below. Thus, for riskier mortgage lending, such as sub-prime mortgages, levels of regulatory capital would necessarily increase considerably.

Figure 7.0: Estimated Levels of Capital Adequacy Across a Range of PD Levels [622]

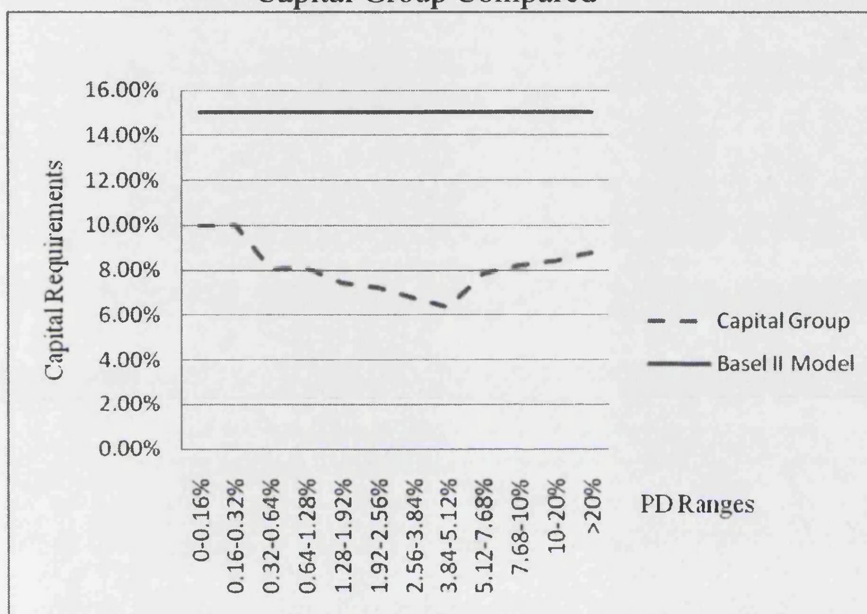


Deviations from industry practices were particularly disconcerting to the Capital Group at the time, because they constituted such a major component of bank's retail portfolios.[623] Based on their own empirical research, they determined that the root of the regulatory stringency was the BCBS's AVC assumptions. They then conducted an extensive study of banks' own internal risk management practices in order to demonstrate to the US Agencies that the BCBS' 15%

[622] Data is from RMA February 2003, p. 59 (Appendix 1, Table 13, p. 59). 'Well Capitalized' status in the US is 1.5 times the Basel standard, so the RMA value in column 6 in Table 13 has been divided by 1.5 by the present author.
[623] RMA February 2003, p. 46; RMA March 2003.

AVC policy should be lowered, along with capital requirements for residential mortgage lending. Once this data was compiled, the group was able to argue that the AVC assumptions of Basel II's residential mortgage policy were consistently greater than internal risk management practices within major banks, as seen in Figure 7.1 below.

Figure 7.1: Asset-Value Correlation (AVC) Values of the BCBS and RMA Capital Group Compared[624]



The Capital Group sent this data to the US Agencies in hopes that it would convince them to change their position. Specifically, they hoped that their data would secure an AVC policy of 6-10%, instead of 15% AVC policy, the former reflecting de facto industry practices.[625] Large US banks that were members of the Capital Group cited these findings extensively, as did other groups such as the Mortgage Bankers' Association.[626] Most vociferous of all was Citigroup, who argued (both individually and through the Consumer Mortgage Coalition) that the 15% AVC was unnecessarily stringent, and met with all US Agencies to argue that the AVC should be lowered

[624] Se RMA February 2003, Appendix 1, Table 4, p. 54.
[625] See RMA April 2003, p. 69; RMA July 2003.
[626] JPMC July 2003, pp. 4, 7; Bank One July 2003, p. 4; MBA November 2003, p. 5.

for sub-prime lending in particular, since these mortgages liquidate faster and therefore held less risk.[627]

As widespread and vocal as the US campaign opposing the Basel II residential mortgage policy was, it featured a substantial degree of business conflict. Two different kinds of private sector groups emerged to countervail the opposition of the groups mentioned above: small banks and mortgage insurance companies.

Business Conflict from Small Banks

While large US banks and some of their associations opposed the residential mortgage policy on the grounds that it was not permissive enough, a number of *small* banks and their associations opposed the policy on the grounds that it was *too permissive*. The reasons for this cleavage have to do with the perceived competitiveness effects of Basel II within the US. Since it had been made clear that Basel II would only be applied to the 20 largest banks in the US, small banks and their associations became increasingly worried about the possibility of Basel II banks out-competing them. While small US banks engaged in very different business models of lending, one area in which they *did* compete was in residential mortgage lending.[628] Small banks' and their associations mobilized substantially to communicate their concerns, with many different groups and levels of national and state-level associations voicing their concerns over competitive equity in mortgage markets due to Basel II.[629] Several groups made the issue a legislative priority at the time, and the Independent Community Bankers of America formally testified before Congress with their concerns.[630]

Business Conflict from Mortgage Insurance Companies

[627] See Citigroup November 2003, p. 24; FOIA January 2004a. FOIA March 2004.
[628] See MBA July 2003; National Association of Realtors July 2003; RER July 2003.
[629] ACB July 2003; New Jersey League of Community Bankers November 2003; World Savings July 2003, pp. 1,3,7; Interview 30P.
[630] See New York Bankers' Association August 2003, p. 2; FOIA July 2003; See Congress 2003b, p. 55; Corroborated in Interviews 72P, 30P, 63P.

Mortgage insurance firms also generated business conflict. On the one hand, they supported the US banks' critique that the 10% LGD floors should be adapted to accommodate private mortgage insurance. On the other hand, however, they argued strongly that the AVC assumptions of the residential mortgage policy were *too permissive*.[631] This position was articulated by the national peak association of mortgage insurers, the Mortgage Insurance Companies of America (MICA). Based on their own expertise dealing with mortgage risk, MICA believed that the Basel II residential mortgage policy did not reflect the additional risk associated with residential mortgage lending, and that the AVC assumption should be increased from 15% to 20%, and in some cases to 23-26%.[632] MICA didn't just argue their case to the US regulators, but also actively argued *against* the arguments that large US banks and their associations were making, stating that banks were offering a distorted picture of mortgage risk.[633]

Regulators' Response

Among the US regulators, the Fed had taken most responsibility for the residential mortgage policy, and the OCC was less interested. Because of the sensitive political environment in which the Fed was operating at the time, it had an incentive to treat the policy very carefully. After the June 2003 hearing in which the ICBA expressed their concerns with Basel II's potential consequences, Fed staff began consulting with small US banks and their associations. This consultative process involved extensive interviews with banks. Based upon their research, Fed staff became convinced that Basel II's residential mortgage policies would give larger US banks a competitive advantage over smaller ones.[634] As such, the Fed did not agree with the demand to change the 10% LGD floor, since they considered it a significant 'safeguard' against regulatory capital falling too low.[635] Moreover, removing the 10% LGD floor would have been politically

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[631] MICA July 2003, pp. 2-3.
[632] See MICA July 2003, p. 9; MICA November 2003, p. 10; FOIA January 2004b.
[633] For example, banks such as Citigroup had cited figures from a government study on mortgage risk, and MICA argued against the reliability of this study, citing the fact that the data was only drawn from 1996-199, a period with was unambiguously positive for the mortgage market. See MICA November 2003, p. 12; See also Pennington-Cross 2003.
[634] As told by later Congressional testimony of the Fed Staff involved. Calem and Follain January 2005, pp. 4, 8-9; Congress May 2005, pp. 35, 40-41.
[635] Corroborated with Interview 75R.

untenable in the context of legislative oversight, as the Fed was particularly sensitive to the congressional access small banks wielded.[636] The issue of competition in the US mortgage market was the single most important issue on the agenda of small US banks, and the senior staff at the Fed were greatly concerned with the potential consequences of their continued mobilization.[637] At the same time, Fed staff did *not* accept small US banks' claims that the residential mortgage policy would lead to takeovers and consolidation.[638] Consequently, the Fed kept the 10% LGD floor in place, despite opposition from large US banks.

The dynamics of business conflict also affected the way the Fed dealt with the other contentious feature of the Basel II residential mortgage policy, the 15% AVC assumption. For a number of reasons, the Capital Group's widely cited data was considered to be of inferior quality.[639] However, the data provided by the MICA was used extensively, and was considered extremely useful because their association's data covered 85% of the insured loans outstanding in the US at the time, and a greater length of time (back to 1987, compared to 1996 for the RMA Capital Groups' data).[640] Fed staff worked extensively with three MICA staff to produce a White Paper in justification of the 15% AVC, and even turned to MICA staff to deal with arguments the Capital Group were making at the time. [641] Not only was the Fed re-affirmed in its position to keep the 15% AVC, but private sector groups such as the Capital Group and a number of large banks decided that opposing it would be pointless.[642] With no changes made to the 15% AVC, this feature remained in the final Basel II draft.[643]

Conclusion

This chapter focused on private sector campaigns concerning policies designed to regulate banks' real estate lending behavior. The emphasis of the process tracing analysis has

[636] This corroborates with their outreach efforts following the June 2003 hearings. See Streeter 2003.
[637] This is evinced not only by the above, but by the fact that the Fed staffers looking into the residential mortgage policy were actively discouraged from publishing their research on the potential competitiveness effects of Basel II on US mortgage markets. See Paletta 2005.
[638] See Calem 2005.
[639] The data provided by the Capital Group was considered to be of inferior quality, since rather that demonstrating what actual AVCs were within large US banks, the Capital Group had generated 'implied' AVC calculations, which were simply estimations.
[640] Calem and Follain October 2003, pp. 15-16; FOIA Jauary 2004b, p. 4.
[641] As evinced by FOIA January 2004b.
[642] Interview 36P. See also RMA 2003, p. 23; Washington Mutual November 2003, p. 16.
[643] See BCBS April 2003, p. 60; BCBS June 2004, pp. 69-70.

been on private sector campaigns organized in the US, which were by far the most substantial. In the case of the first US HVCRE campaign, a broad and complex coalition of US private sector groups mobilized to oppose a strict regulatory policy. By tracing private sector opposition and regulatory response, the analysis found that private sector groups were successful in causing permissive regulatory policy change. While this campaign was highly informational, this component of it did not lead to the policy change; rather, it was private sector groups' use of legislative oversight which caused the Fed to change its position. This campaign provides empirical evidence in support of the Legislative Oversight and the Coalitions hypotheses. The second HVCRE campaign, in contrast, featured many of the same characteristics as the first HVCRE campaign, but a different coalition of groups, and was completely unsuccessful in achieving permissive regulatory policy change, thus suggesting caution when interpreting the power of coalitions and legislative oversight, and suggests that there may be other factors which may be at play which have driven this non-result. The variation of these two cases provides useful empirical material for later across-case analysis in Chapter 10.

Table N: Configuration Table for Private Sector Campaigns and their Outcomes

	Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive)	Legislative Oversight (Oppositional)
HVCRE 1	US		1	1	1	0.67	1	1	1	1	0	1	0
HVCRE 2	US	/	0	0	0	0	1	1	1	1	0.33	1	0
Mortgage	UK		0	0	0	0	.33	.33	0	0	0	0	0
Mortgage	CA		0	0	0	0	0.67	0	0.67	0	0	0	0
Mortgage	DE		0	0	0	0	0	0	0	0	0	0	0
Mortgage	US		0	0	0	0	1	1	1	1	1	0	1

The US campaigns associated with residential mortgage-lending took place during a similar period of time, but the content of this campaign and the environment in which it operated differed from the campaigns targeting the HVCRE policy. We have seen that this campaign was ultimately unsuccessful, because of the business conflict present – suggesting strong support for the Business Conflict hypothesis. On the one hand, mortgage insurance associations provided the Fed with superior data which convinced Fed staff to preserve the policy in its given form. On the other hand, small banks and their associations were opposed to changes to the policy in a permissive direction, as they felt it offered large banks a competitive advantage.

Chapter 8

The Expected Losses and Credit Card Campaigns

This chapter describes and analyses the private sector campaigns associated with two different regulatory policies within Basel II, namely, the policy toward banks' expected losses, and the policy toward banks' credit card activities. The campaigns that private sector groups waged against around these policies were both extensive and complex. As we shall see, the extent of influence that private sector groups wielded over regulatory policy outcomes was much less extensive than the influence they wielded over their regulators.

The chapter proceeds as follows. Section One describes the extensive efforts by every country in the study, as well as transnational efforts, to oppose the 'expected losses' policy within the Accord between January 2001 and April 2003. Section Two describes the efforts of American credit card banks who mobilized in opposition to the Basel II credit cards policy between January 2001 and April 2003. None of these campaigns, I demonstrate, were successful in generating permissive regulatory policy change.

Section Three analyzes the new private sector campaigns which emerged in the United States from April 2003 to September 2003, under very different conditions, to challenge both the expected losses and credit card policies. Section Four analyzes the US regulators' response to these new private sector campaigns, and finds that not only did the US regulators' position change, but they engaged in value-claiming behavior within the BCBS as well.

Section Five then explores the negotiation of US demands to change the expected losses and credit card policies. It describes how these demands were accommodated by the BCBS, and how US private sector groups attempted to influence the content of these changes. I demonstrate that, with respect to the credit card policy, while US private sector groups did manage to generate some permissive regulatory policy change, the extent of this change was circumscribed by US regulators. With respect to the expected losses policy, while the policy's form experienced changes, these did not represent permissive regulatory policy change. This chapter concludes

with an analysis of the contradictory empirical results obtained by the private sector campaigns. While private sector campaigns were, under certain conditions, able to influence their regulators, their success at influencing regulatory policy outcomes was less clear-cut.

Section 1
The Expected Losses Campaigns
January 2001-April 2003

The January 2001 draft of the Accord made it explicit that the Basel II regime would require banks to hold regulatory capital against losses that were unexpected due to future uncertainty in their business lines ('unexpected losses'), as well as against those losses that banks calculated *would* occur as a matter of probability: so-called 'expected losses'. The expected losses policy of Basel II was, after the operational risk policy, probably the most heavily contested policy in the entire Accord. Because it made banks hold *more* capital than they would normally hold to cover against losses, it was, in essence, an extra layer of conservatism.[644]

Private Sector Campaigns across Countries

It would not be an exaggeration to claim that the expected losses policy was universally condemned by the banking industry, which argued that expected losses were already largely covered by reserves, or absorbed by the revenue of business activities.[645] As such, banks claimed that the Basel II provisions would encourage banks to 'double count' the risk of expected losses, which they felt grossly overestimated their true risk exposure. Private sector mobilization in opposition to the expected losses policy occurred at both the national and transnational levels.

A substantial international campaign took place very shortly after the BCBS's announcement of the policy in January 2001, and both the IIF and ISDA criticized the policy

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[644] Interview 95R.
[645] For a review of the expected losses debate, and how it affected overall capital, see Kupiec 2003.

extensively, arguing that it represented 'double counting' that would create market distortions.[646] The expected losses policy was considerably contentious within the IIF at the time, but when they met with the BCBS Models Task Force in November 2001, they were told that the Models Task Force was focused on other technical issues, and did not want to hear about these concerns with expected losses.[647] The IIF reiterated its concern regarding the expected losses policy to the full BCBS as well, repeatedly, yet with similarly disappointing results.[648] The ISDA had also argued against the EL policy, also to no avail.[649] Consequently, both transnational associations resigned themselves to defeat on the policy, conceding by May 2001 that the policy was conceptually defensible given a lack of international standards in accounting.[650]

The IIF was not alone in its stark criticism of the policy. As the IIF Steering Committee on Regulatory Capital noted in 2001, "[b]ankers around the world share this analysis."[651] This assertion was no exaggeration. For example, the Canadian Bankers Association repeatedly made the case that the expected losses policy should be removed from the Accord to its regulator (and Canada's BCBS delegate), the Office of the Superintendant of Financial Institutions (the OSFI). The Association was particularly concerned with the fact that the expected losses policy did not take into consideration banking portfolios such as retail lending, where banks' own internal pricing models covered EL quite explicitly.[652] This oversight was a significant issue for Canadian banks, as they engage in large amounts of retail activity, and thus they made it a major concern from the outset in their engagements with the OSFI.[653] While OSFI listened to these concerns, they did not respond to them.[654] The situation was strikingly similar in the UK, although banks there mobilized less actively around the issue there. In their engagements with the Bank of England and the FSA, British banks and their associations argued that the policy would punish retail lending in particular, but were met with non-responsiveness. After a

[646] IIF 2001a, pp. 20-21; ISDA 2001, p.8.
[647] Confidential minutes of IIF meeting, 20 November 2001 with Basel Models Task Force.
[648] Interview 61R; Confidential internal documentation.
[649] ISDA 2001, p. 8
[650] ISDA 2001, p. 8; IIF 2001b, pp. 14-15.
[651] IIF 2001, p. 15.
[652] Confidential minutes taken by Canadian banker; corroborated in Interview 61P.
[653] Interview 59P; 61P.
[654] Interview 61P.

protracted struggle against the policy, many groups discontinued their mobilization around the EL issue, believing it would not and could not be changed.[655]

In Germany, private sector groups mobilized considerably over the expected losses policy. Alongside their protracted campaigns on the SME policy of Basel II, private sector groups cited their disdain for the expected losses policy.[656] This included not only banks such as the National Association of Private Banks, but also non-financial associations such as the German Federation of Industry (though it represented a much more limited effort).[657] The German Association of Savings and Giro Banks (DSGV) had even argued before the Parliamentary Finance Committee in May 2001 that the expected losses policy might increase the costs of capital.[658] After being "politely refused by regulators", by 2003 German banks had largely given up on their relatively modest campaign to have the expected losses policy dropped.[659]

In the United States, private sector groups were also highly critical of the expected losses policy, and banks of all kinds mobilized substantially on this issue, speaking out in extensive critiques to the US Agencies.[660] In particular, the RMA Capital Group mobilized an extensive and detailed technical critique of the policy. They gathered extensive data within their group to demonstrate empirically the disparity between the level of capital that Basel II required for a typical corporate loan, and the median levels of capital they actually held for that loan; they then sent this data to US regulators and other relevant US Agencies and engaged with them repeatedly on the issue.[661] Despite this strong oppositional mobilization, critiques were politiely "taken into consideration", technical critiques were not engaged with, and no permissive regulatory policy change resulted, despite years of mobilization.[662]

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[655] For example, see RBS 2001, p. 13;
[656] Interviews 9P, 10P.
[657] BDI April 2001. p. 3; Interviews 9P, 10P.
[658] The issue had not been raised repeatedly in Parliament, however, and at the time it was dwarfed by other issues of much greater contention such as the concern with SME finance (See Chapter 5). See Bundestag May 2001, p. 48.
[659] BdB July 2003, p. 9; Interviews 9P, 10P. Though see Bundestag October 2003, p. 53
[660] First Union 2001, p. 4; Citigroup 2001, pp. 2,6-7,11; Bank One 2001, p. 2; New York Clearing House 2001, pp. 7-8; Fleet Boston Financial 2001, p. 3; ABA 2001, pp. 8-9; FSR 2001, p. 2; RMA 2001, pp. 16-20.
[661] RMA 2001, pp. 16-20; RMA February 2003; Interviews 53P, 55P
[662] Interviews 81P, 83P; 53P; 54P; 55P; 81P.

The Response of Regulators

At every turn, the BCBS resisted changing the policy. In the words of one BCBS delegate, "Every time it came up [in discussions with the banking industry] it was immediately dismissed."[663] There were three main reasons why the expected losses policy had become cemented into Basel II, ranging from simple conservatism to complex geopolitical considerations. First, the expected losses policy allowed for an extra layer of conservatism to be built into the Accord. This stringency helped satisfy more conservative members of the BCBS such as the US FDIC as well as several Continental European members. Second, the BCBS had informally sworn, for geopolitical reasons, not to revisit the definition of capital due to earlier disagreements with Japan in the late 1990s.[664] Third and finally, revisiting the expected losses policy would mean opening up highly technical issues, indeed a full recalibration of all risk weights within the Accord, and raised issues of a level playing field if the policy was removed.

Section 2
The US Credit Card Campaign
January 2001-April 2003

Over time, as Basel II was elaborated, the policies that regulated the retail portfolio of banks were expanded.[665] In the process, a very specific policy was designed to tackle a very specific issue: namely, the risk associated with a banks' credit cards business. The BCBS had developed a new IRB risk-weight curve that endeavored to provide a more risk-sensitive treatment of what were known as 'qualifying revolving retail exposures' (QRREs) – the very kind of lending practices that banks managed when they undertook credit card lending.[666] The Anglo-American members of the BCBS had played the instrumental role in ensuring that the retail part of the Accord was differentiated in this way, as they understood the risk associated with credit card lending to exhibit special characteristics. In late 2000 the BCBS Capital Task

[663] Interviews 88R, 95R.
[664] Interview 88R.
[665] See JP Morgan Chase 2001, p. 8
[666] See BCBS July 2001. The term 'revolving' comes from the fact that credit card clients do not pay off their lines of credit all at once but rather over time, and are continually tapping into these lines of credit.

Force subcommittee flagged credit cards as a special kind of retail exposure with additional and unique kinds of risk. They sought to achieve a conservative regulatory approach to this kind of activity through various provisions.[667]

The parameters for the QRRE framework were formulated to ensure that the AVC formula that banks had to use varied inversely with the probability of default (PD). What this feature of the policy meant was that capital requirements for credit card lending increased steeply for low PD, while at higher levels of PD the increase was more tapered. It was a highly stringent assumption that increased the levels of regulatory capital required of banks. In addition, the BCBS wanted to apply a capital charge for the part of a line of credit on a credit card that consumers haven't used up yet, the 'undrawn line'.[668] Relatedly, the BCBS wanted to apply new stringent regulations to the securitization of credit card lending, whereby securitized credit card assets would only be accorded regulatory relief under very strict conditions.[669]

These relatively conservative regulatory positions on credit card lending meant that the 'revolving retail' policy the BCBS had designed would increase the regulatory capital costs of large, sophisticated banks by, on average, 14%.[670] While the BCBS Capital Working Group formally oversaw the development of provisions concerning retail portfolios, US regulators bore most of the responsibility for designing acceptable regulatory treatment of credit card risk.[671] Large banks in the G10 held, on average, about 2% of their total capital in 'revolving retail' exposures at the time, yet in the US this figure was considerably more – and these exposures were concentrated within just a few large US banks (discussed below).[672]

Both the development of the credit card policies, and the private sector contention over their content, were confined to the US. Although the Federal Reserve Board had initially contributed heavily to the development of regulatory provisions concerning credit cards within Basel II, by 2002 much of the technical work had fallen largely on the shoulders of the Philadelphia Federal Reserve Bank, with the OCC and Fed Board also consulting on more

[667] For the BCBS wording, see BCBS January 2001, p. 79; BCBS April 2003b, p. 61.
[668] For example, if you have a $1000 line of credit on a credit card, even though you only use $300 per month, the BCBS was proposing to impose capital requirements on the $700, the undrawn balance. This rule is specified in BCBS April 2003, p. 61
[669] See BCBS October 2002, pp. 98-99
[670] BCBS May 2003, p. 29. See also Wachovia, Letter to BCBS Secretariat, 30 July 2003, p. 8
[671] Interview 64R.
[672] BCBS May 2003, p. 29

general issues related to the policy. The rest of the BCBS did not take a strong interest in the credit card policies at the time, since it was seen as an issue relevant primarily to the US.[673]

The US Credit Card Campaign, 2001-2003

The most vocal opponents of the Basel II credit card policy were, perhaps not surprisingly, the US banks with substantial credit card business. However, there were important differences in the internal organization of these banks that had consequences for how they reacted to the policy. Banks like MBNA, Capital One, Providian Financial, and American Express Centurion were 'mono-line' credit card banks, meaning that their main business was the management of credit card lines. Banks like Chase Manhattan (part of JPMC), and Bank of America, on the other hand, were diversified banks with many business lines besides their substantial credit card portfolios (Appendix 7 details some of these differences), and thus were much less concerned with the policy. The exception was Citigroup.

Citigroup was the largest credit card issuer in the world, and it argued alongside banks like Capital One and MBNA, the 'undrawn lines' feature of the Basel II credit card policy was particularly troubling. For Citigroup, the size of their undrawn lines were almost three times their credit card exposures.[674] For all US credit card banks combined, this figure was even greater, at five times their total managed assets.[675] Consequently, even a small capital charge on undrawn credit lines would have a large effect on these banks' overall capital requirements. The treatment of credit card securitization in the Accord was a very pressing concern of many credit card banks, who used securitization not only as a method of risk management, but as a means of funding.For this reason, monoclines like MBNA were "completely opposed" to this aspect of the credit card policy, that they had never suffered a loss in their 15-year history of conducting securitizations, and it should be placed in Pillar II of the Accord.[676]

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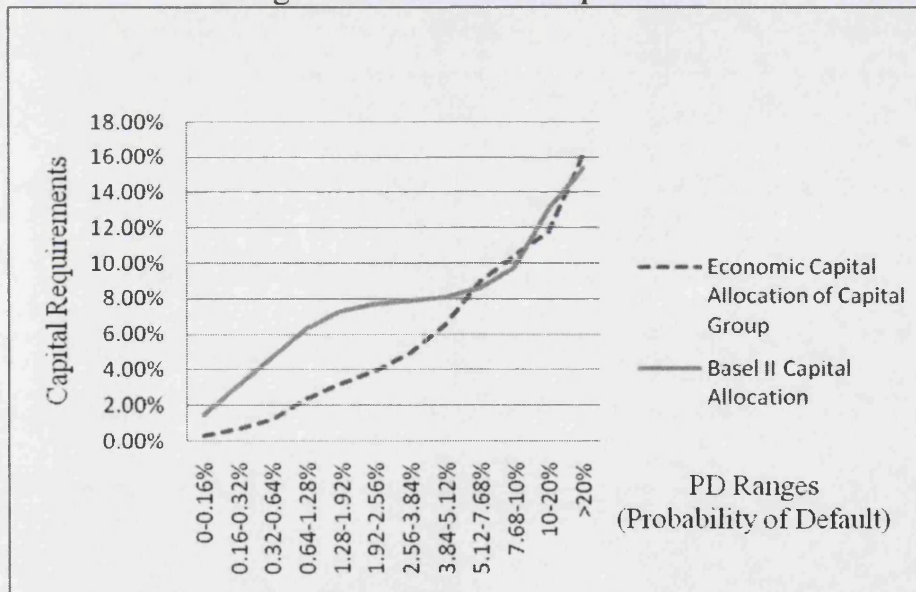
[673] Interviews 95R; 66R.
[674] In 2001 for example this had amounted to $245 billion. Citigroup 2001, pp. 28-29.
[675] At $3 trillion. See Lang et al. 2004, p. 9
[676] MBNA May 2001, pp. 6, 8-9.

The credit card banks had strong associational allies within the US that bolstered their arguments. The Financial Services Roundtable argued against the credit card policies in 2001, as did the RMA Capital Group, as Bank One, Citigroup, and Providian were all active members. As soon as the credit card policy was first announced, the Capital Group pointed out that the BCBS were proposing much higher capital requirements than those generated by the most advanced large banks within their membership, and they illustrated this case empirically, with reference to quantitative data provided by their membership.[677] Based on their own coordinated research, they were able to make a sophisticated informational argument to regulators. As Figure N illustrates, based on their own bank data, they could show that regulatory capital requirements would increase for higher quality credit card exposures, but for more risky exposures they would remain roughly the same.

Figure 8.0: Regulatory capital requirements and Probability of Default (PD) Ranges for Credit Card Exposures[678]



In order to persuade US regulators that the credit card policy should be changed, the Capital Group focused in particular on the AVC assumptions within Basel II's credit card policy, in

[677] See RMA May 2001, pp. ii, 34-37, 57.
[678] Data is from Table 14 of RMA Feb 2003, p. 61.

which the BCBS had built in conservative assumptions by modeling a downward-sloping AVC curve beginning at 15% for low PD and decreasing to 2% for high PD ranges.[679] The Capital Group sent an extensive quantitative report to the US Agencies in February 2003 with their critique of these modeling assumptions.[680] Their critique suggested that the best practices within their firms suggested the use of a *flat* AVC curve in the 6-10% range.[681]

Credit card banks tried various other strategies, sending the Fed aggregated loss statistics to make their case that risk weightings for credit cards should be lower, and arguing to the OCC that they should not be required to hold capital against undrawn lines.[682] They argued to both regulators that the Basel II credit card policy should allow them to make their *own* internal estimates of AVCs.[683]

The Response of Regulators

Despite the considerable efforts that had taken place, the US regulators were not convinced by the banks' arguments, and both the Fed and the OCC treated the data provided by the RMA Capital Group with suspicion.[684] The arguments regarding undrawn lines were not considered convincing, as the regulators still saw undrawn lines as carrying risk.[685] Staff at both the Fed and the OCC were well aware of how important securitization was for the credit card banks, but they had a concern that credit card securitizations did not constitute 'true sales', in that the risk was not actually offloaded from the bank during the securitization. Thanks to their supervisory experience, the OCC had already observed that banks often relied on securitization of credit card lending for *funding* – and in cases when their credit card trusts began to degrade, banks tended to try and provide liquidity to these trusts so that funding didn't dry up.[686] They had shut down several extensive predatory credit card banking businesses across the country since

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[679] RMA Feb 2003, p. 25 (Graph 2), p. 19.
[680] See RMA February 2003.
[681] Interview 36P.
[682] Interview 87R.
[683] Interview 64P.
[684] Interviews 64P; 36P; 8R.
[685] Interviews 87R, 64P.
[686] Interview 87R.

2000, most recently with the SEC in late 2002.[687] The Fed did not have this kind of supervisory experience with the credit card banks, but as they continued to research the issue they found more and more reasons to err on the side of caution. When they pressed banks on an individual basis regarding undrawn lines and securitization, they found that there was resistance to providing clear answers and data, which only strengthened their conservative suspicions.[688] While US regulators did make some small adjustments to the policy, these reforms generally served to *increase* the regulatory stringency of the policy, rather than to decrease it through permissive regulatory policy change.[689] Perhaps not surprisingly, such moves outraged the US credit card banks.

Section 3
The New Expected Losses and Credit Card Campaigns
May 2003 – September 2003

Following the release of the April 2003 draft of Basel II, US private sector groups were incensed at the lack of changes on both the expected losses policy and the credit card policy. They had spent considerable time and resources trying to persuade the US Agencies to change their positions, yet no permissive regulatory policy change had occurred. However, by this time the political-institutional environment had changed. The Congressional hearings on Basel II had begun; Bill HR8043 had been proposed by Congress; and the staff at the House Financial Services Committee seemed more interested than ever in US banks' critiques of regulators' positions.

In this context, large US banks continued their strong opposition to the policy, but now prioritized the issue more than before. Banks such as JP Morgan Chase and Bank of America argued against it as a matter of highest priority not only in their written statements to US

687. See Business Wire 2003.

688

689 Between October 2002 and April 2003, a small change was made to the AVC assumptions of the model, in which the lowest PD ranges were set slightly lower, at 11% rather than 15%. This had the potential to constitute permissive regulatory policy change – were it not for the fact that the this change was accompanied by a 15% *increase* in the amount of expected losses that banks were expected to hold for credit cards. In October 2002, the BCBS had set an offset of Future Margin Income to 90% - yet by April 2003 they decreased the offset to 75%. See BCBS October 2002, pp. 58-59; BCBS April 2003b, p. 60.

regulators, but also in their informal conversations with them.[690] Because the policy affected banking practices and bottom lines so universally, US banking associations could easily address the issue in their engagements with US regulators and with the House Financial Services Committee as well. A plethora of associations and individual banks argued vociferously against the expected losses policy in this context.[691] The President and CEO of the RMA testified before the Senate Banking Committee that the expected losses policy was a major problem that needed to be addressed, and other banks were privately engaging with Congress on their concerns as well.[692]

The US credit card banks were also involved in the expected losses policy in a new way. In April 2003 the amount of capital that banks now had to hold for expected losses had increased by 15%. For US credit card banks, this change was actually a substantial increase in capital requirements, since expected losses on credit cards are typically 10 times higher than those on other loan products.[693] Citibank had always been a vocal opponent of the expected losses policy, but now with this recent change, they had an even greater stake in the expected losses policy's abolition.[694] MBNA and Capital One were also furious with the change, and argued that there was no empirical basis for the decision.[695] Even other banks without substantial credit card businesses explicitly 'linked' their critique of the expected losses policy to its envisioned detrimental effect upon the credit cards market. Banks such as Wachovia and JPMC, for example, made this argument to the US Agencies, alongside their other longstanding arguments aimed at eradicating the expected losses policy.[696] This 'linkage' strategy was not only utilized by large individual banks, but also associations, such as the New York Clearing House Association and the American Bankers' Association at the time.[697] A substantial national coalition had thus developed in opposition to the expected losses policy.

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[690] See Bank of America July 2003, p. 2; JP Morgan July 2003, pp. 5-6; Interview 80P,81P,39R
[691] Wachovia July 2003, pp. 2,5; Providian Financial July 2003, p. 7; Keycorp May 2003; Wells Fargo August 2003, pp. 12-13; Washington Mutual 2003, p. 4; ABA May 2003, p. 3; Consumer Mortgage Coalition July 2003, p. 3; RMA July 2003, p. 15; Martin 2002, pp. 40-42; Interviews 36P, 55P.
[692] Congress. June 2003a, p. 92; Interviews 65R; 80P; 54P.
[693] See Lang et. al. 2007, p. 10.
[694] Citigroup May 2001, 29; Citigroup July 2003, p. 5.
[695] MBNA July 2003, p. 10; Capital One July 2003, p. 2
[696] For example, see Wachovia July 2003, pp. 8-9; JPMorgan Chase May 2003, p. 7.
[697] New York Clearing House. June 2001, p. 8.

Opponents of the Basel II credit card policy also found themselves operating in a more congenial legislative environment, and new organized efforts were unleashed following the April 2003 draft of the Accord.[698] The US credit card industry was an extremely profitable part of the US financial sector at the time, and the credit card policy jeopardized their business models and their profitability in a serious way.[699] MBNA captured the oppositional sentiment to the US regulators' resistance well at the time in a letter to the US regulators, when its CFO stated that "MBNA has been a very diligent and active participant throughout the Basel II process, but many of our concerns have been largely ignored."[700]

The plight of the US credit card industry in the BCBS negotiations came up repeatedly in Congressional hearings; one finds evidence of this legislative attention in the form of testimonies by representatives of the Financial Services Roundtable and the Bond Market Association.[701]
The credit card banks such as Bank One, Citigroup, and Capital One argued their case to the US regulators in this environment, using many of the same information-rich arguments as before, and citing data (their own and that of the RMA Capital Group) on the relatively low risk of credit card portfolios.[702]

While older allies like the American Bankers Association and the Financial Services Roundtable contributed their criticisms of the policy (credit card banks were prominent members of both of these associations),[703] by the spring of 2003 the credit card banks also gained new allies. The US credit card management firms, which (for unknown reasons) had not mobilized previously, now saw themselves to be directly affected by the credit card policy of Basel II. Visa, MasterCard, Discover, and American Express all became attentive to the impending threat of Basel II's credit card policy. With this group of firms now involved in the oppositional campaign, the political leverage of the opposition increased. The permanent Washington D.C. lobbyists for Visa, MasterCard, Discover, and American Express began contacting staff at the House Financial Services Committee with their concerns. Visa also argued to both the BCBS and

[698] For a concise review of US bankers' views on the credit card policy, see Cass 2003, p. S11.
[699] For an excellent and detailed overview of this issue, see Montgomerie 2006, 2007. See also Retail Banking International 2003.
[700] MBNA July 2003, p. 12; Capital One expressed similar concerns at the time. See Capital One July 2003, pp. 1-2 (see also p. 12).
[701] Congress. June 2003a, pp. 43, 51.
[702] See Bank One July 2003, pp. 2-3; Capital One July 2003, p. 4; Myers 2003; Paletta 2004; Citigroup July 2003, p. 5; MBNA July 2003, pp. 7-8
[703] Financial Services Roundtable July 2003, pp. 6-7.

to the US Agencies that damage done to the credit card industry would in turn damage the US consumer, and the US economy as a whole.[704] Now the credit card campaign had not only legislative oversight on its side, but allies as well.

Section 4
The US Regulators' Response to the New Campaigns

By the summer of 2003, private sector arguments against both the expected losses policy and the credit card policy were familiar to US regulators – they had heard these arguments for some years. What was different was the extent of mobilization and, even more starkly, the environment of legislative oversight. In a striking about-face, the Fed Board now concluded that the expected losses policy needed to be changed. As one regulator remarked, "No agency can ignore what the Congress is saying."[705] When written comments from industry came to the Fed Board in the summer of 2003, it became clear to those involved within the Fed Board Staff that the issue needed to be resolved urgently.[706] Now embroiled in a hostile political environment, the Fed feared both the ability of a united US banking community to increase Congressional scrutiny of their behavior, as well as the passage of HR8043. Any amount of further legislative oversight would have complicated the Fed's ability to finalize Basel II at the international level, and thus achieve the many goals it had set out to accomplish five years earlier. It needed to manage the situation, and in contrast to the opposition to the operational risk policy, for example (see Chapter 7), the opposition to the expected losses policy was unequivocal, and united.

An even more dramatic change in position came from the OCC. It supported the Fed's decision to change the expected losses policy, and "became convinced not only that the banks were conceptually correct in their arguments" but that retaining the policy "would have severe ramifications – not the least of which might be to seriously jeopardize the industry's acceptance

[704] Visa. May 2001, pp. 1-2
[705] Interview 78R.
[706] Interview 39R.

of the Basel II framework".[707] Much like the justification within the Fed, the use of information alone by private sector groups cannot explain the radical change in the regulators' position, since this was consistent over time. Rather, one must also consider the fact that this information was now received in an environment of legislative oversight.

It was also decided that the Basel II credit card policy had to be substantially changed as well; interestingly, however, this decision was not driven by the Fed, but rather by the OCC. The concerted oppositional campaign by the credit card banks had, for the first time, caused great concern for Jerry Hawke, the Comptroller at the time.[708] The initiative was taken by the OCC to consult with the US credit card banks at high levels to get their views on the issue.[709] MBNA and Citigroup had been lobbying the OCC privately on the issue, and now Hawke met directly with their senior management in Wilmington and New York, respectively.[710] The OCC also held a special meeting with credit card executives for half a day to allow them to field their concerns.[711] The private sector campaign over the credit card policy had succeeded in persuading the OCC to represent their preferences and fight for more permissive regulatory policy change.

The Fed did not share the OCC's views that the credit card policy needed to be changed. Not only was the Fed convinced of the credit card policy's merits, but they were also critical of the OCC's seemingly sudden accommodation of US credit card banks' concerns.[712] However, given the legislative environment at the time, the Fed was not willing to resist the OCC's now strongly-held views and risk jeopardizing the entire Accord. Congress at the time was highly critical of inter-Agency disagreement, and indeed had even proposed a bill, HR8043 directly affected the Fed's ability to negotiate a common US position. The bill sought to establish a new committee to develop a uniform US position in the Basel II negotiations, and prohibited any US Agency from agreeing to any proposed recommendation of the BCBS until that agency reports it

[707] Hawke April 2004, p. 16; Hawke May 2004, pp. 1-2. See also Hawke's later account in Silverman 2004. The OCC's strong and sudden position with respect to credit cards raises the question of potential pressure from the Bush Administration. While this is a possibility, there is no evidence to suggest that the Bush Administration was interested or involved in the particularities in the specific regulatory policies of Basel II. This is not to say that they would not be if events escalated further, of course.

[708] He would later state that his concerns were directly in response to the comments given by banks at this time. In his own words, "...we felt that that would have been very detrimental to our credit card business." See Hawke December 2003, p. 14.

[709] Interview 29R.

[710] Interview 64P

[711] Interview 29R.

[712] Interview 89R.

to Congress. With the OCC now representing the concerns of the banks it was regulating, the Fed was thus weakened in its ability to support its conservative stance. In the words of one individual from the Fed, the US domestic political situation "forced the Fed to negotiate" with the OCC.[713] Surprisingly, the FDIC did not take a major stance on either of these issues at the time, but it shared the Fed's concern about the OCC's change in position vis-a-vis the credit card policy. The sudden change in position of the OCC on the credit card policy is remarkable when one considers the very negative experience that the OCC had with credit card lending practices in the US during this time. Consistently over the previous 3 years the OCC had been heavily involved shutting down several predatory credit card banking businesses across the country.[714] Whatever this says about the state of the US regulatory environment during this period, it certainly shouldn't have increased the confidence of the OCC in the safety and soundness of the US credit card business.

Negotiating large changes in the expected losses and credit card policies were sure to bbe a challenging task, since there was probably never a worse time to announce to the rest of the BCBS that the Accord needed substantial changes. In addition, the US BCBS delegates were not held in the highest regard at the time, thanks to the US' decision to apply Basel II to only 20 US banks.[715] Moreover, the rest of the BCBS was eager to finalize the negotiations, and agree on a final draft of the Accord by November 2003, in line with the Secretariat's scheduled deadline.[716] Both the UK and Japanese FSAs, along with the German regulators, were already shifting their focus toward implementation at the time, and held strong preferences for a timely completion of the Accord.[717] Indeed, all European BCBS members had a strong incentive to get Basel II completed quickly because they wanted Basel II to be translated into the EU Capital Adequacy Directive. A fear at the time within Europe was that this be adversely affected by the upcoming

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[713] Interview 88R.
[714] Examples include Banks such as Providian National Bank in 2000, First National Bank of Marin in 2001, and NextBank in 2002
[715] Institutional Investor. July 2003; McGregor and Pretzlik 2003; Mingkang 2003. See also Persaud 2003.
[716] See Dams October 2003; Rathmann 2003; Krebsbach 2003; Crabbe 2003, p. S8.
[717] On the Japanese position, see comments of Makoto Hosomi in Jeffry and Thind 2003. On the UK, see Robinson 2003; UK Advisory Group July 2003, p. 1. On the German regulator's preferences, see Schutz et. al. 2003; Institutional Investor 2003.

EU parliamentary election and the expansion of the EU's member states, further delaying an already delayed process.[718]

Thus despite the predictable consequences for the timely completion of the Accord, the Fed sent a note to the BCBS Secretariat, which was passed on to the other Committee members, stating the need for a dramatic change of course.[719] This behavior can be considered value-claiming behavior because no one within the BCBS wanted these changes other than the US. A highly attentive and critical Congress meant that the US delegates could justify their position in terms of domestic acceptance of Basel II, not simply vested national private banking interests. Many European members suspected the changes (especially in credit cards) was due to political pressure; at the same time, the US delegation defended its claims stating that European criticism was of a political, rather than intellectual, nature.[720] The trans-atlantic spat that ensued through the financial press only served to fuel the OCC's determination to push harder, and Hawke was resolutely unapologetic about the US delegation's stance.[721]

Section 5
The International Negotiation of the US Demands

The BCBS, scheduled to meet in November, met one month earlier instead, at the beginning of October. They met in Madrid, hosted by the Governor of the Bank of Spain, Jaime Caruana, the Chair of the BCBS at the time. Widespread concerns that the Accord would not be completed on time, if at all, persisted.[722] The US presented the rest of the BCBS with their issues, which they insisted must be addressed to ensure the US delegation's acceptance of the Accord.[723] There were three major demands that the US put forward, regarding three different

[718] See Rathman 2003. See comments of the President of the Bundesbank in this regard in Welteke 2001, pp. 187-188.
[719] Interview 39R, 40R.
[720] Silverman 2003b; The Economist October 2003;
[721] See Silverman 2003b; Jerry Hawke, quoted in The Economist October 2003. See also the analysis in Holzer 2009, pp. 265-266.
[722] Bundestag October 2003, p. 53.
[723] Interview 89R, 95R.

regulatory policies: credit cards, expected losses, and securitization. The negotiation of the US' securitization demands are discussed in Chapter 9 – the others immediately below.

The US Credit Card Demands and Their Negotiation

The US delegation demanded that the entire credit card policy be revisited and substantially revised. This demand was not welcome by the rest of the BCBS, which not only wanted to complete the Accord, but had little interest in affecting permissive regulatory policy change only to suit US interests.[724] Furthermore, the rest of the BCBS saw these demands as simply accommodating the credit card industry, and were interpreted as highly politically motivated because of the perceived political sensitivity of credit cards in the US at the time.[725] It was seen as a highly political issue in the US, and BCBS participants linked this to the hostile legislative environment in the US at the time.[726] Because of these perceived constraints, it was clear that the US delegation would not revoke, and changes were largely left to the US delegation itself to work on.

In the subsequent months, the OCC would continue to exhibit value-claiming behavior over the credit card policy, offering which further supports the Legislative Oversight hypothesis. Basel II came up repeatedly in Hawke's legislative oversight hearing and in his correspondence with legislators. In this context, he pledged that there was little room for substantive compromise, and that the OCC would not accept features that would unduly disrupt or disadvantage credit card businesses "for the sake of global conformity", and he continuing to cite the importance of industry acceptance of the policy.[727] When Hawke discovered informally that some BCBS delegates offered the US a 1 April 2004 deadline to conclude the policy, he remarked:

[724] In the words of one US BCBS participant, the European members of the BCBS "generally didn't care about credit cards, other than they thought that the entire credit card discussion was a giant giveaway to the US banks!" Interview 88R; Corroborated in Interviews 24R, 95R. The UK and Canadian delegations were sympathetic, however, since their domestic banks had some credit card activity as well (though nothing like the size and extent of the US banks)

[725] Interviews 90R, 95R. See also Hawke May 2004, p. 2.

[726] Interview 95R.

[727] Hawke April 2004, p. 16; Paletta March 2004; Davenport December 2003.

> We've got plenty of time to get these issues worked out, but we aren't going to do it with a gun to our head. [...] The danger here is we get a bunch of ivory-tower people together coming up with some theoretical approach to those issues, and it could end up screwing up a very important industry."[728]

While the US delegation had considerable autonomy in redesigning the credit card policy, it was careful to consult with US private sector groups in order to assuage domestic concerns. In this context, the US Agencies actively solicited the views of the credit card banks during this time, with several meetings held during this period.[729] For example, the Philadelphia Fed held a large conference on the risks associated with different kinds of credit card activity in order to exchange views on the subject, with active participation from the New York Fed, the FDIC, and the OCC.[730]

The monocline credit card banks continued to advocate a lowering of the AVCs in the credit card policy, and in February the US Agencies conducted meetings with the RMA Capital Group to discuss its proposals.[731] The RMA Capital Group had two such proposals for the AVCs for credit cards. Option one was to have banks estimate *their own* AVCs (i.e. a full internal models approach for credit cards).[732] Option two was that the AVCs for credit cards could be *flattened*, thus reducing regulatory capital charges. The Fed and the OCC argued that option 2 (the more conservative of the two options) would be preferable. While less than a year before the Capital Group had advocated that there should be a flat AVC of between 6-10%, they now argued for 3%.[733] While the US regulators were willing to concede the point that the AVC for credit cards could be flat, they didn't fully agree on exact figures. While the OCC favored a low AVC, the Fed wanted a higher one. They agreed to compromise – to set it at 4%, where it remained in the final document.[734] This modification to the policy represented a clear instance of

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[728] See Jerry Hawke, quoted in Paletta March 2004. See also Hawke quoted in Atkins March 2004.
[729] Interviews 55P, 64P.
[730] Federal Reserve Bank of Philadelphia 2004
[731] Bank One November 2003, pp. 1-2; MBNA November 2003, p. 4; RMA Capital Group March 2004, p. 1.
[732] Which, they added, would "provide an excellent first step in moving toward a full internal models approach." See RMA Capital Group March 2004, p. 4.
[733] See RMA Capital Group March 2004, p. 5.
[734] See BCBS June 2004, p. 70.

permissive regulatory policy change, since it meant that regulatory capital for credit cards would decline based on an underlying change to the Basel II model.[735]

US private sector groups also sought to influence the features of the credit card policy which required them to hold capital against undrawn lines. MBNA and Citigroup were particularly active in this regard, with MBNA making detailed arguments about the safety of their securitization practices to the US regulators, and with Citigroup officials meeting with US regulators and detailing the robustness of their own risk control systems.[736] The rest of the US banking community, however, did not share these views in regard to the undrawn lines issue, including the American Bankers' Association, Wells Fargo, Bank of America, and JPMC.[737] JPMC argued that the proposed early amortization features of the Basel II credit card policy "made sense for credit card securitizations", and that indeed they held capital against undrawn lines when they securitized credit card assets.[738] At a large forum in Washington D.C., Fed staffers even forced banks to publicly admit whether or not they actually held capital for undrawn lines.[739]

Perhaps not surprisingly, the Fed did not concede on the undrawn lines issue, as they were completely convinced that it involved high degree of risk.[740] The FDIC was also highly skeptical.[741] The OCC was more supportive of the credit card banks' arguments, but it could not argue against the Fed and the FDIC in light of the differences observed between different US banks. It was thus decided that the credit card policy should retain the requirement to have banks

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[735] For the lowest risk credit card exposures, capital would decrease substantially, since the AVC was lowered from 11% to 4%.
[736] 14 November MBNA, p. 4-5; Philadelphia Fed 2004; See also FOIA January 2004a, p. 4; Citigroup November 2003, p. 22.
[737] RMA November 2003, p. 17; While JPMC had previously disagreed with Citibank and MBNA's strong abhorrence of the undrawn lines feature, they had not stated so publically. Interview 83P.
[738] Lang et. al. 2007, pp. 47-48.
[739] Interview 64P; Corroborated by Interviews 67P, 87R. The fact that the banking industry was now relatively divided on the undrawn lines issue can be seen by the fact that by March 2004, the RMA Capital Group argued that it was no longer an issue of pressing concern. RMA March 2004, p. 3.
[740] Interview 64P. See Philadelphia Fed 2004.
[741] See comments of Keith Ligon in Fed Philadelphia 2004

hold capital against undrawn lines.[742] While not perfect, the compromise helped to allay the OCC's concerns at the time.[743]

Finally in May 2004, at the final BCBS meeting to finalize the Accord, the US delegation presented their revised credit card policy[744] The rest of the BCBS, happy to have the US Agencies in final agreement, accepted the changes.[745] It represented an instance of permissive regulatory policy change, but a very circumscribed one. Regulatory capital requirements were reduced by changing the AVC relationship, but the undrawn lines feature would remain.

The US Expected Losses Demands and Their Negotiation

The US demand for a complete reformulation of the expected losses policy was even bolder than that concerning credit cards, because reforming expected losses would affect every bank in the G10, along with the definition of capital itself, and would thus require substantial re-calibration of the entire Accord, subsequently risking substantial delay. While the rest of the BCBS was aware of the private sector distain for the expected losses policy, it was well recognized that groups in the US were particularly opposed.[746] However, in contrast to the US demands to change the credit card policy, the demands to reform the expected losses policy were not contested by the rest of the BCBS – they were accommodated, without contestation.[747] Indeed, the BCBS was well-aware of the private sector critique of the expected losses policy because of private sector campaigns in many of their own countries, as well as at the transnational level (see above).[748] The BCBS decided together to cooperatively revise the expected losses policy in a particularly careful way. It was not an easy policy to address, since difficulties arose in light of fundamental differences in the ways banks manage their reserves.[749] A simple wholesale 'removal' of the expected losses policy would risk a decline in regulatory

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[742] As such, in the case of securitized credit card receivables, banks still had to hold capital for both the drawn and the undrawn portion of the securitized line. See BCBS June 2004, pp. 71,136; Compare with BCBS April 2003, p. 61.
[743] See Hawke May 2004, p. 2.
[744] See Paletta 2004.
[745] See BCBS May 2004.
[746] See Caruana 2004, p. 3.
[747] Interview 95R; Corroborated by Hawke in Silverman October 2003, p. 15.
[748] Sanio welcomed the changes, and said it was good for German banks. See Dams 2003. Corroborated in 90R
[749] Interview 88R.

capital, something that was relatively unpalatable for most BCBS members. A technical fix was possible through adjusting levels of capital to bank reserves, but this presented a problem: the various members of the Basel Committee supervised banks with very different levels of reserves. Two countries in particular tended to have banks with great reserves: namely, the US and Spain. In recognition of this unevenness, neither the US nor the Spanish delegation sought to maximize their advantage.[750] Instead, the BCBS as a whole sought to design the new policy in a way that countervailed these advantages.

The BCBS decided that when a bank's reserves were less than its expected losses, the shortfall would be deducted from bank capital – half the amount from Tier 1, half from Tier 2. If a bank's reserves *exceeded* their expected losses, then they would be allowed to count the excess capital, but only toward Tier 2 capital (and only up to 20% of Tier 2 capital at that). In other words, banks with large reserves were systematically prevented from reaping windfall advantages from the change. For the majority of the BCBS, they now had assurance that the US would not reap windfall advantages. Furthermore, regulatory capital would not decrease – a point that pleased more conservative Continental European members of the BCBS in particular.[751] While the US delegation knew that this change was not what private sector groups in their country wanted, the compromise was seen as essential in order to avoid both windfall declines in regulatory capital and potential further conflict within the BCBS.[752]

The German banking community, which had argued against the expected losses policy previously and to no avail, was delighted at the changes.[753] However, the US banks and their associations who had actually influenced these changes believed they signified a mere pyrrhic victory.[754] Groups such as the RMA argued that the recent changes represented "an important step in the right direction", but since the removal of expected losses from the calculation of required capital also meant that banks had to subtract expected losses from the actual total capital that a bank needed to hold, they saw no real net benefit.[755] These views were universally held

[750] Interview 90R.
[751] Interview 95R.
[752] Interview 95R; See also Jerry Hawke, quoted in Rehm 2003.
[753] The German delegation, and the German banks and their associations were all pleased with the changes at the Madrid meeting. See Die Welt 2003.
[754] See, for example International Financial Law Review.
[755] RMA December 2003, p. 1.

among the US banking community.[756] As one individual involved in the expected losses campaign put it, "...we won the battle but we may have lost the war."[757]

In this context, US private sector groups continued to advocate for changes. Specifically, they focused on criticizing the kind of assets that banks could count against expected losses, and argued against the caps that the new policy proposed. US banks offered detailed technical solutions that could be employed in order for Basel II to recognize more bank assets against expected losses.[758] A central argument in this regard was that Basel II should recognize the value of a bank's Future Margin Income (FMI) in covering expected losses.[759] The US banking community also argued that when banks had excess provisions, these should be allocated as Tier 1 capital, not Tier 2 capital.[760] Because the BCBS proposed to put a cap on these provisions, this feature was also derided. Citigroup for example argued that it "had no economic basis," and the Financial Services Roundtable called it "an arbitrary, unjustified limit."[761] The US credit card banks were also particularly disturbed at these changes.[762]

Both the US delegation and the BCBS as a whole received substantial comment and critique on how the policy should be reformed[763] However private sector groups' criticisms were not heeded. Indeed, the BCBS even introduced more capital into the system to compensate for any small declines in capital that might have resulted. Because of the extensity of the changes to the expected losses policy, the entire Accord had to be 'recalibrated', in the sense that risk-weight functions within the IRB models had to be adjusted to compensate for the changes made. While the changes to the policy meant that regulatory capital would decline slightly, this decline was compensated. Because regulatory capital was expected to decline by 6% from the changes to the expected losses policy, the BCBS introduced a 'scaling factor' which compensated for this,

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756 Interviews 80P, 81P, 83P.

757 Interview 55P.

758 Bank of America November 2003, p. 5; Citigroup December 2003, Appendix 1.

759 This argument was nearly universal at the time, but see for example MBNA November 2003, p. 4; MBNA December 2003, p. 2; Bank of America December 2003; RMA November 2003.

760 JPMC argued that excess provisions should be counted as Tier 1 capital, at the very least 50% of them. JPMC November 2003, p. 9; American Bankers' Association December 2003; New York Clearing House Association November 2003, pp. 3-4; Financial Services Roundtable December 2003, p. 3; Corroborated by Interview 83P.

761 Financial Services Roundtable December 2003, p. 3; Citigroup December 2003, p. 2.

762 Because the new policy now restricted the extent to which reserves could be used as a component of capital, the result was that their total capital charge would actually *increase* as a result of the new policy. See MBNA December 2003, pp. 2-3.

763 See BCBS January 2004, p. 1; Banking and Financial Services Policy Report March 2004.

by increasing regulatory capital requirements by 6% across the board.[764] There was, however, one adjustment that was made which did offer some regulatory relief for certain kinds of banking activity, namely, the private sector argument against a 20% Tier 2 cap on excess provisions. Private sector critiques suggested that the recognition of excess provisions should not be capped based on Tier 2 components, but should be capped based on a percentage of risk-weighted assets.[765] The specific motivation for this particular change are not clear, but the BCBS officially stated that they agreed with private sector arguments that the 20% Tier 2 cap provided a perverse incentive to banks, and they decided instead to convert this cap to a percentage of credit risk-weighted assets.[766] This may be the case – however it is nevertheless clear that this small change offered regulatory capital relief for credit card banks in particular. Because of this change, credit card banks could now use their large reserves to count them against expected losses.[767] This impacted 'monoline' credit card banks (such as MBNA and Capital One) especially, as it reduced their relative burden of Basel II capital requirements by almost 50% relative to more diversified banks.[768]

Conclusion

This chapter has examined the private sector campaigns organized around both the expected losses policy and the credit cards policy. In Section 1, we saw how different campaigns targeting the expected losses policy emerged in Canada, Germany, the UK, and the US, and at the transnational level as well. Despite the efforts of private sector groups organized both nationally and transnationally, none of these campaigns successfully achieved permissive regulatory policy change. Section 2 examined the substantial private sector campaign launched in the United States against the credit card policy. This campaign too failed to generate regulatory policy change.

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[764] The scalar was set to 1.06, and it was stated at the time that it could change in the future if the BCBS saw fit. See BCBS May 2004, Appendix 1; BCBS June 2004, pp. 4, pp. 12-13; The Financial Regulator 2004.
[765] BCBS January 2004.
[766] BCBS, 30 Jan 2004, p. 5. This percentage of RWA was worked out to .6%, although at national discretion a lower limit could be applied. See BCBS 2004, pp. 14, 80-81.
[767] See Lang et al 2007, pp. 10-11.
[768] Indeed, a later study conducted by the Fed concluded that the average percentage change in required capital for banks with credit card subsidiaries was 44.3%; while for monoline credit card banks it was 23.6%. Data is from Lang et. al. 2007, p. 43 Table 4, Panel A.

Section 3 explored new efforts among US private sector groups to change both the expected losses and credit cards policies. Section 4 demonstrated how US regulators came to change their positions regarding these policies due to the aforementioned renewed mobilization, as well as the threat of constraining legislative oversight. Finally, Section 5 illustrated how the US delegation engaged in value-claiming behavior within the BCBS as a means of forcing accommodation to US private sector preferences. As we have seen, however, this behavior did not lead to unequivocal permissive regulatory policy change. The expected losses policy was modified considerably, but in a way that ensured that capital requirements would not fall. Conversely, the credit card policy did undergo some permissive regulatory policy change, thanks to efforts by specific private sector groups such as the RMA Capital Group. However, the extent of the permissive regulatory policy change was circumscribed, as other aspects of the credit card policy remained intact. This particular case of the second US credit card campaign supports the Mobilization and Information Network hypotheses, in the sense that the particular reactions of regulators and the changes in the credit card policy itself can be attributed to private sector's efforts at mobilizing their concerns (with the OCC) and to providing information (to the Fed). The responsiveness of US regulators, their value-claiming, and the changes to the policy only occurred once legislative oversight was present – suggesting support for the Legislative Oversight hypothesis. Interestingly, the particular disagreements within the US banking community over the credit card policy (specifically in regard to securitization of credit card receivables) was the part of the policy which was *not* changed. This suggests some *within-case* support for the Business Conflict hypothesis.

Despite the variegated success of the campaigns examined in these chapters, it is worthwhile to point out that where private sector groups were most successful was in terms of influencing their own national regulators. In both the credit card and expected losses campaigns, US private sector groups were successful in getting their regulators respond to their concerns by changing their regulators' positions on these policies, and then having them represent private sector preferences at the BCBS. In other words, when assessed in terms of the main dependent variable of interest, permissive regulatory policy change, these campaigns do not offer strong evidence of private sector influence on the final outcome. These campaigns do however offer extensive evidence of private sector influence over the intermediate variables of interest, the

position and the behavior or regulators. The configuration table below illustrates the fuzzy-set scores given to each of the explanatory and dependent variables of interest for use in later fsQCA in Chapter 10.

Configuration Table for Campaigns and Their Outcomes Examined in Chapter 8

	Scale of Campaign/Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive	Legislative Oversight (Oppositional)
EL 2001-April 2003	TN		0	~	~	~	1	1	1	0	0	~	~
EL 2001-April 2003	NI		0	0	0	0	0.33	0	0.33	0	0	0	0
EL 2001-April 2003	CA		0	0	0	0	0.67	0	0.33	0	0	0	0
EL 2001-April 2003	UK		0	0	0	0	0.33	0	0.33	0	0	0	0
EL 2001-April 2003	DE		0	1	1	0	0.67	0.67	0.33	0	0	0.33	0
EL 2001-April 2003	US		0	0	0	0	1	0.67	0.67	.33	0	0	0
Cards 2001-April 03	US		0	0	0	0	1	0.67	1	0	0	0.33	0
EL April 03-May 04	US		0.33	1	1	1	1	1	0.67	.33	0	0.67	0
Cards April 03-May 04	US	/	0.67	1	1	1	1	1	1	.67	0.33	0.67	0

Chapter 9

The Securitization Campaigns

"They were so ticked off at how Basel I had been gamed [that] they wanted to close every possible loophole there was...It felt like we were being *punished* because we figured out a way to game it before"[769]

This chapter explores the private sector campaigns organized against the securitization policy of Basel II. Securitization is the practice of bundling future obligations associated with an underlying asset (such as mortgages, or business receivables) and then packaging and selling this bundle as a tradable security. This practice was very popular among banks while Basel II was being developed. Indeed, as many have pointed out within the IPE literature and elsewhere, the growth and structural importance of securitization during this period were central to the constitution of global, and particularly US, financial markets.[770] As such the cases examined herein offer a unique opportunity to examine private sector influence upon transnational regulatory standard formation concerning securitization practices.

This chapter is divided into four sections. Section 1 describes the BCBS's general approach to securitization, culminating in the Basel II securitization policy published in October 2002. Section 2 then explores private sector campaigns organized in different countries and at the transnational level, and argues that none of these campaigns were successful in generating permissive regulatory policy change over the Basel II securitization policy. Section 3 then examines the US private sector campaign. I argue that the US campaign, characterized by an

[769] Interview 61P.
[770] See Schwartz 2009; Langley 2006; Shiller 2008; Blackburn 2008.

extensive and complex national coalition of private sector groups targeting the US regulators, utilized legislative oversight and information to their advantage. Section 4 analyzes the fruits of their labors. I argue that US regulators responded to the US private sector campaign first by changing their position on particular aspects of the securitization policy, then engaging in value-claiming behavior at the international level, and finally using information provided by US private sector groups to ensure permissive regulatory policy change. However, the extent of permissive regulatory policy change which occurred, I note, was circumscribed, offering some changes but denying others.

Section 1
Securitization: A Central Regulatory Concern

The BCBS had a longstanding concern with securitization; indeed, one of the main motives underlying Basel II was the prevention of international regulatory arbitrage resulting from securitization.[771] Banks were moving their risks off balance sheet through securitization vehicles to avoid regulatory costs, and yet regulators at both the BCBS and at national levels knew that risk was not *actually* being removed from the financial system.[772] As one BCBS participant put it "[s]ecuritization challenged the whole fabric of banking regulation at the time"[773] The challenge of regulating securitization was shared throughout the G10 and beyond, and was particularly marked in the US, where such markets were most developed.[774]

The approach taken toward securitization within the BCBs reflected what might be called a 'cautiously stringent' approach. Continental European BCBS members were eager to address this area of bank activity conservatively (see below).[775] However, the US, UK, and Canadian BCBS participants, while committed to improved regulatory standards and reining in the emergent risks, also sought avoid damaging what they simultaneously believed were the useful elements of securitization.[776] While the entire BCBS had an interest in the securitization policy, there was nevertheless a recognition that securitization was a highly complex and technically

[771] See Jones 2000. See also Congress June 2003a, p. 53.
[772] See Harris 1998.
[773] Interview 21R.
[774] See Costello 1998; Jackson 1999, p. 26.
[775] Interviews 90R, 95R, 73R.
[776] Interviews, 95R, 73R, 21R

detailed area. Given that the US and UK delegations had the greatest expertise in this area from their domestic regulatory experience, the majority of the technical work of the Securitization Sub-Group of the BCBS was delegated them.[777]

This particular mix of standpoints was reflected in the form and content of the Basel II securitization policy as it existed in October 2002.[778] The policy attempted to recognize the ways banks used securitization to distribute risk within the financial system. However, in contrast to most other policies within the Accord, the BCBS was wary of utilizing banks' own internal ratings systems to assess securitization-related risks, and favored strictness regarding capital adequacy requirements for securitizations. Reflecting these concerns, BCBS Securitization Sub-Group formulated two main approaches for securitization exposures, each reflecting relatively conservative assumptions. The 'Supervisory Formula' approach was a complex mathematical formula in which regulatory capital requirements would be assigned given the 'effective number of exposures', the 'thickness' of a securitization tranche, a 'credit enhancement level', and an 'exposure-weighted average LGD' within a given securitization exposure.[779] While banks could use this Supervisory Formula for assessing risk for exposures which were not externally rated by credit rating agencies, a number of conservative assumptions were built into the Supervisory Formula model. Among these was a minimum 56 basis-point value to be used as part of the model. What this 56 basis point value meant was that, even when banks had calculated that a given securitization exposure was extremely low, i.e. the 'best of all possible cases', the Supervisory Formula included a 7% *floor* below which their regulatory capital requirements could not fall.[780] As an alternative to this 'Supervisory Formula' approach, banks could also use a Risk-Weighted Assets (RWA) approach to measure their level of regulatory capital for a given exposure.[781] This approach was much less complex than the Supervisory Formula, but it could only be used for securitization exposures which had an external rating assigned to them.[782] Like

[777] The BCBS Securitization Sub-Group also often felt that there was insufficient quality information available, and therefore opted for higher risk weights as a default position. See for example Murra 2003. Confirmed in interviews 84P, 40R.
[778] BCBS October 2002.
[779] See BCBS April 2003, p. 117-118
[780] 56 divided by .08 x 100% = 7%. See BCBS October 2002, p. 9; BCBS April 2003, p. 116.
[781] The use of this approach depended on whether or not the bank was an originator or an investor in a securitized asset.
[782] Actually, if an exposure was 'unrated', under the RWA approach, it was subject to an outright deduction from the capital base of a bank.

the Supervisory Approach, the RWA approach also had a number of conservative assumptions built into the model; its capital floor was also set at 7%.[783]

While the securitization policy attempted to reflect 'best practices' in the management of securitization risk at the time, overall it was designed to be a *stringent* regulatory policy. The third Quantitative Impact Study conducted by the BCBS between October 2002 and May 2003 revealed that, as an average across the G10, the regulatory capital requirements for securitization exposures would increase substantially. Due to the general lack of regulations in this area, capital requirements were expected, on average, to increase by an average of 129% across the most advanced banks in the G10 banking systems.[784] It is hardly surprising then, that the Basel proposals sparked substantial concern within the securitization industry.[785] Reflecting the widespread growth of securitization at the time, campaigns emerged at various national levels and at the transnational level as well. The most substantial campaign, as we shall see below, took place within the US.

Section 2
The Variety of Securitization Campaigns

The BCBS released its proposed securitization framework in October 2002. In the eyes of private sector groups across the G10, it was a complex, disconcerting and excessively stringent policy. As Appendix 8 details, securitization markets were booming all over the world at the time; thus, it is not surprising that private sector campaigns emerged in various countries, such as Germany, the UK, and Japan. However, the national-level campaigns were relatively modest, and in many case efforts were channeled into to *transnationally* mobilized oppositional campaigns.

Private sector mobilization over the Basel II securitization policy in Germany was very modest. The ZKA provided some detailed critiques, which centered upon the overall extent of

[783] This capital floor had been based on Peretyatkin and Perraudin 2003.
[784] See May 2003, p. 29.
[785] In May 2003 it was widely believed within the securitizations community that CP3 was more or less the last word on securitization framework. See Murra 2003; Whitehead 2002; Odenback 2003.

capital requirements for securitization.[786] The ZKA argued that the sum total of the capital requirements for ABS transactions should not be higher than before a securitization is conducted.[787] However, while the ZKA argued that the cumulative capital charges for securitization were too high, it did not offer a specific, targeted critique of specific risk weights. It instead called into question the consistency of the BCBS' approach to securitization in general, arguing in particular that the 56-floor should be reduced.[788] German private sector groups raised their concerns about the Basel II securitization policy before the Parliamentary Finance Committee.[789] The reception within the Bundestag, however, was relatively muted.. The Parliamentary Finance Committee was aware of private sector concerns, but these demands were treated as neither urgent nor worthy of further attention.[790]

In the UK, concern over the potential consequences of the securitization policy was greater than in Germany, because of the greater extent of securitization practices in the UK market. However, this concern was not channeled through the peak national banking associations. The BBA and LIBA decried what they viewed as the unnecessarily conservative nature of the RBA securitization policy, but did not offer a systematic critique. They criticized the '56 floor', but only indirectly.[791] Instead, the UK banking community expressed its concerns through transnational organizations such as the Bond Market Association (BMA) and the ISDA.

The Japanese private sector response mirrored the British. The Japanese Bankers' Association argued that the assumptions embedded in Basel II's securitization model were unduly stringent, and that the risk weights should be lowered to differentiate sub-investment grade securitization tranches from those of higher value.[792] Not only were securitization markets expanding at the time (see Appendix 8), but some individual Japanese banks had extensive investments in securitized products.

The Canadian Bankers' Association criticized numerous aspects of the Accord's treatment of securitization. The CBA organized a Securitization Sub-Group to deal with the more

[786] See ZKA 2003, p. 5.
[787] ZKA 2003, p. 5
[788] ZKA 2003, p. 52
[789] See Bundesag January 2003, p. 45.
[790] See Bundestag January 2003, p. 171.
[791] BBA and LIBA 2003, p. 16.
[792] JBA 2003, p. 9.

technical aspects of the Basel II policy. This body was able to generate specific technical proposals, which it communicated to the Canadian regulator, the OSFI.[793] On the one hand, the CBA advocated that the 56 floor be removed, arguing to the OSFI that it would result in regulatory capital requirements more than double the amount banks already held, and making it "so punitive it could have significant impact on the merits of the business [of securitization in general]."[794] Canadian banks however perceived the policy to be the result not of the OSFI's position with respect to securitization, but rather the regulatory stance in the *United States*.[795] As such, their comments on the Basel II securitization policy offered policy alternatives as well as critique.[796]

The Transnational Campaign: The 'SA'

Most private sector criticism of Basel II's securitization policy was expressed through transnational organizations. Even the concerns of US associations, such as the American Securitization Forum (ASF), were channeled into transnational activism, though this would change over time.[797]

The principle transnational private sector critic of Basel II's October 2002 securitization draft policy was an association of associations, a coalition representing the most important national and international banking organizations. The European Securitization Forum, the American Securitization Forum, the ISDA, and the International Association of Credit Portfolio Managers (IACPM) joined together, and they jointly produced a highly detailed, 77-page critique of Basel II's securitization policies. This group, referred to informally as the 'Securitization Associations' (henceforth the 'SA'), included senior representatives from some of the largest banks in the world, such as Fortis, HSBC, Merrill Lynch, Sociète Génèrale, MBNA, BNP

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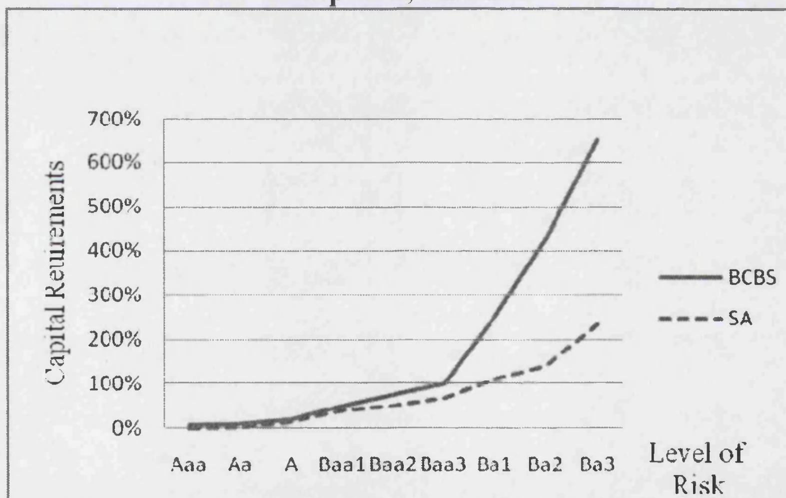
[793] Interviews 60P, 61P. See CBA 2003, pp. 26-29.
[794] CBA 2003, p. 29.
[795] Interview 61P.
[796] CBA 2003, pp. 28-29.
[797] Interview, 61P.

Paribas, and ABN AMRO, along with the US law firm specializing in securitizations, Mayer, Brown, Rowe and Maw.[798]

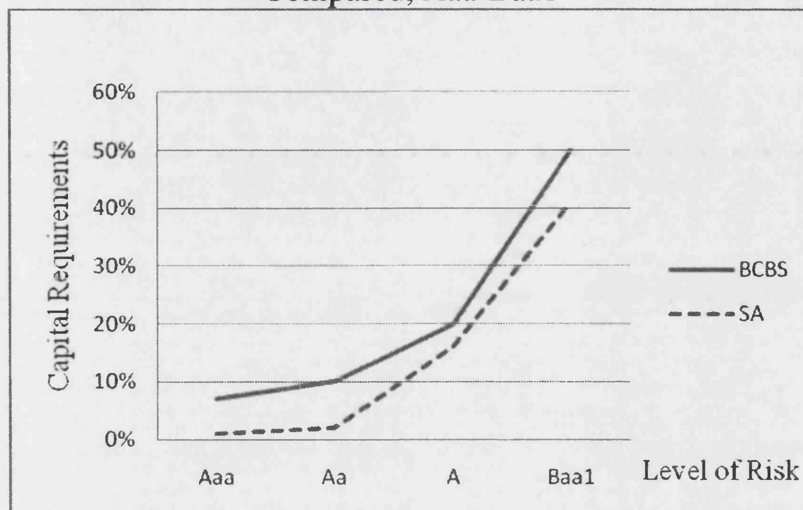
After the October 2002 draft of Basel II was released, members of the SA began to research and collect empirical data concerning the projected impact of the policy, with the help of their numerous coalition partners. Their research indicated that the policy's capital requirements were unreasonably high; consequently, the SA argued against the policy's embedded conservative assumptions.[799] Their critiques of these policies were thus highly technical, and they had mobilized considerable quantitative resources in order to make it.[800] Based on their own extensive surveying of securitization practices, they demonstrated empirically that the risk-weight assumptions of Basel II's securitization framework were unduly stringent at every point on a spectrum of risk. Figures 9.0 and 9.1 below illustrate the case that the SA presented to the BCBS in regard to 'highly granular securitization pools'.[801]

Figure 9.0: BCBS Proposals and SA Proposals Compared, Aaa-Ba3



[798] Securitization Associations January 2003, p. 46.
[799] It was determined that for the Supervisory Framework, the risk weights were too conservative and the formula too complicated – for the RBA, risk weights were found to be even more conservative. See Securitization Associations January 2003, pp. 2-4, 11.
[800] See Securitization Associations Jan 2003, p. 12.
[801] The same relationship was argued for the 'base case' as well. See Securitization Associations January 2003, p. 15 (Table 3B).

Figure 9.1: BCBS Proposals and SA Proposals Compared, Aaa-Baa1



This international campaign of the SA had the distinct advantage of meeting in 'roundtables' with the BCBS Securitization Sub-Group at the time.[802] While members of this Sub-Group, whose most active members were US regulators, were well aware of the systemic importance of securitization instruments, the SA alleged that Basel II's securitization policies would cause a liquidity crunch, which would ultimately expand beyond banks to insurance investors as well. Furthermore, they argued that the stringent modeling assumptions of the BCBS would lead to hedge funds' acquisition of non-investment grade securitization positions, which would in turn increase the level of systemic risk in the financial system as a whole.[803]

Regulators' Response

Regulators in Germany, the UK, Japan and Canada neither changed their positions nor their behavior within the BCBS. Although regulators in each of these countries took an active interest in the concerns of their banks, the securitization policy of Basel II was seen as an important international compromise. The stringency of this regulatory policy was important for Continental European (including German) members of the BCBS, and both the policy's

[802] As evinced in Securitization Associations January 2003, pp. 13-14. Corroborated in interview 84P.
[803] Securitization Associations January 2003, p. 9.

modeling assumptions and the details were viewed by all as essential for the proper regulation of securitization. No regulator from Germany, the UK, or Canada engaged in value-claiming behavior during this period.[804] And despite the extensity of the SA's campaign and their highly technical argument, their efforts did not have traction within the BCBS as a whole either. Although the SA continued to operate at the transnational level, the majority of the private sector mobilization now took place within the United States, and focused on US regulators. Two leading members of the SA, the BMA and the American Securitization Forum (ASF) took the lead in a new, nationally focused campaign.

Section 3
The US Securitization Campaign

Following the April 2003 draft of the Accord, the ASF and the BMA, both heavily involved in the SA, decided to focus on US regulators. The American Securitization Forum was actually an adjunct of the (UK-US) Bond Market Association (BMA), whose members were involved in US securitization transactions as issuers, underwriters, dealers, investors, servicers and professional advisors. They decided to concentrate their attention on US regulators for a number of reasons. Through their engagement with the Securitization Sub-Group, members of the ASF had established an ongoing dialogue with the Fed. Also, in light of the high degree of skepticism among European BCBS members, it felt it would have a greater chance of success with the Americans. Furthermore, given the Fed's seeming receptivity to empirically-based arguments, they believed they could persuade the Fed by providing its with data and analysis beyond that required to demonstrate industry-specific needs.[805] Finally, it was well known not only that the US Agencies were taking the lead within the BCBS on securitization, but also that Congress was increasingly interested in the issue.

Securitization in Congress

[804] Interviews 35R, 90R, 95R.
[805] Interview 84P.

The BMA began engaging with Congress on the Basel II securitization policy, following the failed transnational efforts. Legislative interest in the securitization proposals was strong, and interested in private sector commentary – perhaps partly because of the important political contributions coming from the industry. The Securities Industry and Financial Markets Association (SIFMA) was the parent organization to the ASF, and was the second largest contributor to House Financial Services Committee Chairman's 2002 electoral campaign.[806] Both the Senate Committee on Housing, Banking and Urban Affairs, and the House Financial Services Committee, invited a representative from the BMA to air their concerns during the June 2003 oversight hearings.[807] The BMA sent its President, Micah S. Green, to testify on behalf of the securitization industry. In his testimony to the US Senate Committee Green argued that there should be more reliance on internal risk models,[808] and that the stringent modeling assumptions of the Basel II securitization policy "lacked a proper theoretical or empirical foundation". Furthermore, he argued that Basel II reduces the incentive for banks to participate in securitizations, thus limiting banks' ability "to effectively...disseminate the risk of a particular transaction through the marketplace."[809] Furthermore, Green framed his critique in terms of its dispersed social effects. He argued that the Basel II proposals would not just hurt the securitization sector, but US *consumers* as well. According to Green, "considering who ultimately benefits from a vibrant securitization market, consumers of homes, car buyers, or other people who need capital, this is very important"; he further asserted that securitization brings "the high finance, the technology of finance down to the consumer level through lower cost home mortgage."[810] Such a framing of the securitization policy's costs was highly effective, as it co-opted concerns that a transnational regulatory policy could adversely affect the well-being of American citizens-cum-consumers. In the both the House and Senate hearings, both Chairmen were very receptive and sympathetic to Green's argument.[811] Indeed, both Chairmen,

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[806] SIFMA donated $30,999 to Chairman Oxleys Campaign Committee and Leadership PAC in the 2002 cycle. Source: Opensecrets.
[807] It is not clear whether these committees contacted the BMA, or vice versa.
[808] Congress June 2003a, p. 35.
[809] Green 2003, p. 4.
[810] Congress June 2003a, p. 36. See also Congress June 2003b, p. 48.
[811] For Shelby's exchange with Green, see Congress June 2003a, p. 51. For Bachus' exchange with Green, see Congress June 2003b, pp. 54-55.

Representative Bachus and Senator Shelby, expressed their support for the concerns of the securitization industry.[812]

Focusing on the US Regulators

Following the Congressional hearings, groups like the ASF continued to refine their arguments and strategize a way to achieve permissive regulatory policy changed. They deployed a more focused argument to the US regulators, asserting that the conservative assumptions of the Basel II model were based on the market for Collateralized Debt Obligations (CDO) market, and were derived from a questionable source. The ASF insisted that the BCBS's touchstone LGD levels had been empirically demonstrated to be much higher than bank's own internal allocation of capital, as indicated by best practice.[813] The ASF thus maintained that the 50% LGD assumption would lead to "great distortions of capital" for senior, relatively thick securitization tranches. They argued specifically that, instead of having a different LGD assumption for each different kind of securitization, a workable LGD assumption for thick, granular securitization positions ought to be between 5% and 10%.[814] Such a range was legitimized with reference to extensive empirical data, and bolstered by claims that the BCBS' work represented "unjustifiable and punitive capital requirements for securitizations."[815] Their efforts at criticism were shared by many other private sector groups, such as Bank One, KeyCorp, and the Mortgage Bankers' Association.[816]

The ASF also proposed specific alternations to the policy, such as the suggestion that, contrary to the existing instantiation of the securitization policy, banks should be allowed to use their own internal ratings for certain kinds of securitization activity. Specifically, the ASF argued that banks should be allowed to use their own internal ratings for Asset-Backed Commercial Paper (ABCP) programs. In an ABCP program, a bank establishes a special purpose vehicle

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[812] Senator Shelby had also explicitly questioned Hawke on how the securitization policies of Basel II would affect US securitization markets, given that there were much more advanced than in other countries. See Congress June 2003a, p. 26.
[813] See Securitization Associations July 2003, p 6.
[814] ASF September 2003, p. 2; See also ASF November 2003, pp. 3-5.
[815] ASF November 2003, p. 3.
[816] See Capital One July 2003, p. 6; KeyCorp July 2003, p. 3; MBA November 2003, p. 7; ABA July 2003, p. 3.

(SPV) to issue 'commercial paper', that is, a claim on corporate securities, for firms seeking a source of finance outside of bank loans or issuing stock. While the SPV is often 'legally remote' (that is, remote from bankruptcy) from the bank that establishes it, banks try to 'sweeten the deal' by providing the *buyers* of the commercial paper with services such as lines of liquidity or credit enhancement. Because of the nature of this practice, most ABCP programs were not rated by external rating agencies, but rather were internally risk-assessed, i.e. within the banks themselves.

Through their engagement with regulators, the ASF learned that regulators were concerned about banks' ability to address correlations in their internal systems. The ASF argued that this concern was unwarranted, since banks' own internal risk estimates were believed to be just as good, if not better, than those provided by rating agencies. [817] Furthermore, the ASF argued to the US regulators that banks' internal rating system for ABCP conduit transactions was a superior alternative to the Basel policy's complexities. [818] Their critique was actively shared by the American Bankers' Association and individual US banks as well.[819] The BMA also shared their critique, and underlined to the Fed how vital the commercial paper market was at the time. Such a claim was easily validated, as the commercial paper market represented the largest segment of the US money market – 2.665 trillion at the end of 2000 – and was expanding rapidly at the time.[820]

Over time, specialized associations like the ASF were joined in their criticism by other private sector actors, such the real estate industry. Three private sector associations in the US were particularly concerned about the potential threats to their industries: the Real Estate Roundtable (RER), the Commercial Mortgage Securities Association (CMSA), and the Mortgage Bankers' Association (MBA). While the RER and MBA drew members from the real estate industry who were significantly invested in securitization processes, the CMSA's members focused on business associated with commercial real estate debt.[821] As Appendix 8 illustrates, the Commercial Mortgage Backed Securities market was very large at this time, with $60 billion

[817] ASF September 2003, p. 3.
[818] Securitization Associations July 2003, p. 11.
[819] See ABA July 2003, p. 6; PNC July 2003.
[820] BMA May 2001, p. 2
[821] The CMSA contained a very diverse membership base, including both lenders and investors in CRE debt, mortgage bankers, mortgage servicing firms, law firms that represent CRE debt business, bond underwriters, rating agencies who rate CRE debt, and accounting firms.

in new issuance in 2002 alone. These real estate groups were particularly concerned that these markets would be adversely affected by Basel II's failure to differentiate between CMBS instruments and other forms of securitization, such as Collateralized Debt Obligations (CDOs).

The RER, CMSA and MBA thus argued that Basel II should differentiate between these practices to accommodate the special low risk properties of the CMBS market. The RER and CMSA worked and coordinated their positions in presentations to both to regulators and Congress.[822] Referring to empirical evidence, they claimed to the US regulators that whereas BB-rated defaults averaged over 11% for CDO and ABS instruments, for CMBS, the figure was only a fraction of that, at .43%.[823] The MBA also made an empirical case, and added that because banks, life insurance firms, and pension funds were all key investors in the CMBS market, "the financial security of average Americans...is affected by the security and liquidity of the real estate debt market."[824] The RER and the CMSA focused their pro-active campaign on the Fed, as it was understood that this body constituted the central driving force behind the securitization framework. Members of the RER and the CMSA met with Ferguson and his staff repeatedly to discuss their concerns, and were given some reassurances that should the right kind of data be forthcoming, the Fed would consider having the policy changed.[825]

Regulators' Response

The US Agencies understood securitization not only as a vital regulatory issue, but also as one impacting the competitiveness of US banks. While the Fed was somewhat sympathetic to certain private sector critiques, the OCC was more skeptical.[826] Although the Fed remained conservative in the face of uncertainty, it was also receiving considerable negative feedback, and viewed private sector mobilization as an important signal that the Basel II securitization policy might damage US securitization markets.[827] Securitization was not only a booming practice in the US at the time, it was also seen to be an important systemic driver of risk mitigation at the

[822] Interviews 44P, 50P.
[823] RER and CMSA July 2003, p. 12.
[824] MBA July 2003, p. 2; Interview 50P.
[825] See RER and CMSA November 2003, p. 4. See also Croke and Roberts September 2003
[826] Interview 95R.
[827] For example, they were skeptical of the claims that CMBS' were less risky. See BCBS October 2002b, p. 6; Dev 2002.

time. Consequently, at the October 2003 meeting of the BCBS in Madrid, the US delegation, led on this issue by the Fed, announced that the Basel II securitization policy needed to be revised. As was the case with the expected losses and credit cards policies described in Chapter 8, the Fed also asserted in this instance that failure to revise the policy would inhibit the US's ability to ratify the Accord.

Despite raising this concern at the 11th hour, the rest of the BCBS heeded the US delegation's demand. The Chair of the BCBS at the time, Jaime Caruana, was well aware of the substantial concern surrounding securitization proposals at the time, and thus was sympathetic.[828] Other European members were also well aware of the broad concerns over securitization, but they were also had stringent preferences regarding securitization, and were consequently more skeptical.[829] Despite these differences of position, however, the Continental Europeans decided to let the US delegation revise the securitization framework largely as it saw fit, and did not resist the value-claiming behavior of the US delegation. The BCBS acknowledged the securitization issue as crucial to the US delegation. While the German delegation in particular was not entirely sympathetic to the US position, there was an implicit mutual understanding that they would not target vital US issues.[830] There is some possibility that German delegates were cooperative in this way because of the fact their previous victory with SMEs – raising the spectre of issue-linkage in the negotiation (this is attended to analytically in Chapter 10).

The BCBS agreed at this meeting that they would simplify the treatment of securitization by eliminating the Supervisory Formula and replacing it with a less complex formula.[831] Just as importantly, however, the US was granted the autonomy to revise the securitization framework largely by itself. [832] The Fed was granted this autonomy not only because there was impatience for further negotiation, but also because securitization was seen as a highly technical subject and, as highly important to the US, they had the greatest incentive to 'get it right'.[833] There was thus confidence that the US delegation – principally the Fed – could revise the securitization

[828] Caruana September 2003, p. 1.
[829] Interviews 90R,95R.
[830] See Bundestag October 2003, p. 59
[831] BCBS October 2003, p. 1.
[832] Interviews 35R, 90R, 95R. See also Bundestag October 2003, p. 66.
[833] Interview 95R; See also Bundestag May 2003, p. 52; Bundestag October 2003, p. 66.

framework appropriately, especially given the structural importance of securitization markets in the US – the fact that the US had (by far) the largest securitization markets.[834]

Continued Campaigning

After the BCBS announced that the securitization policy would be revised, a plethora of relatively silent groups began to speak out alongside the ASF, and all the while the issue remained highly salient to Congress, who wrote and put pressure on the US regulators.[835] In this context, the ASF sought to provide US regulators with information that would persuade them to advocate permissive regulatory policy change.[836] After surveying their membership, they communicated to the US regulators that the 56-floor would require them to hold "nearly double the economic capital" than they otherwise held, perhaps even more.[837] The ASF also actively raised its proposals for ABCP programs, and argued that allowing banks to use their own internal ratings would address many of the substantive concerns of the industry as a whole. This point was also advocated bilaterally by many of the largest US banks. [838]

The RER and CMSA also provided more data to the US regulators, obtained not only from their members but also from rating agencies such as S&P, Moody's, Fitch, and from the real estate capital markets of the US investment banks Morgan Stanley and Lehman Brothers. This data suggests that CMBS exposures were equivalent to, or in some cases even less risky than, corporate exposures, and that the ratings of these exposures was substantially backed up by several layers of quality control.[839]

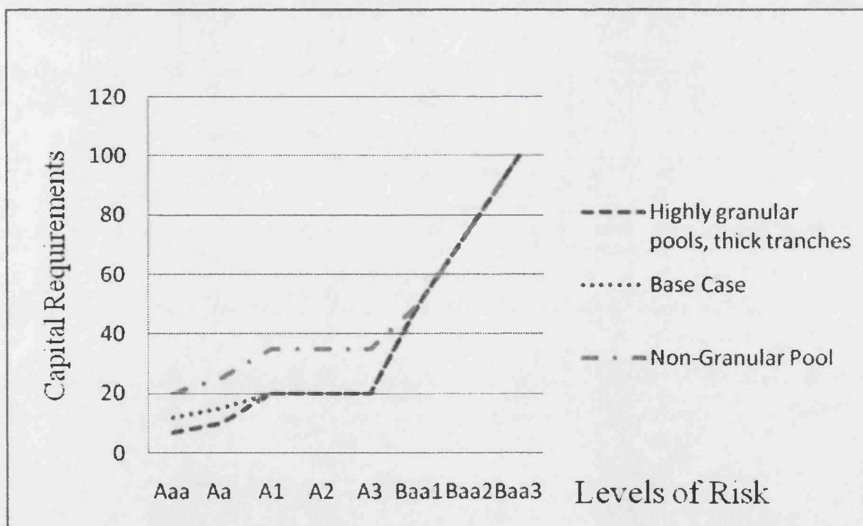
Regulatory Policy Outcomes

[834] Interview 95R.
[835] See FSR November, 2003, p. 8; Merrill November 2003, p. 5; PNC November, p. 19; Bank of America November 2003, p. 53. See also Congress November 2003, p. 9.
[836] According to some accounts at the time, the Fed was very receptive to detailed information at this time. Interview 53P.
[837] ASF November 2003, pp. 8, 53.
[838] See for example ASF November 2003, pp. 15-17. JPMC November, 2003, pp. 10, 56; CSFB December 2003, p. 4; ABA November 2003, p. 12.
[839] Specifically, they argued that the historic default rate was lower – see figures 4a and 4b in RER and CMSA November 2003, pp. 2, 11, 19, 20.

After several months of technical work on the securitization policy, the US regulators presented the rest of the BCBS with their proposals. These changes were not controversial within the BCBS, and were announced by the BCBS Secretariat after a relatively uneventful meeting in January 2004, and were later affirmed in the final June 2004 document. These changes reflect an instance of circumscribed permissive regulatory policy change, as some features of the Basel II securitization policy were changed, while others were not.

There were significant changes to the securitization model assumptions. Not only was the Securitization Formula simplified, but some of its parameters were altered as well, making it less stringent and easier for banks to use.[840] For the RWA approach, the risk weights for senior securitization tranches were significantly lowered. Figures 9.2 details the original Basel II proposal in this respect, circa April 2003. Figure 9.3 illustrates the systematic lowering of the risk weights in the January 2004 re-draft of the securitization framework.[841]

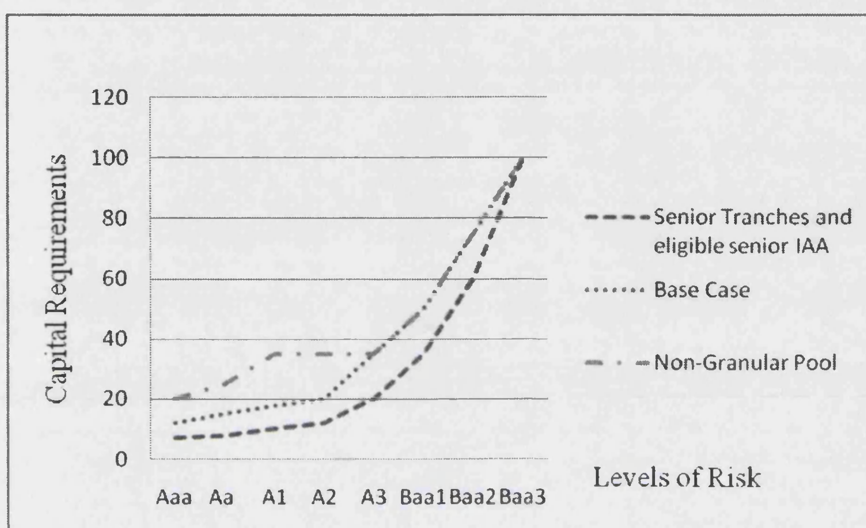
Figure 9.2: Risk Weight Curves for Securitized Assets in the April 2003 draft of Basel II



[840] The BCBS proposed in January 2004 to lower the value of this key parameter from 1000 to 75. However by June 2004 in the final Basel II document Tau is put back to 1000. See BCBS January 2004a, p. 3; BCBS June 2004, p. 133.

[841] These data are from BCBS January 2004c, p. 6. These changes remained in the final Accord's draft. See BCBS 2004, pp. 128-132.

Figure 9.3: Risk Weight Curves for Securitized Assets in the June 2004 draft of Basel II



The argument regarding ABCP programs was also heeded. On the basis of the information that private sector groups provided, the Fed had accepted the argument that ABCP programs should be given special permissive treatment. The Fed reversed its former position on how regulatory capital was to be measured for unrated securitization exposures, and an 'Internal Assessment Approach' was formulated. This new feature of the Basel II securitization policy stated explicitly that, when dealing with liquid facilities and credit enhancements associated with ABCP conduits, banks would be allowed to derive their *own* risk weights for unrated exposures by mapping their own internal risk assessments to external credit ratings.[842] The BCBS claimed this measure reflected an approach "more aligned with industry practices."[843] Indeed, this sentiment had been exactly what US private sector groups like the ASF and others had been arguing. While there

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[842] BCBS January 2004a, p. 20; BCBS January 2003c, p. 2, pp. 9-11.
[843] Banking and Financial Services Policy Report 2004.

were some details and open questions that concerned US private sector groups, the overall picture was a positive one.[844] The ASF thanked the BCBS for heeding their longstanding critique.[845]

Despite these significant changes to the Basel II securitization policy, some stringent aspects of the policy remained. The regulatory capital floor for securitizations was left in place. While the BCBS discussed the possibility of removing the floor, the body was not persuaded of the merits of a lower floor.[846] Indeed, broad consensus remained regarding the value of the 56 floor.[847] As illustrated in Figure 9.3 above, the lowest risk weight possible for securitization transactions remained at 7%. Furthermore, the securitization policy was not differentiated to accommodate CMBS markets. The BCBS had discussed the issue seriously, but it ultimately decided that this policy change would not be a good idea.[848] The reasons for the rejection of this campaign were relatively simple: the RER and CMSA had failed to convince the Fed.[849] Furthermore, the kind of differentiation that the CMBS campaign advocated would not "improve materially the [risk-based assets'] overall sensitivity to risk," thus the policy did not have traction within the BCBS as a whole.[850]

Conclusion

This chapter has examined the various private sector campaigns that contested Basel II's securitization policy. This chapter began by describing campaigns that took place at the national level in Germany, Canada, the United Kingdom, and Japan, and also at the transnational level. The most extensive of these campaigns was that of the 'Securitization Associations' (the 'SA'), which channeled the concerns of many national associations, including groups in the US. Each of these campaigns exhibited different characteristics, as seen in the Configuration Table below; however, none of them were successful in achieving permissive regulatory policy change. These

[844] See FOIA February 2004.
[845] ASF March 2004. See also Structured Finance International 2004.
[846] See BCBS January 2004c, p. 7.
[847] See April 2003, p. 116 and BCBS June 2004, p. 132.
[848] See BCBS January 2004c, p. 7.
[849] See BCBS January 2004c, p. 7.
[850] See BCBS January 2004c, p. 7.

cases provide further evidence that private sector groups are not always successful at achieving influence, despite concerted efforts

Following the failed transnational efforts, US private sector groups became extensively mobilized beginning in the spring and summer of 2003, and launched a considerable campaign regarding the securitization policy. As an example of a successful national private sector campaign, this campaign offers support for the Mobilization, Information Network, and Legislative Oversight hypotheses. Each of these underlying conditions appears to have played an important role in first influencing the US regulators – especially their *position* on the issue within the BCBS – and then in securing permissive regulatory policy change at the BCBS level.

While the precise reactions of US regulators to private sector groups' detailed arguments are not known, the evidence suggests that the US regulators were very receptive to the private sector securitization campaign. Interestingly, when the US delegation engaged in value-claiming behavior within the BCBS, they were not met with resistance by the rest of the BCBS. US private sector groups thus played an important role in driving through a variety of changes to the Basel II securitization policy by providing the Fed with substantial information. However, the evidence also suggests that the principle architect of these changes, the Fed, was not resistant or 'pressured' into such changes, but rather was receptive and cautious regarding what it saw as an important part of the US banking system. The Fed's receptivity, and the fact that the rest of the BCBS accommodated the Fed's demands because of the shared belief in the importance of securitization to the US banking system, offers some empirical support to the Mobilization hypothesis. The structural importance of US securitization markets was also widely recognized within the US and among the rest of the BCBS – suggesting some support for the Structural Power hypothesis. The presence of supportive legislative oversight may have played a role in influencing the US regulators' decisions, but the evidence in this regard is more 'correlative' than 'causal'. The US regulators had been long exposed to the ASF's arguments, but it was only in the summer of 2003, during a period of supportive legislative oversight, that the regulators decided to take steps to change the securitization policy. While the US securitization campaign successfully influenced the content of Basel II, the actual extent of permissive regulatory policy change was circumscribed – as denoted in the fuzzy-set score of .67 for this case in the Configuration Table below.

Configuration Table for Private Sector Campaigns and their Outcomes in Chapter 9

Regulatory Policy	Country	Possible Interdependency	PRPC	Regulator Influenced	Regulator Changes Position	Value-Claiming Behavior	Mobilization	Coalition	Information	Non-Bank Allies	Enemies	Legislative Oversight (Supportive)	Legislative Oversight (Oppositional)
Securitization	DE		0	0	0	0	0.33	0.67	0.33	0	0	0.67	0
Securitization	UK		0	0	0	0	0.67	0.33	0	0	0	0	0
Securitization	NI		0	0	0	0	0.33	0.67	0.33	0	0	0	0
Securitization	CA		0	0	0	0.33	0.33	0.33	0.33	0	0	0	0
Securitization	TN		0	~	~	~	1	1	1	.67	0	~	~
Securitization	US		0.67	0.67	0.67	1	1	1	1	.67	0	0.67	0

Chapter 10

Across-Case Analysis

While previous empirical chapters have engaged in detailed process-tracing analyses of private sector campaigns targeting different regulatory policies in Basel II, this chapter engages in across-case analysis. Given the diversity of contexts in which campaigns took place, comprehensive across-case analysis can help to ascertain whether or not general patterns of influence exist. Furthermore, evaluating patterns which exist across cases helps to discern the possibility that some aspects of the power relationship between private sector groups and regulators might have been missed due to the particular limitations of process-tracing analysis (as discussed in Chapter 2). In particular, the role of institutions and dimensions of structural power are explored – contextual aspects of campaigns that are not amenable to the method of process tracing.

This chapter is divided into five sections. In Section 1, I provide a stylized summary of the findings in Chapters 3-9. I conclude that evidence across cases suggests strong support for the business conflict hypothesis, but that in general there is evidence both in support and against most hypotheses of the study. In Section 2 I engage with two methodological issues that are important to address before proceeding with systematic across-case analysis: dealing with possible interdependencies across cases, and considering structural power effects at the agenda-setting phase of Basel II's development.

In Section 3, I use fsQCA to assess the necessity and sufficiency of individual conditions – both those which were 'observed' in earlier process tracing, and also structural power variables. In Section 4, I use fsQCA to assess the *combined sufficiency* of different conditions, in order to assess whether or not there is a particular *combination* of conditions which are sufficient in explaining private sector influence. This analysis finds no evidence for a general combinatorial pattern within transnational campaigns, but it does find one for the national

campaigns: that is, a particular 'recipe' of conditions which are jointly sufficient in producing permissive regulatory policy change (PRPC).

Section 4 introduces several institutional variables into the analysis and considers their possible role in producing PRPC. I use fsQCA and statistical regression analysis to assess such relationships across-cases, and carry out further robustness checks to consider how strong the empirical findings are under different conditions. In Section 5, I explore some of the mechanisms at work across cases, paying particular attention to the intermediate dependent variable, which assesses whether the national regulator was influenced or not.

Section 1
Evaluating General Patterns

The empirical chapters in this study provide an extensive resource for engaging in across-case analysis. In Table 10.0 below, these hypotheses are cross-configured with each of the empirical chapters in the study based on empirical support found through process tracing analysis. An 'S' indicates that there was empirical support for a given hypothesis, while a '~' indicates that empirical material with which to test a given hypothesis was unavailable for that particular Chapter.[851] A lower case 's' indicates that the hypothesis was supported in that this factors' absence was associated with non-influence, as per the case of business conflict in many of the proceeding chapters.

Table 10.0: Evaluating Hypotheses in the Study and on the Basis of Within-Case Evidence

[851] Such an 'overview'-type evaluation of hypotheses within a large IPE study has precedent in Drezner 2007, pp. 206-207.

		Chapter 3- Transnational Campaigns	Chapter 4- CRE	Chapter 5- SMEs	Chapter 6- Operational risk	Chapter 7- Real Estate	Chapter 8- EL, Cards	Chapter 9- Securitization
	Name of Hypothesis	*Hypothesis Evaluation*						
H_1	Legislative Oversight	~	S	S		S	S	S
H_2	Mobilization	S			S		S	S
H_3	Information Network	S	S		S		S	S
H_4	Structural Power	S				S		S
H_5	Business Conflict	S	S	s	S	S	S	S
H_6	Coalitions	S	S	S	S	S		
H_7	Transnational Pathway	S	~	~	~	~		
H_8	National Carrier Pathway	~	S	S	S	S	S	S

As this table illustrates, within-case evidence existed for a variety of hypotheses, usually in conjunction in instances when private sector influence occurred. This stylized summary of results illustrates what has been made evident throughout the chapters of this study: that there is considerable contingency and diversity in the extent to which private sector groups have been able to achieve permissive regulatory policy change. Such a pattern is made even more evident when one considers that in instances where private sector influence did not occur, many of the variables associated with each of these hypotheses were present, indicating falsifying evidence.[852] Rather than providing a stylized description of such falsifying evidence, which is inevitably highly complex, I rely on fsQCA below to evaluate these patterns across cases.

As this table illustrates, the process tracing analysis of earlier chapters found support for a number of hypotheses in the study. In particular legislative oversight played an important role in five of the six national campaigns investigated, suggesting strong support for this hypothesis. We have seen that, in many of these campaigns, regulators reacted differently to private sector

[852] The notable exception to this is the Business Conflict hypothesis, which received consistent support across chapters.

demands once legislative oversight was present. The mobilization of private sector groups was also found to be present in each of the successful campaigns examined, suggesting strong support for this hypothesis as well. Private sector groups communicated their preferences and concerns to regulators at both the transnational and national levels, and this such communication was seen, on a number of different occasions, to affect the responsiveness of regulators and in turn produce permissive regulatory policy change. However, it did not do so automatically, and would appear to be dependent upon other factors to be effective.

The provision of information also played an important role in a number of successful campaigns, although as we have seen it did not play an equal role in all cases. Campaigns such as the Operational Risk campaign and the Securitization campaign in the United States examined in Chapters 6 and 9, respectively, showed strong support for this particular mechanism of influence, as private sector groups strategically used studies and data to convince regulators to change course and to adapt policies in line with their own preferences. At the same time, we have also seen how in campaigns such as the first HVCRE campaign in the United States and the SMEs campaign in Germany, the provision of information was not an important part of the campaign's success. There has been evidence for the Structural Power hypothesis as well, in that Chapter 9 demonstrated that the structural importance of credit cards and securitization markets played a role in changing previously stringent regulatory policy decisions. In Chapter 3's analysis of the W-factor, structural power was also considered to be a plausible factor in private sector influence. While private sector coalitions played an important role in some private sector campaigns, the evidence of previous chapters suggests that this factor was not a critical one (though this will be analyzed systematically below).

While this simplistic across-case evaluation reveals some patterns, by using the data contained in the Configuration Tables within each chapter, a systematic across-case analysis is possible using the methodologies described in Chapter 2. In what follows I investigate the necessity and sufficiency of individual conditions, as well as joint sufficiency, and I employ a combination of fsQCA and statistical regression analysis to assess the robustness of the findings. I also investigate the potential hitherto unobserved role of institutions. Before such comprehensive across-case analysis can take place, however, the next section investigates the issue of interdependencies across cases, discusses the possibilities of structural power taking

place at the agenda-setting phase, and establishes a number of structural power variables that will be used in subsequent across-case analysis.

Section 2
Addressing Interdependencies and Structural Power at the Agenda-Setting Phase

Before systematic across-case analysis can take place, an important issue to address is the issue of possible across-case interdependencies. As was discussed in Chapter 2, two kinds of interdependencies need to be considered: 'spillover effects', and 'issue linkage'. In order to address spillover effects, all cases marked with an 'I' in the configuration table are collapsed into one single case using the logical OR procedure specified within the QCA literature.[853] I treat instances where private sector groups were unsuccessful in their efforts to achieve permissive regulatory policy change, despite an earlier successful campaign, as a unique kind of case which is analyzed separately, and referred to as 'after-campaigns'. With these changes made, I employ two different datasets – a dataset which includes interdependencies, as reported in the Configuration Tables of previous chapters, and a dataset with the spillover effects addressed through the logical OR procedure described in Chapter 2. FsQCA analysis below will employ these different datasets in the same initial analyses; however, in general the dataset with spillover effects eliminated will be considered the superior data, because possible interdependencies will be addressed, thus minimizing distortions.

Interdependencies are also a concern by means of 'issue linkage', whereby the negotiation of one policy is dependent on the negotiation of another policy. As was discussed in Chapter 2, a variety of aspects of the Basel II policymaking process minimize the potential for such an interdependency across policies, since most regulatory policies were designed as discrete entities, not only at different points in time, but also by different individuals in different subcommittees within the BCBS. Over the course of detailed process tracing, it was only in the negotiation of three policies that any evidence of issue-linkage was found. For the negotiation of the W-Factor (explicated in Chapter 3), the removal of this policy from Pillar I of the Accord

[853] This involves taking the highest value for a given range of the same variable, and is a common practices in the fsQCA literature.

occurred alongside the implicit agreement that another aspect of the Accord would be addressed more seriously than it had been, namely procyclicality. The removal of the regulatory capital floor of the operational risk policy (examined in Chapter 5) was also motivated in part not by factors endogenous to that particular policy, but by decisions made on other aspects of the Accord. Finally, for the negotiation of the securitization policy – specifically during the time of the strong US demands in October 2003 – there is also some evidence of issue-linkage (in terms of negotiation with Germany at least), although the extent to which this issue-linkage had a causal impact on the negotiation of the securitization policy outcome is questionable. These three instances of possible issue-linkage are taken into account in the analysis below by removing them from the sample of cases which analyze relations of necessity and sufficiency between the intermediate variable 'regulator influenced' and the main dependent variable, 'PRPC'.

Addressing Structural Power at the Agenda-Setting Phase

Another issue that should be addressed is structural power at the agenda-setting phase of Basel II's development. It is also important to address this here because such an analysis helps to establish some of the *policy-level* structural power variables used in subsequent analysis.

To what extent were the initial regulatory policy proposals affected by conditions of structural power? As Figure 2.0 in Chapter 2 described, this possibility is a very difficult dynamic to measure empirically, because there is no 'prior' regulatory policy position with which to compare the actual regulatory policy proposal. Consequently, an empirical analysis of structural power at this stage in regulatory policymaking is limited by an unknown hypothetical. Despite this serious empirical limitation, it is possible to investigate the relative stringency or permissiveness of regulatory policies when they were first proposed. To conduct this analysis, I considered three forms of policy-specific structural power that are associated with each of the business lines of the twelve regulatory policies considered in the study. Such an approach follows the methodological approach of assessing influence by 'degree of preference attainment', since causal processes cannot be observed.[854]

[854] See Dür 2008a: 567.

Table 10.1: Structural Power Properties Associated with Regulatory Policies' Initial Positions

	Regulatory Policy Examined	Costliness of Initial Policy Proposal	Structural Power Indicator		
			Importance to Financialized Accumulation	Potential mobility of business line	Size of Associated Business Line
1	Full internal models	~	~	~	~
2	Internal Ratings approach	.33	1	0	1
3	Interest Rate Risk	.67	0	0	1
4	W factor	.67	1	1	1
5	Operational risk	1	0	.33	1
6	Commercial real estate	1	.33	0	.33
7	SME Lending	~	~	~	~
8	HVCRE	1	0	0	0
9	Residential mortgages	0	1	0	1
10	Revolving (Credit Cards)	.67	.67	.33	.33
11	Expected Losses	1	0	0	1
12	Securitization	1	1	.67	.33
	Other Retail	0	.67	0	.67

Based on substantive knowledge of each of these regulatory policies, I gave a fuzzy-set score to each of the 12 regulatory policies for the *costliness* of the *initial* regulatory policy proposal, i.e. the first time the respective policy was put onto the agenda. By costliness I mean to assess whether or not the policy increased regulatory capital requirements. Such costliness is derived from the early quantitative impact studies (QISs) conducted on policies, or substantive knowledge of their content when QIS data is not available. The internal ratings approach described in Chapter 3 and the initial residential mortgage policy described in Chapter 7 were both policies which when initially proposed were not costly – indeed capital was expected to *decrease* by 5% for internal ratings and 60% for residential mortgages under their respective

initial proposals.[855] However most other regulatory policies were costly at the initial proposal stage. The initial regulatory policy proposal for securitization for example was estimated to increase regulatory capital requirements by 108%.[856] As Chapter 3 outlined, the operational risk capital charge was initially set at 20% of *total* regulatory capital – a substantial increase in regulatory capital from the status quo at the time (hence why it was so strongly resisted). For this reason, these policies are coded as 1 in terms of costliness. Other regulatory policies witnessed an expected increase in regulatory capital, but at more moderate levels. For the initial credit card policy, for example, regulatory capital was expected to increase by 14%.[857] Likewise, for the interest rate risk policy and the W-factor, while the initial regulatory policy proposals were costly, they were not extremely costly when compared to the other policies 'full in' this set (and thus are valued at .67).

I also include a variable which assesses the potential mobility of a regulatory policies' business line. Such a coding entails using knowledge about global market shares as well as the costs of moving business lines to other jurisdictions outside the BCBS' purview.[858] Most of the regulatory policies listed above are not potentially mobile in this respect – commercial real estate, or the internal ratings of banks' processes are highly unlikely to be relocated outside the G10. Neither is it likely that markets for these products/practices would locate elsewhere should the G10 impose costly regulatory requirements: to access commercial real estate markets in the US, one has to operate in the US; to operate internal ratings of a G10 bank one must *be* a G10 bank, etc. The significant exceptions to this are the W-factor and securitization policies. As Chapter 3 established, the W-factor policy involved the residual risk associated with derivatives transactions. While in 2001 BCBS countries have 90.5% of the world share of premium traded derivatives contracts within their markets, they only have 71% of the world *volume* of derivatives exchanges. Because the W-factor involved a regulatory cost on transactions, it is conceivable that derivatives markets could have migrated outside the BCBS in some fashion in response to the costliness of the regulatory policy proposal. The securitization policy proposal

[855] See BCBS November 2001a, p. 3 (Table 1). A small number of banks would have increased capital requirements, but the majority would decrease. See BCBS November 2001a, p. 6; See BCBS November 2001b. For residential mortgage capital requirements, see BCBS May 2003, p. 29.
[856] See BCBS November 2001, p. 5
[857] See BCBS May 2003, p. 29.
[858] In some other empirical examinations of the structural power hypothesis, the variation in mobility is understood to affect policy outcomes - see Walter 2000, p. 67.

can also be associated with potential mobility, because securitization instruments could change locality on the basis of special purpose vehicles outside the G10. The ease with which such a change could be done arguably varied according to countries' relationships with offshore entities, a factor which varies by country and not policy (this is addressed in a separate variable below). The securitization policy was coded at .67 rather than 1, because securitization markets, and the liquidity associated with them, were overwhelmingly concentrated in the BCBS (especially within the USA, as Chapter 10 illustrated). Thus, there would be significant market access and liquidity costs associated with potential mobility.[859]

I also included a variable for the relative size of each regulatory policy proposal. The relative average size of the business lines is calculable by the BCBS's own quantitative impact studies, which measured the allocation of regulatory capital within the average large G10 bank under the de facto norm (i.e. Basel I). Because Basel I allocated capital relatively evenly across different business lines, these capital allocations can serve as a rough proxy for the size of the business lines associated with each policy. Securitization and revolving retail exposures were both relatively very small, at between 1.5% and 2% and between 2% and 2.8% of total capital.[860] Other business lines were quite large and occupied an extensive proportion of banks' portfolios – such as residential mortgages (11%-11.8%), and SME lending (9.8-18%).[861] Other regulatory policies do not have quantitative figures associated with them, but can be judged based on substantive knowledge of the policy area and given their review in previous chapters. The internal ratings approach, for example, had to do with the vast majority of internal bank practices, and therefore is within this set. So is the W factor, since derivatives activity represented a large component of bank's business lines at the time. The commercial real estate policy described in Chapter 4 was relatively limited in its reach, as was the HVCRE policy described in Chapter 7.[862]

Finally, I included a variable which assesses whether or not a given business line associated with the regulatory policy in question was important for financialized accumulation or not at the time. The concept of 'financialization' has been used by social scientists to make

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[859] This is further supported by Structured Finance International 2002 (p. 46), 2003 (p. 54) and 2004 (p. 52).
[860] See BCBS May 2003, p. 29; QIS 5, p. 22.
[861] See BCBS May 2003, p. 29; QIS 5, p. 22.
[862] See also BCBS May 2003, p. 32.

empirical and theoretical sense of the rise of finance in contemporary capitalism "by evaluating how individuals, firms and the domestic economy are increasingly mediated by new relationships with financial markets".[863] It is the primacy of financial sector accumulation that is associated with this phenomenon, as the "prevalence of the dictates of finance capital" is considered "a structural feature of capitalism."[864] The literature on financialization is highly variegated in its content and emphasis; however, there is a central locus of empirical indicators used to describe and/or assess the extent to which financialization has taken place. The phenomenon is associated with high rentier incomes,[865] high returns on financial assets and the general profitability of the financial sector.[866]

Coding these values entails some qualitative judgment, and thus I rely on external criteria within the literature on financialization. While analyses of financialization are often made with respect to specific state contexts, or sometimes to the global economy as a whole, it is also the case that specific financial instruments and practices are understood to be critical to financialization. Several financial instruments and practices stand out in particular within this literature, especially asset securitization.[867] While on this basis it is uncontroversial (at least by the standards of the existing literature) to associate the Basel II securitization policy with financialization, so too are the policies with business lines which fed securitization markets at the time, such as residential mortgage lending.[868] In addition, derivatives markets are also widely viewed as a fundamental component of financialization, and are alluded to repeatedly in the existing literature.[869] Consequently, each of these areas is considered fully in the set of policies associated with financialization as identified with the literature. Credit cards are another financial instrument associated with financialization, although this is done less often than with other financial instruments in the literature, and the credit card policy is given a .67 score ('in but not fully in' the set).[870]

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[863] See Montgomerie 2009, p. 1, from Engelen 2008, p. 111
[864] Langley 2004, pp. 540-41.
[865] Epstein and Jayadev 2005 50, 67-68; Power, Epstein and Albrena 2003
[866] Froud et. al. 2000, p. 100; Arrighi and Moore 2001, pp. 61-62; Langley 2004; Dumenil and Levy 2005, 2007; Lipetz 2001; Raviv 2008, pp. 297-98
[867] See, for example, Sassen 2010, pp. 36-37; Montgomerie 2008; Montgomerie 2009; Langley 2006
[868] This point is described in Chapter 7, and is also made in Langley 2006.
[869] See Pryke and Allen 2000; Bell and Sekine 2001, pp. 51-52; Dodd 2005; Pollin 2007, p. 148; Wigan 2010; Bienefeld 2007, pp. 23-24
[870] See Montgomerie 2006; Montgomerie 2007; Montgomerie 2009.

This analysis also raises the question of whether or not the policies selected for analysis may themselves select on an unknown factor which distorts these results. Of particular interest is the possibility that regulatory policies which were initially permissive were excluded, since cases would be positive evidence for structural power at the agenda-setting phase. To assess this possibility, I searched the Quantitative Impact Studies to specifically find regulatory policies in which regulatory capital was expected to decrease when the policy was initially proposed. The only regulatory policy which fulfilled this criteria but was not included in the study was 'other retail' lending, the part of banks' retail lending portfolios that is not associated with either revolving retail exposures or mortgage exposures. The 'other retail' policy was expected to decrease capital requirements by 34-41%, and thus as indicated in the last row of Figure N above. I therefore coded it as non-costly.[871] Assessing the importance of retail bank lending for the financialization is possible since the literature on financialization has identified rising household indebtedness as a critical component of the financialization process.[872] While there are many sources of household indebtedness during this period. One source is lines of credit from banks, a source of personal liquidity which is captured in banks' retail lending portfolios. Consequently, I coded other retail as within the set of policy areas associated with financialization. Assessing the potential mobility of this business line is not difficult, given the fact that retail lending is highly localized in character, is not syndicated through banking groups, and is not a concern of international banking groups.[873] Regarding the size of this policy, non-mortgage, non-revolving retail lending composed approximately 7-8% of bank's total capital, and thus I coded it as in but not fully in the set of large policies (.67).[874]

Table 10.2: Measuring Explicit Connections between Structural Power and the Absence of Costliness

	Policies Included in Study	Policies Included in Study Plus 'Other Retail'

[871] BCBS May 2003, pp. 23-29.
[872] Montgomerie 2009, pp. 11-13.
[873] Interview 55P.
[874] See BCBS May 2003, pp. 23,29.

	Test of Necessity	Test of Sufficiency	Test of Necessity	Test of Sufficiency
Importance to Financialization	.88	.47	.82	.53
Potential Mobility of Business Line	**.25**	**.28**	**.24**	**.28**
Large of Associated Business Line	1	.38	.91	.43

These results reveal mixed indications that structural power was at play in the agenda-setting phase of Basel II's development. Policies important to financialization and associated with large business lines appear to be necessary, but not sufficient, conditions for the absence of costliness. This might be interpreted as the BCBS 'backing off' from stringent regulatory policy decisions for large and systemically important regulatory areas. There is no evidence, however, that the potential mobility of business lines associated with different policies played a role as a structural determinant of costliness at the agenda-setting phase, either in terms of necessity or sufficiency. As Table N above demonstrates, results are not affected when the 'other retail' policy is included in the fsQCA. A test of joint sufficiency also revealed that there was no combination of conditions which was logically sufficient above the standard 75% threshold when 'other retail' was included or not.[875]

Understood in its most comprehensive sense, structural power is hypothesized as affecting not only the policies proposed on the agenda, but also policies that were *not* on the agenda. Understood in this strict sense, however, there is no clear empirical strategy which can assess the efficacy of the structural power hypothesis, since such an empirical test confronts a substantial observational equivalence problem. Put simply, when one considers the range of potential factors which *might* explain why a phenomenon did *not* occur, there is not only an expansive possible list, but no way of knowing how that list should be delimited. In the context of Basel II, one could plausibly ask (to use a hypothetical example) why a special new, stringent, regulatory capital requirement for predatory lending was not put on the agenda, or indeed was never even discussed. It may be a fruitful line of inquiry to ask why such a policy was not on the agenda. However, it is not a question that can be investigated from a positive empirical point of view, because there are no observed phenomena (let alone variation) to be explained. Latour's

[875] The presence of financialization and large business line, combined with the absence of mobility yielded a .73 consistency score. When 'other retail' is excluded from the sample, this decreases to .67.

argument that non-observable phenomena may be irrelevant if they leave no trace seems prescient here.[876]

In order to systematically consider the importance of structural power at the policymaking phase, I make use of the three policy-level structural variables listed above plus two additional structural power variables which are derived from the factor indices described in Chapter 2. Table 10.3 below illustrate the factor scores for the countries in the study for both of these variables. For each of these variables, I used the fuzzy-calibration method within the fsQCA 2.0 software to generate a continuous fuzzy-set scoring for each variable.[877] Based on the set of all countries in the RSPSF variable, I defined an upper benchmark of 1.5, 0 for the crossover point, and -1.5 for the non-membership benchmark. For the SDSFK variable, the same method was used, but with thresholds of .5, 0, and -.5, respectively. The fsQCA software converts the factor scores to a continuous fuzzy-set score by means of a transformation based on the log odds of full membership in the set.[878]

Table 10.3: Factor Scores and Fuzzy-set Values for National-Level Structural Power Variables

	Relative Structural Power of the State in Finance (RSPSF)		Structural Dependence of the State on Finance Capital (SDSFK)	
Country	Factor Score	Continuous Coding	Factor Score	Continuous Coding
Canada	-0.3831	0.24	0.144115	0.70
Germany	0.81345	0.92	-0.22762	0.20
Japan	1.43792	0.99	-1.78519	0
United States	2.05756	1	0.384374	0.91
United Kingdom	0.66898	0.88	0.403185	0.92

I also consider the possibility that the potential mobility of a policy's business line might influence outcomes not only by nature of the policy in question, but also by the potential for

[876] Latour 2004, p. 70.
[877] See Ragin, Drass and Davey 2006.
[878] See Ragin, Strand and Ribunson 2008.

capital within a given country to 'flee' offshore.[879] While the BCBS has formally banned the use of offshore shell banks,[880] because soft-law rules are not necessarily universally enforced and because off-balance sheet vehicles are not bound by the strict reporting requirements that apply to banks as a whole, it seems at least plausible that offshore financial centers may affect the constraints the BCBS is subject to.[881] To operationalize this possibility, I utilized Schwartz's recently analyzed list of countries which contain substantial corporate shell activity.[882] These localities are used for corporate bookkeeping purposes, and as such represent convenient places where banks can establish special purpose entities or structured investment vehicles. Consequently, they represent localities from which banks in BCBS countries could *potentially* move their assets (provided that these countries were not believed to eventually comply with Basel II, or to not enforce it). I obtained data from the IMF's surveys of portfolio investment flows for each BCBS country and measured the percentage of total world portfolio investment activity accruing to the list of corporate shell countries.[883] A fuzzy-set score was provided to each of the countries in the study for this variable 'Offshore Shell Potential', which is used as one of the several structural power variables analyzed below.[884]

Finally, before proceeding, as one last test of possible structural power selection effects, I examine the relationship between private sector mobilization, broadly conceived, and the numerous structural power variables employed in the study. I perform such a test because it is possible that private sector groups in structurally privileged situations might mobilize differently because they suspect they are structurally privileged in a particular way. Such privilege could be, for example, a by-product of the state in which they are located in, or the regulatory policy domain in which they are engaged. To test this possibility, I ran correlation tests on a matrix of each of the structural power variables used in the study against different measures of private

[879] The literature stressing the importance of 'preferential tax regimes' on the operation of global finance (Palan, Murphy and Chavagneux 2010; Palan 1998) are relevant in this context only as an institutional constant. Inasmuch as they may be critical to actual processes, tax havens operate as a relative constant across policies. Where they may be relevant as a factor which varies across countries – since access to corporate shells may vary by policy.
[880] Sharman 2010, p. 10
[881] Sharman 2010, p. 15; Palan, Murphy and Chavagneux 2010
[882] See Schwartz 2009, p. 62.
[883] This method of calculation has precedent in Schwartz 2009, pp. 62-63, though I used different data. Specifically, I used Table 8 – Geographic Breakdown of Total Portfolio Investment Assets. See http://www.imf.org/external/np/sta/pi/geo.htm
[884] The countries of focus of this study express the majority of variation across the BCBS – from 2% to 24%. I provided a four-value fuzzy-set score to each of the countries in question: Germany at 2% became 0; Canada at 4% became .33; the UK at 14% became .67; the US at 15% became .67; and Japan at 20% became 1.

sector mobilization in order to test for highly correlated (i.e. above .80) relationships. I first performed this test against the mobilization variable, as reported in Table N below. I then did so against the variable for information, and an 'alternative' metric for mobilization, which simply combines (by summation) the value of the 'mobilization' and 'information' fuzzy-set values.[885] As Table 10.4 illustrates, none of the variables in this matrix are highly correlated, suggesting that the structural power selection effect in question is not apparent.

Table 10.4: Correlation Tests for Structural Power Variables with Mobilization Indicators

	Mobilization	Information	Alternative Mobilization Proxy
Information	~	1	~
RSPSF	.23	.18	.34
SDSDF	.39	.35	.36
Financialization	-.00	.07	-.01
Potential Mobility	-.06	-.26	-.17
Offshore Shell Potential	.12	.05	.05
Size	-.23	-.32	-.27

Section 3
Testing Necessity and Sufficiency

The Configuration Tables at the end of Chapters 3-9 provide a wealth of information which can be analyzed systematically using fsQCA and other forms of across-case analysis. The 'non-interdependent dataset' constitutes a total of 32 cases – 7 transnational campaigns, and 26

[885] I also conducted a test which entertains the most expansive possible notion of mobilization by summing all fuzzy-set scores, and conducting a correlation test on the structural power conditions in the study. The same results apply.

national campaigns. As Table 10.5 below demonstrates, there was considerable variation on the main dependent variable, 'permissive regulatory policy change'.

Table 10.5: Distribution of Dependent Variable for All Campaigns

	Fuzzy-set Value	*0*	*.33*	*.67*	*1*
All Campaigns	Number of Cases	22	3	3	5
Transnational Campaigns	Number of Cases	4	1	1	1
National Campaigns	Number of Cases	18	2	2	4

As this Table illustrates, while most national campaigns were unsuccessful in achieving the ultimate goal of permissive regulatory policy change (PRPC), some were successful. This variation can be analyzed through fsQCA by examining the conditions associated with each of these cases. Using this data, I used fsQCA to discern which relations between the explanatory variables and the dependent variable of interest constituted a relation of logical necessity. In other words, what explanatory variables are necessary for the outcome of permissive regulatory policy change (PRPC) to occur? The use of a consistency score allows me to assess the extent to which the superset relationship between a given explanatory variable approximates logical necessity for the dependent variable to occur across cases. Tests of logical necessity within the existing literature necessitate a consistency score which is higher than 75% (the typical consistency cutoff for sufficiency), and so I define the consistency cutoff for necessity at 85%.[886] Table 10.6 below reports the results of this analysis, with each explanatory variable being expressed in accordance with the expectation of its related hypothesis.[887] All values are rounded up at the second decimal place.

[886] Ragin 2008, p. 118; Schneider and Wagemann 2009b, p. 406; Ragin 2006.

[887] In other words, connoting absence (~) of enemies is displayed, because the Business Conflict hypothesis expects the absence of business conflict to be a necessary condition for influence, not business conflict itself.

Table 10.6: Necessity Analysis Results for Private Sector Campaigns

Causal Condition	Consistency Score	Consistency Score	Consistency Score
Mobilization	1	1(1)	1
Coalition	1	1(1)	1
Information	.67	.95(.95)	.95
Non-Bank Allies	0	.58(61)	.58
~Enemies	1	.95(89)	.95
Legislative Oversight (Supportive)	~	.84(83)	~
~ Legislative Oversight (Oppositional)	~	1(1)	~
Relative Structural Power of the State in Finance	~	.97	~
Structural Dependence of the State on Finance	~	.70	~
Importance to Financialization	1	.33	.33
Potential Mobility of Business Line	.5	.17	.17
Size of Business Line	1	.67	.67
Offshore Shell Potential	~	.56	~

Private sector mobilization, coalitions, and lack of enemies are necessary conditions across both transnational and national-level campaigns. The use of information is a necessary condition for influence only for the national campaigns, and this is also the case for the absence of oppositional legislative oversight. Only one kind of national-level structural power condition was found to be individually necessary, and that was the structural power of the state in finance. Both its continuously-coded and manually coded variants were consistent above the 85% threshold. Two policy-level structural power variables were above the 85% consistency threshold – importance to financialization and size of the associated business line – but interestingly only for the transnational campaigns.

I then engaged in a test of the *sufficiency* for each of the individual explanatory variables employed in the campaigns examined in chapters 3-9. As is conventional in the fsQCA literature, I use a 75% consistency threshold.[888] Table 10.7 below reports the results from this analysis.

Table 10.7: Individual Sufficiency Analysis Results for Private Sector Campaigns

Causal Condition	*Consistency Score*	*Consistency Score*	*Consistency Score*
Mobilization	.32	.28(.35)	.29
Coalition	.30	.35(.40)	.33
Information	.27	.36(.43)	.34
Non-Bank Allies	0	.44(.50)	.41
~Enemies	.28	.22(.24)	.24
Legislative Oversight (Supportive)	~	.42(.52)	~
~ Legislative Oversight (Oppositional)	~	.21(.24)	~
Relative Structural Power of the State in Finance	~	.26(.26)	~
Structural Dependence of the State on Finance Capital	~	.27(.27)	~
Importance to Financialization	.50	.20	.20
Potential Mobility of Business Line	.50	.21	.21
Size of Business Line	.32	.21	.21
Offshore Shell Potential	~	.26	~

As these results indicate, no individual explanatory condition is sufficient above the 75% threshold in explaining the outcome of permissive regulatory policy change. This result is the same not only for transnational and national campaigns, but also for all campaigns combined. In other words, however construed, there is no 'one thing' or one single condition on its own which is logically sufficient in explaining private sector influence across cases.

[888] It is widely accepted within the fsQCA literature that a 75% consistency threshold should be employed, especially for tests of sufficiency. See Ragin 2006a, p. 3; Ragin 2008, pp. 118, 136; Schneider and Wagemann 2009b, p. 406.

Section 4
Combinatorial Analysis

In contrast to simple analyses of necessity and individual sufficiency, one of the analytical strengths of fsQCA is its capacity to analyze *combinations* of factors which are sufficient in producing the outcome of interest (as discussed in Chapter 2).[889] FsQCA allows for the systematic analysis of *conjunctural causation*, i.e. the notion that the presence or absence of individual conditions is not what explains outcomes, but rather the particular combinations of factors.

I first employ fsQCA to analyze whether or not there is any evidence for combined sufficiency on *all* the cases examined within the study. I note from the outset that such an analysis which does not differentiate between transnational and national campaigns is somewhat artificial, since there are conditions in national campaigns (such as legislative oversight) which are not in transnational campaigns. Nevertheless, I run the fsQCA software and find that there is no combination of factors which is sufficient above the 75% threshold of consistency. The combination of mobilization, information, coalitions, non-bank allies and lack of enemies is consistent only at 56%, and therefore cannot be said to be a sufficient combination. This finding supports the notion, discussed earlier, and remarked upon throughout this study, that there are great idiosyncrasies in the operation of private sector influence. However, once again I note that collapsing all campaigns into the same dataset is potentially misleading.

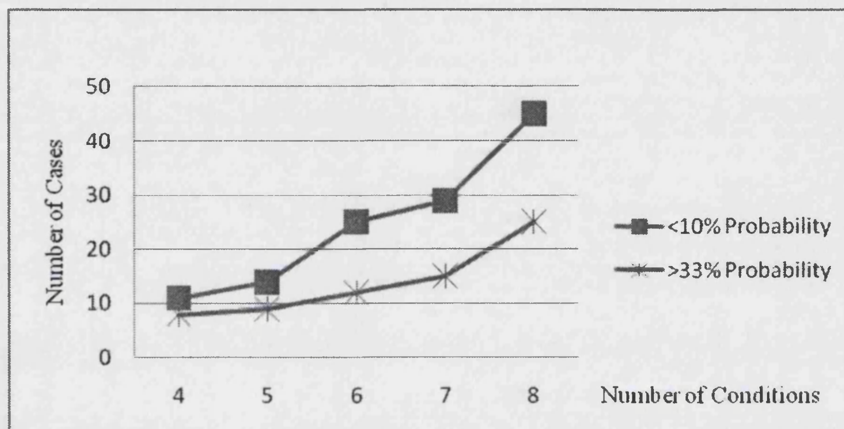
Transnational Campaigns

I then differentiate the data and employ fsQCA to engage in a test of combined sufficiency for the transnational campaigns in the study only. Such an analysis is constrained by the number of explanatory conditions that can be specified within a given model to be tested. Recent experimental research by Marx suggests that there is a relationship between the number of conditions considered and the number of cases in a QCA dataset.[890] This relationship is

[889] See Schlosser et. al. 2008; Ragin 2008. See also discussion in Chapter 2.
[890] See Marx 2006, pp. 18-20.

similar in character to a 'degrees of freedom' constraint in conventional statistical analysis. Marx's experimental research suggests that models be specified which fall above these curves to ensure a high degree of reliability.[891]

Figure 10.0: Conservative QCA Model Specification Floors[892]



While his data presumes an even distribution on the dependent variable (and the data for this study clearly does not), it does suggest a need for caution in the number of conditions included in a fsQCA combined sufficiency test, especially when the data set is very small.[893] On this basis I specify different models of no greater than four or five conditions.

Table 10.8 below indicates findings for tests of joint sufficiency for the transnational cases, in which I used fsQCA's to find the highest consistency score on a given number of combinations of explanatory conditions. I specified four different models in which joint sufficiency might be expected based on different combinations of explanatory conditions, as indicated by the 'filled' black squares below. The 'A's in Models 1 and 2 indicate that fsQCA indicated the absence of a condition, rather than (the expected) presence of a condition. As Models 1-5 have consistency scores below the 75% threshold, none of these models can be considered logically sufficient. In models 6-10, I used fsQCA to 'find' combinations of

[891] Marx 2006, p. 21
[892] Data is from Marx 2006, p. 19 (Table 5)
[893] This conservative precaution is recently employed in Avdagic 2001, pp. 15-16

conditions with the highest consistency scores, using the 'Subset-Superset' analysis function in fsQCA 2.0.

Table 10.8: Tests of Joint Sufficiency for Transnational Cases

		Model									
	Explanatory Condition	1	2	3	4	5	6	7	8	9	10
1	Mobilization										
2	Coalition										
3	Information	A	A								
4	Non-Bank Allies		A								
5	~Enemies										
6	Financialization										
7	Potential Mobility										
8	Large Business Line										
	Consistency of Solution	.60	.50	.50	.50	.60	.75	.75	.75	.75	.75
	Number of Cases	2	3	3	4	3	1	1	1	1	1

As Figure N illustrates, models 6-10 all have consistency scores *just* at the 75% threshold, thereby suggesting that each of these combinations is at the threshold of a logically sufficient combination. However, as the last row indicates, there is only one case in which the specified models actually exist: the W-factor case. As noted in Chapter 3, there was some evidence that structural power may have been at work. These findings provide further support for that claim, but they do not constitute across-case evidence, since the W-Factor is only one single case. Furthermore, as the W-Factor case was one in which there was evidence of issue-linkage, these findings cannot be said to be robust from a case-oriented perspective, since the outcome may have relied on other considerations.

These findings suggest that no pattern of logical sufficiency exists across the transnational campaigns in the study. To be sure, however, this finding does *not* mean that transnational private sector influence has not occurred in the formation of Basel II. As two of the cases in Chapter 3 have demonstrated, influence did indeed take place – in particular in the case of the use of internal ratings. However, these findings do suggest that, at least for the cases examined in this study, there is no consistently sufficient pattern that suggests a relationship

across cases between the particular content of transnational private sector campaigns and permissive regulatory policy change.

National Campaigns

I then use fsQCA to engage in a test of combined sufficiency for the national campaigns examined in the study. Following the conservative recommendation by Marx and Avdagic described above, I employ models of 4 variables each. I first specify 5 different models of four conditions each in which observed conditions combine to produce a potentially jointly sufficient result. In order to attend to the possibilities of interdependencies across the data, for each of these models, I ran fsQCA for the 'full' dataset, as indicated by 'A', and the non-interdependent dataset, 'B'. As described in Chapter 2, this dataset uses all data from the Configuration Tables for national campaigns, but uses the logical OR procedure to collapse data into a common value. As Table 10.9 below illustrates, these different models produce very different consistency scores, but this variation is similar across datasets A and B.

Table 10.9: Joint Sufficiency Tests for Observed Campaign Characteristics

		Model 1		*Model 2*		*Model 3*		*Model 4*		*Model 5*	
	Explanatory Condition	A	B	A	B	A	B	A	B	A	B
1	Mobilization										
2	Coalition	■	■								
3	Information	■	■	■	■						
4	Non-Bank Allies			■	■	■	■			■	■
5	~Enemies	■	■	■	■			■	■	■	■
6	Leg. Oversight (Supp.)	■	■	■	■	■	■	■	■		
7	~Leg. Oversight (Opp.)										
8	Consistency of Solution	.65	.72	.77	.83	.61	.69	.52	.58	.58	.69
9	Number of Cases	7	7	5	5	7	6	11	9	7	6

As Table 10.9 illustrates, only Model 2 is consistent above the 75% threshold, and this feature is the same for both variants A and B. This feature suggests that a combination of conditions is jointly sufficient for PRPC: a campaign that utilizes information, and has non-bank allies, a lack of enemies, and legislative oversight present, is a logically sufficient combination for private sector influence across the cases examined. To investigate this data further, I used Subset

Analysis within fsQCA to specify all possible models between 3 and 4 conditions which have consistency scores above the 75% threshold. Table 10.10 below reports the results, which uses the non-interdependent dataset (B in the above).

Table 10.10: Joint Sufficiency Results using Subset Analysis

		Model								
	Explanatory Condition	1	2	3	4	5	6	7	8	9
1	Mobilization				■				■	
2	Coalition		■				■			
3	Information	■					■	■	■	■
4	Non-Bank Allies	■	■	■	■	■	■	■	■	■
5	~Enemies	■	■	■	■	■				
6	Leg. Oversight (Supp.)	■	■	■	■	■	■	■	■	■
7	~Leg. Oversight (Opp.)			■				■		
	Consistency of Solution	.83	.79	.79	.79	.79	.77	.77	.77	.77
	Number of Cases	5	5	5	5	5	5	5	5	5

A total of 9 different models were 'discovered' through the Subset Analysis which fulfilled the criteria specified above. The highest consistency score is Model 1, with a consistency score of .83. Once again the same pattern emerges in terms of the consistent configuration, though now we have a firmer basis from which to conclude this combination is the 'optimally consistent' solution, or 'recipe', as it is sometimes called in the QCA literature.[894] When 'after-campaigns' (national campaigns which took place after PRPC was secured at least once over a given policy) are eliminated from the dataset, the consistency score rises to 1 – perfect consistency. Eliminating 'after-campaigns' means eliminating the second HVCRE campaign described in Chapter 7. Because this campaign featured information, non-bank allies, lack of enemies, and legislative oversight but did *not* achieve PRPC, this case serves to lower the overall consistency score if included.

To test the robustness of the findings for the national private sector campaigns, I ran several regressions using the non-interdependent dataset.[895] For the first Model, Model A, I analyzed the data through a simple logistic regression model.[896] Because logistic regression

[894] The language of a 'causal recipe' is employed in Ragin 2008.
[895] Only this dataset is utilized because statistical regression analysis has a strong observational independence condition.
[896] Logistic regression models are sometimes used to compare fsQCA results. See Grofman and Schneider 2009.

analysis requires a binary dependent variable, I recoded all .67 values for PRPC as 1 and all .33 as 0. I then ran a regression on this data using logistical regression technique sometimes used in small datasets, called 'Firthlogit', to estimate the net effects of the explanatory variables on the outcome.[897] The results are consistent with the analysis above which suggests that no individual condition/variable can 'explain' PRPC on its own, though I would urge caution in interpreting levels of statistical significance on such a small dataset.

Table 10.11: fsQCA and Regression Results for Dependent Variable of 'Permissive Regulatory Policy Change' (PRPC)

	Model	A	B	C	D	E
		Logistic Regression Coefficient	OLS Correlation Coefficient	OLS	OLS	OLS
1	Private Sector Mobilization	2.746	.247			
2	National Coalition	.841	.244			
3	Information	2.596	.329	.600***		
4	Non-Bank Allies	-.431	-.023	-.048	.148	.101
5	Enemies	-1.947	-.232	-.260	-.182	
6	Legislative Oversight (Supportive)	.238	.173	.333**	.426**	.422**
7	Legislative Oversight (Oppositional)	.004	-.230			
	Constant	-4.894**	-.256	-.150	.055	.044
	Df	18	18	21	22	23
8	*R2*	~	.6195	.5606	.3038	.2865

Note: * indicates statistical significance at the 10% level, and ** indicates statistical significance at the 5% level. All p-values in regressions of such a small size should be treated with caution.

I then deploy a simple OLS model to estimate the net effects of each explanatory variable in the national campaign data on the outcome of permissive regulatory policy change.[898] As Model B above reports, none of the individual explanatory variables co-varies in any statistically

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[897] Firthlogit is a module for the Stata statistical software, and was developed by Joseph Coveney. See Firth 1993; Georg 2006; Heinze and Schemper 2002; Zorn 2005; Georg 2006.
[898] I used Stata Version 9.0.

significant way with the outcome of interest.[899] I then ran OLS regressions using different combinations of the core 'recipe' described above, as indicated by Models 3-5 above, and found statistical significance in the information and supportive legislative oversight variables. While these results are only supplementary in character, they (and in particular Model 3) support the recipe finding as per above. As with all of these findings, however, because of the small number of observations regressed (N=26), the levels of statistical significance should be treated with great caution.

An important consideration is whether or not the observed campaign characteristics might themselves combine with structural power variables. To analyze this possibility, I repeated the Subset analysis technique described above, this time including the 6 structural power variables. As Table 10.12 illustrates, 8 different combinations of conditions had consistency scores of above 75% (combinations already described above, were excluded).

Table 10.12: Combining Observed Campaign Characteristics and Structural Power Variables

		Model							
	Explanatory Condition	1	2	3	4	5	6	7	8
1	Mobilization			■					
2	Coalition								
3	Information	■	■			■			■
4	Non-Bank Allies	■		■	■	■	■	■	■
5	~Enemies		■				■	■	■
6	Leg. Oversight (Supp.)	■	■	■	■	■	■		
7	~Leg. Oversight (Opp.)								
8	RSPSF – Continuous			■			■		
9	SDSFK – Continuous				■	■			
10	Importance to Financialization								
11	Potential Mobility								
12	Large Business Line	■	■		■			■	
13	Potential Shell Mobility							■	■
	Consistency of Solution	.83	.80	.77	.76	.75	.78	.83	.78
	Number of Cases	1	2	5	1	4	5	1	4

As these results illustrate, there are a number of models which have relatively high consistency scores, such as Models 1 and 7, but these only cover one single case, and therefore cannot be

[899] This result should be taken with great caution, as high P-values on regressions with a small number of observations are not necessarily indicative of statistical non-significance.

considered across-case patterns. Model 2 covers three cases, and suggests that the 'allies' variable might be replaceable when a large business line is in question. Likewise, Model 5 suggests that the absence of enemies might be replaceable in a context of state structural dependency on finance capital. For each of these models, however, only four cases are fulfilled – and they are only those in the US. While these combinations should not be discounted on this basis alone, Models 3 and 6 stand out as superior in the sense that they cover more cases, across both the US and Germany, and therefore can be considered more generalizable. Both of these models suggest the importance of the relative structural power of the state in finance as a functional substitute to one of the components in the optimal 'recipe' highlighted above.

As a final investigation of how 'agency' variables might combine with structural power variables, I ran successive models including the recipe plus each structural power variable individually, to see if any 5-variable combination of the recipe plus a structural power condition could improve upon the recipe finding. I found that none of these models were able to do so. However, when the RSPSF variable was included, the consistency score remained the same (at .83), and five cases satisfied the condition. What these and the above findings suggest is that the RSPSF does not diminish the sufficiency of the recipe, and may be considered a functional part of it.

Finally I considered structural power variables by themselves, again performing the Superset Analysis to find the combination of causal conditions with the highest consistency score. There was no combination of conditions above the 75% consistency threshold, and the highest consistency score for a combination of structural power variables was .52, for RSPSF*Importance to Financialization*Potential Mobility of Business Line*Large Business Line. This finding suggests a challenge to the Structural Power hypothesis, since there is no combination of structural power conditions which is jointly sufficient in producing PRPC.

Section 5
Considering the Impact and Relevance of Institutions and State Power

An important consideration in this study is the extent to which the outcomes observed across cases are related to the institutional characteristics of the countries considered in the

study. The role of institutions may affect outcomes either as constraints on actors' behavior, channeling the energies of interest groups, or, alternatively by acting as resources for actors' behavior.[900] Institutionalist arguments of private sector influence find their clearest explication in the political economy of trade literature,[901] but also exist in arguments about private sector influence in financial sectoral policy, particularly in quantitative studies that work within a public choice analytical framework.[902] Institutionalist arguments sometimes arise in commentary and discussion of private sector influence as well, as seen for example in the recent comments of Lord Turner regarding regulatory capture in the US versus the UK, and also in some qualitative studies, such as that of Zhang and Underhill's argument that regulatory capture occurred in Thailand and South Korea because of weak national institutions.[903] Moreover, Busch has argued that a thoroughgoing empirical understanding of how interest groups work in financial sector politics means appreciating the workings of such institutions, not only in terms of how actors will behave, but also in terms of how decision-makers will respond.[904]

In the context of this study, particular attention to institutional variation is important because successful national campaigns only took place in two out of the five countries studied, namely the United States and Germany. This finding raises the question of whether or not there are some institutional particularities common to these two states which have enabled private sector success – conditions which might be absent in other countries. Across most of the institutional variants examined in the study, however, Germany and the United States are different. As Chapter 2 illustrated, Germany is clearly a CME, while the US is clearly not. Given that a variety of literature suggests this distinction should have a material impact on financial sectoral outcomes, the fact that successful national private sector campaigns are found in these different settings suggests that this distinction is not a significant determinant of private sector influence (see also below).[905] Other differences between the US and Germany abound. As the factor analysis of Chapter 2 revealed, the US state is structurally dependent on finance capital, whereas the German state is not. Germany is a parliamentary system of government, while the US is a presidential one; Germany is a proportional representational system, while the US is not;

[900] Keohane and Milner 1996; Streeck and Thelen 2005; Clark 1998.
[901] Cf. Rogoswski 1989.
[902] See Posen 1993; Barth, Caprio and Levine 2006; Rosenbluth and Schaap 2003; Kroszner and Stratmann 1998.
[903] See Turner in Ford 2009; Zhang and Underhill 2003: 246-247
[904] See Busch 2007.
[905] See Wade 2007, pp. 125-7; Schwartz 153-55; Zimmerman 2010, pp. 125-6

and Germany's political leadership at the time of legislative oversight was left-wing (the Social Democratic and Green Coalition), while in the US it was right-wing (the Republican Party). From a simple comparative perspective, these differences suggest that successful private sector influence is not contingent upon particular institutional conditions.

To analyze the role of institutions on outcomes, I replicated the method utilized earlier for structural power variables. I first engaged in a test of individual necessity and sufficiency of each of the institutional variables described in Chapter 2. Continuous values were converted to four value-fuzzy set scores, and missing data for Germany on the importance/position on deregulation variables was regarded as .33 (out but not fully out of the set), based on substantive knowledge of the political climate in Germany with respect to regulation. For necessity and individual sufficiency analysis, each variable is considered in its present and absent (~) form, as indicated in Table 10.13 below. As these results indicate, the tests of individual necessity indicate that there are only two (related) conditions which are necessary for PRPC to occur: de jure-regulatory independence, and the 'independence factor' described in Chapter 2.

Table 10.13: Tests of Individual Necessity and Sufficiency for Institutional Variables

	Necessity	Sufficiency
Causal Condition	*Consistency Score*	*Consistency Score*
CME Score	.31	.19
~ CME Score	.69	.26
Revolving Door	.55	.23
~Revolving Door	.67	.34
De Jure Regulatory Independence	1	.24
~ De Jure Regulatory Independence	0	0
Independence Factor	.88	.26
~ Independence Factor	.19	.19
Importance of Deregulation	.67	.29
~ Importance of Deregulation	.55	.28
Position on Deregulation	.67	.27
~Position on Deregulation	.55	.30
Proportional Representation	.33	.20
~Proportional Representation	.67	.25
Right Wing Executive	.67	.36
~Right Wing Executive	.67	.13
Parliamentary System	.33	.11
~Parliamentary System	.67	.50

Since one is a component of the other, these cannot be considered unrelated factors, and must be considered separately in any forthcoming analysis. What this finding suggests, however, is that independence of the regulatory agency is a necessary condition for PRPC. This is a very unexpected finding, and appears somewhat contradictory. As Table N below reports, no condition is individually sufficient in explaining PRPC. The latter findings regarding the content of political systems in which national campaigns took place complements Busch's recent finding that political system variation had no observable effect on the form of regulation adopted nationally.[906]

I also replicated the Superset Analysis conducted above. Superset analysis of the institutional factors alone revealed that there is no combination of institutional conditions that is sufficient above the 75% level. This finding suggests that it is not institutional conditions alone that are producing the outcomes observed, and thus further supports the notion that the observed actions of private sector groups had a causal impact on the outcome. I then included the each of the conditions which form the 'recipe', and investigated how these might combine with institutional variables to produce different consistency scores. I found that no combination of 'recipe' conditions and 'institutionalist' conditions combines with a greater consistency score than the recipe alone across cases.

These findings suggest a challenge to an institutionalist position regarding private sector influence. The finding that a high level of regulatory independence is a necessary condition for private sector influence is the exception to this. It should be noted, however, that this finding is both contradictory to most expectations (independence should *impede* influence, not enable it), and that the actual extent of variation on this institution was extremely limited within the BCBS countries, as described in Chapter 2. The strength of these findings might be further investigated using different measurements of institutional diversity, but it is notable that even if one imagines other sources of institutional variation between the US and Germany, this variation is considerable. Germany and the US have very different kinds of policy networks in finance.[907] Financialization is associated with 'Anglo-American' capitalism of the period under study,

[906] See Busch 2008.
[907] See Busch 2008.

which clearly encapsulates the US (and the UK), but certainly not Germany.[908] The literature on 'rentier power' clearly suggests that the US rentier class had considerable institutional strength during this period, whereas in Germany this was not the case.[909] Each of these sources of variation potentially undermines the argument that particular institutional arrangements produce, or contribute to private sector influence, because influence took place *despite* this institutional diversity.

The finding that the revolving door variable does not appear to affect outcomes is supported by additional qualitative evidence from within previous chapters. Tom de Swaan, the previous Chair of the BCBS, took a prominent role on the Managing Board of Directors of the IIF. The IIF was, as we have seen, an extremely vociferous and engaged private sector group across a number of campaigns. The IIF's success was, however, highly variable, with their internal ratings campaign being a success, but other campaigns such as operational risk and expected losses being failures, new sentence suggesting at least one way in which the revolving door does not affect outcomes. A similar example can be seen in the personnel movement of a critical Senior Economist at the US Federal Reserve Board, John Mingo, who became the lead consultant to the RMA Capital Group. This group too was highly important within the US, as we have seen with the HVCRE campaign, the credit card campaign, the expected losses campaign, and the residential mortgage campaign. However, as we have seen across chapters, the success rate of the RMA Capital Group was, like the IIF, highly variable, and thus it is difficult to support the notion that the revolving door positively or negatively affected regulatory policy outcomes. A more focused and extensive study might be appropriate to fully interrogate such claims.

To conduct a more systematic empirical test, I ask how the 'recipe' competes against alternative explanatory variables in explaining PRPC. Using statistical regression analysis, I specified six different models in which the 'recipe' variable competes for a statistically significant net effect on PRPC. The 'recipe' variable is coded as an interaction term, in which its strength varies by the extent to which each of the conditions within the recipe described above are met. As was the case with other explanatory variables, I include each of the structural power

[908] See, for example, Langley 2004, p. 540.
[909] Cf. Power, Epstein and Abrena 2003; Epstein and Jayadev 2006.

variables and each of the institutional variables described in Chapter 2, which vary by country. Model 1 pits the recipe variable against the structural power variables, and finds the recipe to be the only variable with a statistically significant coefficient; the same is true (at least at the 5% level of significance) for all other models. The remaining models select institutional and structural power variables which are not highly correlated. Model 2 includes institutional conditions related to deregulation and regulatory independence, whereas Model 3 includes regulatory institutions, and Model 4 includes electoral institutions. Models 5 and 6 include combinations of structural power characteristics and institutions in non-correlated combinations. As Table 10.14 illustrates, the 'recipe' variable is consistently statistically significant at least at the 10% level, and usually at the 5% level.

Table 10.14: OLS Regression Results for Recipe Competing with other Variables

	Explanatory Variable	*Model 1*	*Model 2*	*Model 3*	*Model 4*	*Model 5*	*Model 6*
1	'Recipe'	.747**	.629**	.609**	.563*	.687*	.563*
2	RSPSF – Continuous	.365					.259
3	SDSFK – Continuous	.235					-.111
4	Importance to Financialization	-.164				-.175	
5	Potential Mobility	-.503				-.249	
6	Large Business Line	-.048				-.029	
7	Offshore Shell Potential	-.039					
8	CME Score			.110		.198	
9	Revolving Door			-.490			-.428
10	De Jure Reg. Independ.			1.625*			1.694
11	Independence Factor		.829			-.454	
12	Importance of Dereg.		.776				
13	Position on Dereg.		-1.00				
14	PR System				.231		
15	Right Executive				-.231		
16	Parliamentary System				-.550*	-.405	
	Constant	-.109	-.321	-1.180	.550*		-1.391
	Df	*18*	*21*	*21*	*21*	*18*	*20*
	R^2	*0.4719*	*0.4076*	*0.4128*	*0.4308*	*0.4757*	*0.4308*

This kind of statistical regression analysis is useful to test the efficacy of statist arguments that involve the importance of state power in affecting outcomes. Simmons, for

example, has argued that the US is "hegemonic" in international financial regulatory affairs, because of its considerable market size, and thus able to act unilaterally.[910] Numerous works in political economy have contested such a claim regarding US dominance, but still argue for the importance of state power.[911] To a certain extent, this has already been addressed in the 'relative structural power of the state in finance' (RSPSF) variable, which encapsulates one version of state power. On the other hand, as described in Chapter 2, because RSPSF was constructed on the basis of relative position of states, it does not match well with some statist arguments. Consequently, following this literature I use Gross National Income (GNI) as a proxy measurement of state power.[912] As is standard in the statistical literature that uses such a large figure, I also took the natural logarithmic function (ln) of these values as well as an alternative measure (GNIln).[913] Finally I performed a manual fuzzy-set coding of state power in this vein using the following codings: the US and Japan =1, Germany and the UK =.67, and Canada=.33, GNIfs.

To consider how well the recipe competes for net effects on PRPC in comparison to statist arguments, I re-ran regression models 1 and 6 above, but with RSPSF being replaced with each one of the GNI variables (GNI, GNIln, and GNIfs) in succession. The results were no different in terms of levels of statistical significance or magnitude of effects than that above. I also ran simple regressions with only the recipe variable and each of the GNI variables in succession. Against each measurement of GNI, the recipe variable was statistically significant at the 5% level, while the GNI variable was not. Finally, I also tested the GNIfs against PRPC within fsQCA. The results are similar to that described above for the relative structural power of the state in finance: GNI is a necessary condition (at 89% consistency), but is not a sufficient condition (at 27% consistency). These results thus support the notion that a national campaign taking place in a powerful state is a necessary condition for private sector influence at the transnational level.

As a final robustness check, I examined whether or not the particular fuzzy-set measurements used might have generated the observed results, an important question given the

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[910] Simmons 2001, p. 595.
[911] See Drezner 2007, pp. 23, 121; Braithwaite and Drahos 1999, p. 113; Posner 2009.
[912] I selected 2001, the middle of the period of study. This variable is consistent with those who see state power in financial regulation as largely influenced by market size, as per Simmons 2001 and Gidinis 2008.
[913] See Geortz 2009.

criticism of fsQCA as a method, as discussed in Chapter 2. First, I recode all values for 'permissive regulatory policy change' as 'crisp sets', i.e. as 1s or 0s, whereby a .33 score is converted to 0 and a .67 score is recoded to 1. I then reran the fsQCA analysis described above to see if the results are different. They are not: the recipe is exactly the same combination of explanatory variables, and the consistency score is only slightly smaller, at 80%. I then recoded the original variables along a different spectrum from the one employed in the study, employing .83 and .17 values, as is sometimes done within the fsQCA literature. This analysis yielded the same recipe as well, but with a consistency score of 82%. These results are summarized in Table 10.15 below. What they suggest is that, rather than biasing the results of the study, the specific values used to code fuzzy-set values do not have a significant effect on the main combinatorial finding of the study.

Table 10.15: Robustness Checks for Different Fuzzy-Set Measurements

Fuzzy-Set Coding Values	*Out of the Set*	*Mostly Out of the Set*	*Mostly In the Set*	*Fully in the Set*	Consistency Score When Using this Method
Values in Study	0	.33	.67	1	83%
'Crisp' set Values	0	0	1	1	80%
'Alternate' Values	0	.17	.83	1	82%

Section 5
Mechanisms across Cases

While the above two sections have found a specific combination of variables to be relevant in explaining permissive regulatory policy change, the data provided by the previous empirical chapters still presents the opportunity to explore these relationships further. In particular, what are the mechanisms by which private sector groups succeed in influencing Basel II's content? Earlier chapters which engaged in within-case analysis explored the mechanisms within each case.

We have seen that while no one thing that private sector groups do can exercise influence over Basel II, a specific *combination* of explanatory variables is sufficient for influence – what I have called the 'recipe'.[914] This finding has been investigated using both fsQCA and statistical regression techniques. It is also worthwhile to point out, however, that there is strong qualitative evidence for these findings as well. This can be illustrated by a simple contrast of five different national campaigns, two of which were successful and three of which were not, as illustrated in Table 10.16 below. The content of the successful German SME campaign was strikingly different from the Japanese SME campaign examined in Chapter 5, as there was a lack of a private sector coalition and use of information in the latter. Three conditions missing in the US residential real estate campaign correspond to its failure to generate PRPC, a point that was illustrated starkly in the narrative described in Chapter 7. If we draw from the 'full' (i.e. potentially interdependent) dataset, another such case shows a similar pattern. The 'first' US credit card campaign was mobilized and organized as a coalition, but failed to acquire non-bank allies or generate legislative oversight associated with its aims. In contrast, the German SME campaign and the first HVCRE campaign displayed the configuration suggested by the recipe, and did generate PRPC. As the respective chapters (4 and 7) made clear, these respective campaigns took place in very different contexts, to say nothing of the institutional differences between the US and Germany.

Table 10.16: Comparing Different Combinations of Conditions Across Different Campaigns

	German SME Campaign	Japanese SME Campaign	US Residential Real Estate Campaign	US first HVCRE Campaign	US Credit Card Campaign 2001-2003
Private Sector Mobilization	P	P	P	P	P
National Coalition	P	*A*	P	P	P
Information	P	*A*	P	P	P
Non-Bank Allies	P	*A*	P	P	*A*
Enemies	A	A	*P*	A	A
Legislative Oversight (Supportive)	P	P	*A*	P	*A*
Legislative Oversight (Oppositional)	A	A	*P*	A	A
Did Permissive Regulatory Policy Change Occur?	YES	NO	NO	YES	NO

[914] The language of a 'recipe' to describe a combination of sufficient conditions is also used by Ragin 2008.

To further investigate the mechanisms of influence, it is also possible to focus on the intermediate dependent variable, the extent to which the national regulator has been influenced or not. To investigate this I first ask whether or not 'regulator influenced' is a *necessary* condition for PRPC change to occur. I find that it has a consistency score of 94.5 %, indicating nearly a perfect superset relationship. In order to take into consideration the possibility that 'issue-linkage' affected outcomes, I then removed the cases where there was some possibility of issue-linkage the post-2001 US operational risk campaign, and the US securitization campaign. A test of necessity under these conditions yields a consistency score of 1 – perfect consistency. A simple correlation test of 'regulator influenced' with PRPC yields an 84% correlation; with the cases containing possible issue-linkage removed, this becomes 81% - still highly correlated. A test of sufficiency of 'regulator influenced' yields a consistency score of 74%, and 71% when the abovementioned cases are eliminated. These finding are striking in that it conforms well to specific qualitative findings within a variety of the individual cases explored in Chapters 4-9. Specifically, while influencing a national regulator was usually the precondition for PRPC, in a number of different instances where the regulator was influenced by a national campaign, this intermediate influence did *not* lead to PRPC. As Table 10.17 below demonstrates, the nine cases within the study in which the national regulator was influenced by private sector groups, only six of these cases also featured permissive regulatory policy change.

Table 10.17: National Campaigns that Were Successful in Influencing the National Regulator

Permissive Regulatory Policy Change	Campaign was Concerning	Year of Campaign	Country of Campaign
1	SMEs	2001-2002	Germany
.33	CRE	1999	Germany
1	CRE	1999-2000	Germany
1	Operational Risk	2001	United States
1	HVCRE	2003	United States
0	Expected Losses	2002	Germany
.33	Expected Losses	2003	United States
.67	Credit Cards	2003	United States
.67	Securitization	2003-2004	United States

This finding in itself is an interesting finding, because it suggests that influencing their regulators is not a 'surefire way' for private sector groups to influence the content of Basel II. Nevertheless, as we have seen in several of the case studies mentioned above, there is causal evidence for the 'regulator influenced' mechanism at work. On this basis, we can ask: what influences a regulator? I conducted a test of necessity and individual sufficiency on each of the explanatory conditions in the study for the outcome 'regulator influenced'. The results are reported in Table 10.18 below.

Table 10.18: Necessity and Sufficiency Analysis
Results for 'Regulator Influenced'

Causal Condition	Necessity Consistency Score	Sufficiency Consistency Score
Mobilization	.96	.42
Coalition	.96	.49
Information	.83	.48
Non-Bank Allies	.48	.50
~Enemies	.91	.31
Legislative Oversight (Supportive)	.70	.55
~ Legislative Oversight (Oppositional)	1	.31
Relative Structural Power of the State in Finance	.97	.33
Structural Dependence of the State on Finance Capital	.64	.32
Importance to Financialization	.39	.30
Potential Mobility of Business Line	.13	.21
Size of Business Line	.61	.24
CME Score	.37	.28
Revolving Door	.48	.25
De Jure Reg. Independence	1	.31
Independence Factor	.84	.32
Importance of Deregulation	.57	.31
Position on Deregulation	.57	.29
PR System	.39	.30
Right Executive	.61	.42
Parliamentary System	.39	.17
GNIfs	.87	.33

As these results illustrate, the individual conditions necessary for permissive regulatory policy change to occur are also those necessary for the national regulator to be influenced, with only two exceptions. Supportive legislative oversight was a necessary condition for PRPC to occur, yet it is *not* necessary for the national regulator to be influenced. As the third column in this table illustrates, no individual condition was sufficient in explaining the regulator being influenced, which is consistent with earlier findings for PRPC. I then conducted a test of joint sufficiency of the national campaign data, using only the non-interdependent data and setting 'regulator influenced' as the outcome. The fsQCA findings in terms of combinatorial relationships are also exactly the same, with the recipe in the same configuration of outcomes and having a consistency score of 83%.

Conclusion

This chapter has engaged in across-case analysis using a variety of methods. Rather than discussing the significance of the findings of this analysis, this conclusion provides a summary of the main across-case findings. The central finding of the across-case analysis is that rather than any individual condition being sufficient in generating permissive regulatory policy change (PRPC), there exists a complex combination of conditions that does so; however, this combination is only significant for national-level campaigns. This combination of conditions suggests that underneath the contextually rich and highly complex world of private sector campaigning, there is a conjunctural causal process at work which can explain private sector influence. Specifically, across-case analysis found that when private sector groups utilize information, have non-bank allies, and have supportive legislative oversight on their side, they are able to influence their regulators and, in turn, generate permissive regulatory policy change at the transnational, BCBS level. Other factors such as mobilization and the presence of a national coalition do not diminish this sufficiency, but they do not appear to be a critical part of the recipe. This 'recipe' is, however, conditional on the absence of enemies within the national campaign – a finding also observed in within-case analysis of previous chapters. This result has been tested using a variety of methods, and has been supported both by investigating underlying mechanisms and through reference to individual cases which were explored qualitatively in earlier empirical chapters.

While this 'recipe' has been shown to be robust in competition with macroeconomic and macro-institutional factors, it is also a very fragile and contingent recipe for influence. To risk stretching the analogy, it is not a recipe for which private sector groups can easily assemble the ingredients. The reason is that there is no 'one thing' that was done which influenced regulators and outcomes, but rather a number of things that, once in place, have had powerful effects. This 'conjunctural' pattern suggests that *none* of the individual hypotheses in the study can be supported in terms of logical sufficiency. There is no sufficient path to influence: there is only a recipe, a combination.

In terms of necessary conditions, a variety of conditions fulfill the criteria as consistently necessary conditions as specified in this chapter. Table 10.9 below lists those conditions which were deemed necessary across cases in different scales and forms of analysis in this chapter. An 'N' indicates that the condition was necessary above the 85% threshold specified in the study; a '~' indicates it was not; and a grey coloring indicates that testing necessity was not possible for that given scale/form of analysis.

Table 10.9: Conditions Fulfilling Necessity Criteria Across Different Scales and Forms of Analysis

	Agenda-Setting Stage	Transnational Campaigns	National Campaigns	Regulator Influenced
Mobilization		N	N	N
Coalition		N	N	N
Information		~	N	~
~Enemies		N	N	N
Oppositional Legislative Oversight			N	N
Relative Structural Power of the State in Finance			N	N
Importance to Financialization	N	N	~	~
Large Associated Business Line	N	N	~	~
De Jure Regulatory Independence			N	N
GNIfs			N	N

While these overall results are very complex, several findings are relatively consistent across different scales and forms of analysis. Specifically, mobilization, coalitions, and the absence of enemies are all necessary conditions whenever they have been tested. Each of these conditions is necessary for PRPC in both transnational and national campaigns and is *also* necessary for the national regulator being influenced by its domestic private sector.

Table 10.20 below offers a succinct summary of overall hypothesis evaluation. The Legislative Oversight Hypothesis receives strong but conditional support, as it has been shown to be a consistently critical condition for PRPC, but one which is contingent on other factors also being present. The plethora of within-case evidence that regulators respond to the threats associated with legislative oversight further supports this position, as does the fact that while legislative oversight is not a necessary condition, it came close (with consistency scores of .84 and .83 in different tests in this chapter). Legislative oversight was important not only in influencing regulators' behavior, but also for affecting the bargaining dynamic within the BCBS in a way that favored private sector preferences, as seen for example in the German commercial real estate campaign described in Chapter 4. Furthermore, many first-hand accounts from private sector participants affirm the importance of this factor.[915]

The Mobilization Hypothesis received some support but primarily as a necessary condition, rather than as critical part of the jointly sufficient 'recipe' of conditions. To be sure, including mobilization does not diminish the consistency of the recipe; however, it was not found to be a critical component of it. Within-case analysis of earlier chapters conveyed in many instances the importance of private sector mobilization, and yet even these narratives suggest its importance primarily as a necessary condition.

The Information Network Hypothesis received relatively strong support in the within-case analysis of previous chapters, with private sector groups providing key information which led to PRPC, such as Chapter 3's finding with respect to internal ratings, and Chapter 9's finding with respect to securitization. While its necessity across scales/forms of analysis was found to be

[915] Especially Interviews 77R, 78R, and 90R.

variable, it was nonetheless found to be a critical component part of the jointly sufficient recipe, and therefore received strong but conditional support.

The Structural Power Hypothesis received very inconsistent support. Although some within-case evidence of structural power at work was found, across-case evidence for the efficacy of structural power was very mixed, for both national-level and policy-level structural power variables. The structural dependence of the state on finance capital was neither a necessary condition nor part of a jointly sufficient one across cases. None of the three policy-level structural power variables were found to be of relevance to the national campaigns, but large associated business lines and importance to financialization were necessary conditions for transnational campaigns, and furthermore provided evidence for structural power at work at the agenda-setting phase. Within across-case analysis of national campaigns, the 'relative structural power of the state in finance' (RSPSF) was found to be a necessary condition. This finding, and the fact that RSPSF was found to be also necessary as a condition to influence the national regulator suggests that the findings of this study may be conditional on structurally important states within the international financial system (so too does the 'GNIfs' variable which has similar characteristics to RSPSF, as noted above). Such states may be the only ones to bargain aggressively in international negotiation, or it may be the case that private sector groups only mobilize significant campaigns in these states, since they believe the probability of their success to be higher. I note however that, according to the analysis of possible structural power selection effects in Chapter 2, there is some limitation to the diversity of structural power conditions explored in this study. Specifically, 'externally weak' but 'internally strong' states, such as Sweden and Spain have not been represented in this study, thus limiting the possible generalizability of these findings.

The Business Conflict Hypothesis receives strong across-case support, since it was both a critical part of the recipe and a necessary condition. This finding was the most straightforward in the entire study: whenever business conflict was present, private sector campaigns were not able to influence the Accord. Such an outcome was found not only in across-case analysis, but also concrete empirical cases – such as the transnational operational risk campaign, and the US residential mortgages campaign.

The Coalitional Hypothesis received very mixed support. The presence of non-bank allies in a campaign was found to be a critical part of the jointly sufficient recipe of conditions producing PRPC, but the presence of a national coalition was not. This variability suggests that while private sector coalitions are undoubtedly important, the particular content and efficacy of the coalitional *form* matters a great deal. We have seen in individual cases examined that coalitions helped to coordinate positions (such as the internal ratings campaign in Chapter 3), and in other instances coalitions played a key role in not only coordinating information exchange among private sector groups, but also in building a unified voice and generating legislative interest and sympathy with private sector concerns (such as in the second SME campaign examined in Chapter 5). Coalitional activity, as we have seen in previous chapters, is relatively commonplace in private sector campaigns, at both the national and transnational levels, and across-case analysis affirmed its importance as a *necessary* condition for private sector influence.

Table 10.20: Evaluation Summary of 'Means of Influence' Hypotheses

	Name of Hypothesis	Overall Evaluation
H_1	Legislative Oversight	Strong But Conditional Support
H_2	Mobilization	Some Support
H_3	Information Network	Conditional Support
H_4	Structural Power	Variegated
H_5	Business Conflict	Strong Support
H_6	Coalitions	Mixed Support

In terms of pathways of private sector influence, on the basis of earlier within-case analysis and the analysis of this chapter we can say that there is mixed evidence for the Transnational Pathway hypothesis. On the one hand, instances of influence clearly occurred at this level. As we have seen in the Internal Ratings and W-Factor campaigns examined in Chapter 3, there is evidence that private sector groups exerted such influence. As we have also seen in the analysis of this chapter, however, there are no relationships of individual or joint sufficiency for the transnational campaign examined. The National Carrier Hypothesis, on the other hand, received stronger support. Two conclusions can be drawn from this finding. The first being the

purely empirical finding that given the associational diversity of private sector mobilization over Basel II, the national scale appeared to work best for the campaigns investigated herein. Second, this result also produces further (albeit indirect) evidence in support of the legislative oversight hypothesis; indeed, the threat of legislative oversight is the only power resource or 'means' that private sector groups lacked in their engagement with regulators at the transnational level. The robustness of this particular finding, however, should be interrogated in further empirical research, especially since the number of transnational campaigns examined in this study was small in comparison to the number of national-level campaigns.

Conclusion

This study engaged with a central question: How do private sector groups influence transnational financial regulatory policymaking? To answer this question, I investigated the different actions and strategies that private sector groups employed in their attempts to influence the content of transnational financial regulatory policy, which I referred to throughout as 'private sector campaigns'. Using extensive primary empirical material relating to the formation of the Basel II Accord between 1998 and 2004, I examined the relationship between the content and context of these campaigns, and their varied levels of success. I further used a variety of qualitative and quantitative methods to test different hypotheses prevalent within the existing academic literature regarding how private sector groups influence financial regulatory policymaking.

I undertook process tracing analysis to ascertain the relationships between the explanatory variables of interest, namely, the actions and contexts of private sector efforts, and the dependent variables of interest, the reactions of regulators and permissive regulatory policy change. Through a series of narratives detailing private sector groups' reactions to, and campaigns concerning, the formation of Basel II, I have analyzed the operation of private sector influence in its particular institutional contexts. While process tracing allowed me to explore private sector influence in Basel II through 'within case' analysis, I also analyzed patterns across the cases in the study through Fuzzy-Set Qualitative Comparative Analysis (fsQCA), as well as statistical regression analysis. By analyzing in empirical detail the actual content of private sector campaigns, their conduct, and regulators' reactions to them, I ascertained several instances of private sector influence over a number of different regulatory policies within the Accord, and many other instances of non-influence. I further established patterns that affected this variation.

This study has not sought to critique or 'prove' any existing theory. The primary aim, rather, was to engage in detailed empirical study to explore an under-examined terrain and to test

specific hypotheses, under the neo-pluralist assumption that there may be a variety of power resources available to private sector groups, both in terms of instrumental actions and structural power resources and contexts. Empirical hypothesis testing serves not only to ascertain the validity of social scientific conjectures made within the social world, but also to account for actual processes within that world. Exploring private sector attempts at exercising influence over the formation of the Basel II Accord thus enabled me to engage in an analysis of a particular dimension of the political economy literature which is extensively theorized, but rarely empirically researched: namely, private sector influence over transnational financial regulatory policymaking. By way of conclusion, I first summarize my main empirical findings, and then discuss their implications for the existing literature and some dominant theoretical paradigms within IPE.

Main Findings: What is Inside the Black Box of Influence?

The aim of this study, as discussed in the Introduction, was to 'look inside' the 'black box' of private sector influence over financial regulatory policymaking through detailed empirical study. What have I found inside? We have seen that private sector influence can be *pervasive*, as it occurred throughout the Accord's formation and over a range of different policies. We have seen that private sector groups' means of influence were diverse, not only in their variety but in their contextually-bounded deployment. However, we have seen also found that private sector influence was highly *contingent*, in particular on the factor of business conflict. A central finding in this regard is that there is a specific *recipe* of factors that are both necessary and sufficient for private sector groups to achieve influence. Finally, we might also say that this recipe is itself highly fragile, since its individual components are not under the control of any one actor.

Pervasiveness

Private sector groups successfully organized to influence Basel II both at the transnational and national levels. I documented numerous instances where private sector

campaigns successfully generated permissive regulatory policy change in the Accord by convincing the BCBS as a whole to change course as they were developing a particular regulatory policy; by proposing new permissive regulatory policies; and by either convincing or enabling their national regulators to represent their preferences within the BCBS. In short, private sector groups exercised their influence over the Accord in numerous different ways. In this regard I have found support for both the 'Transnational Pathway' hypothesis and the 'National Carrier' hypothesis, in various instances. But what were the power resources or 'means' that private sector groups used?

Diversity

This study has demonstrated that private sector groups use a diverse range of power resources in the realization of their ends. In some cases, they successfully utilized information to convince regulators to change course on a policy. In other cases, they made prodigious use of the threat of legislative oversight over their national regulator. Their mobilization strategies were often an important element in their campaigns, and offered important signals to regulators in a number of different contexts. Coalitions were also formed and served to coordinate strategies and information among private sector groups. Private sector groups were successful at influencing the Accord when organized at both the transnational level and at the national level. The diversity of means that private sector groups used was extensive; yet influence persist amidst a variety of different institutional conditions and contexts.

Contingency

Yet despite these diverse power resources, private sector influence was highly contingent on a particular set of conditions which, if not in place, failed to realize its aims (see below). This finding points to the high degree of *contingency* of successful private sector influence. While it is perhaps tempting to allude to the immanent contingency of nearly all social processes, I pursued the investigations of patterns nonetheless. Within-case analyses pointed to the importance of business conflict in particular. When private sector groups do not express a unanimous set of regulatory preferences, and when they mobilize against each other's aims ('business conflict'),

even the most substantial private sector campaigns were found not to succeed. Across-case analysis has also enabled me to evaluate each of these hypotheses in the study as a necessary and/or sufficient condition in generating influence over Basel II's regulatory policies, and here too the findings suggest contingency.

Within both the transnational and national campaigns explored, I found across-case support for the Mobilization, Coalitions, and Business Conflict hypotheses as underlying *necessary* conditions for influence to occur. Under some circumstances, the Structural Power Hypothesis was also found to be an important necessary condition as well, though this importance varied with the particular of structural power condition explored. However, none of these hypotheses received support as individually *sufficient* conditions for influence. Utilizing the particular strengths of fsQCA, I also engaged in an analysis of the *combined sufficiency* of different sets of conditions present within the campaigns examined. Here the findings were striking. Analysis of transnational campaigns revealed that no particular combination of conditions was found to be sufficient in generating influence. Within the national campaigns examined, however, I found a distinct combination of conditions which were found to be sufficient in ensuring private sector influence, which I have characterized as a particular '*recipe*' of sufficient conditions.

A Recipe

FsQCA demonstrated that within the national private sector campaigns examined, a particular 'recipe' of conditions were sufficient in generating private sector influence in Basel II. Specifically, nationally organized private sector campaigns are sufficient in producing the outcome of permissive regulatory policy change when they utilize information, have a legislative environment supportive to their efforts, and act in an environment free of business conflict. This 'recipe' is not 100% consistent across cases, but it is robust even when subject to empirical validation checks using a variety of different methods and measurement techniques. Furthermore, because the study has engaged in detailed process tracing analysis of private sector campaigns, we can point to specific instances where this 'recipe' has led to private sector influence. In other words, this finding is not the result of simple covariate analysis. Rather, it is a

finding which was arrived at, and stands up to, methodological triangulation. As Chapter 10 demonstrated, the 'recipe' of conditions which are together sufficient in generating private sector influence is robust in comparison with other factors, such as a variety of forms of institutional circumstances. I interrogated the specific mechanisms that may be at play within this recipe, and here too the findings stand up to scrutiny. Yet while the 'recipe' represents a relatively strong and robust finding, it is, in another, perhaps more substantive sense, very *fragile*.

Fragility

The recipe described above is fragile in at least two senses. First, it is fragile in the sense that there is no 'one thing' that private sector groups can do to influence their regulators and regulatory policy outcomes; rather, 'a number of things' must be in place for influence to take place. Second, it is fragile in another, more substantive sense, since the conditions that constitute the recipe are not easily generated through intentional action. In this regard, it would be misleading to say that there is an 'optimal strategy' that private sector groups could pursue to exert influence. On the contrary, many of the conditions – or 'ingredients' – in this recipe are, significantly, conditions which *no one group* can control.

A number of examples help to illustrate this point. In the case of the US campaign surrounding the residential mortgage policy within Basel II, banks were not able to control the fact that mortgage insurance companies provided regulators with useful data to support their conclusions, nor were large banks able to control the fact that small community banks used their resources to countervail demands for permissive regulatory policy change. In a similar manner, we have seen this dynamic at the transnational level, during the operational risk campaign. The Institute of International Finance and the International Swaps and Derivative Association were steadfastly opposed to the operational risk policy of the BCBS, yet they were not able to control the fact that a 'splinter group' emerged within their ranks, the International Technical Working Group, which provided the BCBS with data that enabled them to design a highly stringent regulatory policy. The fragility of the recipe can be further shown through the ways in which some of the resources of private sector groups are not even of their own making. Legislative oversight in the US was generated in large part by the radical opposition to the Pillar I capital charge for operational risk led by the Financial Guardian Group. Yet once a process of legislative

oversight was in place, diverse groups were able to make use of it, including not only large banks that, for example, generated demand for changes to the securitization and the credit cards policies, but also small banks who were also thereby able to leverage their demands.

All of these findings, though interesting in and of themselves, suggest a number of implications for the existing literature. In what follows, I first discuss some of the limitations of this study in terms of addressing the central research question. I then turn to the contributions that the findings of this study might make to the existing literature and future research programs.

Contributions of the Study and Its Findings

As has been made clear from the outset, this study has not purported to explain the entirety of Basel II's content, nor has it sought to 'add up' instances of influence in order to produce an overall evaluation. Rather, the aim has been to explain private sector groups' role in influencing specific regulatory policies within the Accord with the intention of better understanding just how private sector influence in transnational financial regulatory policymaking actually works. In this regard, the important historical structures underlying the basis for Basel II's early formation, and the reasons for the Accord itself, have not been systematically explored. As Chapter 2 has established some configurations of structural power, such as 'externally weak' but 'internally strong' states have been left out of analysis. This focused research design does not mean, however, that the findings of this study do not have important implications for the existing literature exploring the political economy of financial regulation.

In what follows, I argue that there are three clear implications for different literatures. First, I focus on the existing empirical claims regarding 'regulatory capture' of the BCBS in the IPE literature, which have been widespread. Second, I argue that the findings of this study also speak to existing theoretical perspectives on private sector influence more generally, and debates within them regarding the respective role of instrumental and structuralist perspectives. Finally, I argue that the particular approach taken in this study, that of empirical pragmatism and neo-pluralism, can offer insights to IPE more generally.

Regulatory Capture in the IPE of Finance Literature

One implication of this study's findings is related to the tenability of strong statements concerning regulatory capture which, as we have seen in Chapter 1, are highly prevalent in the IPE of finance literature. A generous interpretation would be that the claim regarding 'regulatory capture' in the case of the BCBS has been only 'contingently' correct. As I demonstrated throughout this study, private sector groups were indeed able to successfully influence the content of Basel II, across a number of different contexts. However, in many other instances, private sector groups were spectacularly unsuccessful. This study has explored the determinants of this variation, and has revealed some patterns which may be relevant for future investigation of regulatory capture.

A less generous interpretation would suggest that existing depictions of regulatory capture are highly misleading. The depictions of private sector influence examined in Chapter 1 denote an extensity of influence that is incommensurate with the existing evidence. It is entirely possible that campaigns this study has *not* explored may reveal a more extensive level of influence than represented herein. Nevertheless, variation in outcomes has been a persistent theme in this study, and as an empirical fact it is undeniable: private sector groups didn't always get the regulatory changes they wanted. We have seen that this variation is true not only when the largest banks in the world clamor for change, but also when many of the associations of the largest banks in the world clamor for change. Private sector groups only influenced Basel II under very particular conditions. Their influence was much rarer than 'regulatory capture' would suggest, and even when private sector groups were successful, they were often successful only in circumscribed ways.

It might be said that the existing depictions of 'regulatory capture' are at a level of descriptive generalization that it is not subject to challenge, in the sense that *some* private sector influence occurred, and that (from a normative perspective) 'some' is 'too much.' This argument is completely reasonable. However, such an argument is of a different type than the strong empirical assertions actually made within the literature regarding Basel II, which claim that

Basel II is the prime example of "capture of the regulatory process by the industry it is supposed to regulate";[916] that Basel II signifies "the capture of regulation by large multinational banks";[917] that the "private sector is writing its own script";[918] that the BCBS "fell victim to regulatory capture by large international banks"[919]; and that Basel II is "the perfect example of regulatory and supervisory capture"[920] or "the domination of global financial supervision and regulation by private actors."[921]

It is indeed the case that Basel II's risk sensitive approach to capital adequacy offers advantages to some of the largest and most sophisticated banks in the world. However, as I have argued in Chapter 1, preference alignment between a regulatory policy and private sector groups is not sufficient evidence that private sector groups were responsible for the content of such policies. To be sure, some permissive regulatory policies were successfully advocated by banks. The most significant in this regard would be the expanded use of internal ratings within banks' risk portfolios. However even in this case the BCBS' policy still reflected a significant departure from what private sector groups had been demanding. Moreover, large banks did not achieve the objective that many scholars claimed they achieved, namely the use of their own internal credit risk models to set their own levels of capital adequacy. Examination of structural power at the agenda-setting phase suggested the possibility that private sector groups may have benefited from some (but not all) structural constraints associated with regulators' initial regulatory policy proposals, but only in particular ways (as necessary, but insufficient conditions for influence).

This study has not sought to 'add up' influence or to give a holistic account of 'how far influence has gone.' My objective has been to focus on the *how* question of private sector influence, with the aim of better understanding the machinations of this oft-cited but seldom empirically explored phenomenon. As Saner and Yui have recently remarked, we are just beginning to explore the complex of relationships between state and non-state actors in the process of transnational policymaking.[922] I consider this study, as a specific and empirically focused one, to make a modest contribution to that vast and developing literature. Much of the

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[916] Helleiner and Porter 2009, p. 20.
[917] Ocampo 2009, p. 10
[918] Tsingou 2004, p. 11.
[919] Goldin and Vogel 2010, p. 13.
[920] Tsingou 2010, p. 24.
[921] Underhill and Zhang 2008, p. 533.
[922] See Saner and Yiu 2008.

existing literature has emphasized that non-state actors such as private sector groups play an increasingly important role in processes of globalization; I have shown this role to be important, but I caution that we should be careful not to overstate it. I consider the generalizability of the findings of this study to be potentially contingent themselves on the historical and structural conditions in which Basel II was forged. In this regard it is possible that different actors within the financial sector may possess more effective strategies or capacities to influence regulators, either instrumentally or structurally. Perhaps, for example, because the banking sector is more highly regulated than parts of the financial sector such as hedge funds and/or investment banks, regulators have a stronger degree of discretion and therefore power over their banks. This view would certainly be consistent with the finding regarding the importance of legislative oversight and non-bank allies.

Implications for the Political Economy of Banking Regulation Literature

Because of the particular approach taken in this study, namely that of neo-pluralism, and because I have considered a range of hypotheses drawn from different research programs within political economy, my findings have implications for diverse literatures. In what follows I first discuss these implications of my findings for instrumentalist and structuralist perspectives on private sector influence before discussing the significance of my findings for neo-pluralism.

Instrumentalist Perspectives

As I described in Chapter 1, there are a variety of different perspectives on the political economy of financial regulation which focus on the actions of private sector groups, which is sometimes referred to as 'instrumentalist' perspectives.[923] Public choice approaches to banking regulation that emphasize the importance of legislative oversight as a tool for disciplining regulators have been vindicated in a number of case studies examined in this study. As I demonstrated in a variety of different instances, private sector groups' use of legislative oversight has proven an effective tool in this way. For national private sector campaigns, it is a

[923] As established in Chapter 1. See Fuchs and Lederer 2007

very important necessary condition, both to influence regulators and to engender actual permissive regulatory policy change at the transnational level. On both these counts, however, it was found to be an insufficient condition in and of itself, and must be combined with other factors to be effective.

The literature on 'policy networks', from which I drew several hypotheses, also receives some support from my findings, but such support is highly conditional and qualified. Private sector groups have successfully exchanged information with their regulators, and have mobilized to communicate their concerns, not only formally but informally as part of an ongoing dialogue in many instances. Mobilization was found to be a critical necessary condition, but an insufficient one as well, whereas information was a critical part of the recipe of jointly sufficient combination of conditions. Information is not individually sufficient perhaps because regulators do not accept it at face value; rather, they are often deeply skeptical of its underlying basis. The importance of private sector coalitions was found to be mixed, and in a very particular way: national or transnational coalitions were found to be important necessary conditions, whereas they weren't essential parts of the 'recipe' of combined sufficiency. The involvement of non-bank allies in a campaign was, however, found to be a highly important part of that recipe. This finding was an interesting and somewhat surprising one, and may suggest complementary support for the view that it is only when threatened that national regulatory agencies adapt to pressure. In contrast to campaigns waged exclusively by banks and their various associations, non-bank private sector groups are not under the discretionary control of regulators; as such they may be (or may be perceived to be) a more threatening force than banks themselves.

While this study added to the tradition of policy network theory, its findings were also critical of it. The process-tracing involved in studying various campaigns at both national and transnational levels allowed for not only a deeper understanding of bank-regulator interactions during an important and significant instance of policymaking, but also allowed for the testing of hypotheses. As Thatcher has noted, because policy network analyses often lack a substantive theory of power, hypothesis testing tends to be lacking.[924] Similarly, Macartney has opined the lack of attention to the specific role of interest groups in policy networks in finance.[925] The

[924] Thatcher 1998, p. 404.
[925] Macartney 2008.

respective role of mobilization, coalitions, and the use of information in campaigns has been investigated systematically across cases, thus adding to the already-existing work which explores this domain. However, the policy networks that were uncovered in this study suggest a much less cooperative relationship between banks and regulators as is often depicted in the existing literature. While the exchange of information and dialogue were often very cooperative and cordial, conflict between regulators and private sector groups was also endemic. More importantly, in order to affect actual policy change, much more was needed that communication through the given policy network, as dense as those relationships may have been. It was, quite consistently, the force of legislative oversight, along with other specific campaign elements, that incented regulators to change.[926]

Structuralist Perspectives

A prominent tradition of thinking about private sector influence over regulatory policymaking considers the structural power of private sector groups. As Chapter 1 detailed, structural power arguments take a variety of different forms in different literatures. Do my findings confirm or challenges the claims made within this broad tradition? At the most basic level of analysis, the considerable variation in levels of success should give pause to the efficacy of structural power arguments. On the one hand, one could suggest that simply the presence of costly private sector mobilization suggests that structural power has 'failed', and thus the campaigns examined were ones where empirical tests of structural power were mute or redundant. As I have argued, however, the causal effects of structural power may occur at either the agenda-setting phase or the policymaking phase, and both phases have been investigated. Moreover, the examination of the possible 'structural power selection effects' associated with the countries, and policies, chosen for analysis revealed a diversity of structural power conditions in the sample, minimizing the possibility that the campaigns investigated were ones which selected for particular structural power characteristics already.

[926] The notable exception to this would be the US operational risk campaign in 2001 which, as argued in Chapter 6 and Chapter 10, possessed a unique conflation of conditions which led to policy change.

Many have commented on the difficulties of measuring structural power, and thus of assessing its related claims empirically.[927] At the same time, those working within some structuralist traditions have argued for the need to focus on specific mechanisms and channels of capital's power.[928] This study has taken up a variety of structural power claims as empirical claims subject to scrutiny, not only where possible in process tracing analysis, but also through the utilization of five different structural power variables, assessed through different across-case methodological techniques.

Two classes of frequently cited and theorized variants of structural power arguments were found to have no empirical support in the context of Basel II's development. The structural dependence of the state on finance capital was not found to affect the success of national-level campaigns. The same was true for the potential mobility of different business lines associated with different regulatory policies – even when country-level variation in the capacity to access corporate shells was considered. That both of these variants of structural power arguments are prominent within the political economy literature should give us pause. It is of course possible that the formation of Basel II represents a very special case in which structural constraints operate differently. While such a conjecture would have to be tested empirically, given the diversity of different kinds of regulatory policies examined herein (at least in terms of different areas of banking activity), there is some evidence to support Levy and Egan's argument that international institutions are, in relative terms, isolated from structural pressures in comparison with states.[929]

As Bernhagen has recently pointed out, there are no established standards for measuring structural power claims empirically.[930] Given the relative paucity of actual *tests* of structural power hypotheses, one wonders whether or not this paucity is due to the fact that structural power is difficult to test by its nature or because it is actually tested so infrequently. It is certainly testament to the latter that the findings of this study add to only a small number of other existing studies – all of which have either extremely mixed, or wholly negative findings

[927] See Bernhagen 2008; Duer 2008a, p. 567; Fuchs and Lederer 2007, p. 6.
[928] See Levy and Egan 2000, p. 140.
[929] Levy and Egan 2000, p. 145.
[930] Bernhagen 2008.

regarding the empirical efficacy of structural power claims.[931] It is also tempting to suggest that structural power claims are rarely investigated as empirical propositions because those who mobilize such claims do so within traditions where they have become an accepted part of political ontologies, as in much Neo-Marxian theory and world-systems theory. Such a suggestion certainly echoes Langley and Schwartz's recently accounts, respectively, regarding the self-referential and untested claims regarding financialization.[932] How ironic, then, that this variant of structural power claims received some support in this study. This support was highly qualified, however: a regulatory policy important to financialization was found to be an important necessary condition for private sector influence only in transnational campaigns and at the agenda-setting level of Basel II's development. A large regulatory policy was also found to have the same across-case patterns.

The notable exception to these mixed results with respect to structural power was the finding regarding the relative structural power of the state in finance, which was found to be a persistently necessary condition for private sector influence over Basel II. Being a member of a state with relative structural dominance in the financial domain, such as Germany or the United States, would seem to be a necessary condition for private sector influence through the national pathway. It is tempting to suggest that private sector groups in such states mobilize 'more' or 'harder', because they suspect they have an advantage in achieving influence by virtue of their states' representatives at the BCBS. While such a dynamic seems plausible, correlation tests suggested this relationship to not be the present.

Statist and Institutionalist Perspectives

State power was found to be an important necessary condition for private sector influence, in the same way that the relative structural dominance of the state in finance was found to be. This finding suggests an important role for state power in channeling private sector concerns, as noted above. In this respect, the fact that four out of six instances of influence through the national pathway were via the United States may suggest the structural importance of

[931] See Bernhagen and Brauninger 2005; 2007, 2008; Walter 2000; Helleiner 2008.
[932] See Langley 2004, p. 541; Schwartz 2008, pp. 32-36.

the US. On the other hand, however, influence from the US was often less systematic than that of Germany, as the influence generated by US campaigns was highly circumscribed in the case of credit cards and securitization. In this regard, the fact that German regulators were, under the right conditions, able to influence the Accord in significant ways, even despite US resistance, suggests support for a number of authors' contentions operating within a statist tradition that the US no longer maintains dominance in international financial affairs, at least in banking.[933] As such, this study adds to those who have criticized Simmons' hypothesis regarding US dominance in financial affairs.[934] I have done so in different ways: While the work of Drezner has considered state power based on qualitative analysis across regulatory issue domains, my study was of course focused solely on financial regulation; while Posner's research has examined securities regulation, my focus has been on banking.[935] At the same time, the contribution of my study shows the limits of state power. A strong state may be a necessary condition for private sector influence over transnational financial regulatory policymaking, but it is one of several, and is not a sufficient condition. Moreover, by demonstrating instances of successful transnational campaigns, I have shown that private sector groups need not even work through their states as a matter of course, but can influence policymaking on a transnational basis.

This study also explored the respective role of institutions in driving, and/or conditioning private sector influence. An institutionalist approach might consider interests to be endogenous to the institutions which order actor behavior, and thus empirical regularities should be found among particular institutional configurations as they correspond to outcomes. My findings provide a challenge to such perspectives.[936] Through across-case analysis which considers a variety of institutional conditions, I have shown that institutional factors or configurations are poor predictors of influence. In addition, I have shown from qualitative within-case analysis that private sector influence occurred under a variety of institutional contexts: at the transnational level in a number of instances, and at the national level in macroinstitutional environments that were strikingly different from one another. In this sense, the agency-oriented perspective advanced in this study has received considerable support as a fruitful line of enquiry. Despite

[933] See Drezner 2007, pp. 23, 121; Braithwaite and Drahos 1999, p. 113; Posner 2009.
[934] Simmons 2001.
[935] Posner 2009; See also Posner and Veron 2010.
[936] As we saw in Chapter 2, however, the extent of institutionalist diversity is limited in some dimensions. As such the empirical grounds that this study provides to challenge institutionalist claims can be considered limited to the institutionalist variety within the G10.

these contributions, there are limits to how far my findings regarding the importance of institutions might be. In particular, the low level of institutional diversity that actually existed within the G10 at the time of Basel II's development suggests the possibility that institutional configurations outside this spectrum may yield different results. In addition, it might be pointed out that other areas of financial regulation, such as hedge funds, the securities sector, and insurance are regulated under different institutional conditions, meaning that findings in those areas may be different, potentially, than those I have found in banking.[937]

Neo-Pluralism and the Approach Taken in This Study

More than any other tradition within political economy, my empirical findings support the perspective that I have taken, that of neo-pluralism. Both instrumental actions taken by private sector groups and structural conditions have been used to explain influence, an approach commensurate with the existing neo-pluralist literature.[938] Support for a neo-pluralist perspective has been most vividly demonstrated by the strong findings regarding business conflict. While business conflict has been explored in a variety of different transnational policy domains within the literature on neo-pluralism, such as trade and the environment, this study further demonstrates the efficacy of this mechanism in the domain of banking regulation.[939] I have not only shown the operation of business conflict through within-case analysis, but also demonstrated its importance as a mechanism which functions across-cases. These findings are relevant not only for neo-pluralism but for other traditions which emphasize business conflict – for example the Amsterdam School of IPE which emphasizes the 'fractionalization of capital'.[940]

In analyzing both instrumental actions and structural power conditions together as empirical questions (rather than philosophical ones), following Sell, I have considered structural power and instrumental actions to act in potential conjunction with one another.[941] While it is a

[937] While Basel II did feature mobilization of investment banks and some insurance firms (such as in Chapter 7 and 8), these firms were engaged with issues of commercial banking regulation, not the direct regulation of their industries per se.
[938] See Falkner 2007, Sell 2000, pp. 92-93.
[939] See Cox 1996; Falkner 2010.
[940] Compare, for example, Cerny 2010: 304-5 and Falkner 2010 with Van Apeldoorn 2004; Overbeek 2004; Macartney 2009; Van der Pijl 1984.
[941] See Sell 2000, pp. 92-93.

mainstay of neo-pluralism that structural power should be taken seriously, the precise conditions under which structural power is operative are not explored empirically.[942] I have tested such a notion empirically, and found 'agency' conditions much more important than 'structural power' ones, though some (such as the relative structural power of the state in finance) are important necessary conditions, and do not diminish the consistency of a jointly sufficient solution.

It is with respect to contingency of private sector influence that this study has made its most central contribution. More so than its initial progenitors such as Lindblom, the proponents of neo-pluralism within IPE tend to emphasize the complexity and contingency of private sector influence. As Cerny has recently noted in his recent work on neo-pluralism, processes and outcomes in the context of globalization can be regarded as highly contingent on multiple complex and often unpredictable factors.[943] Similarly, Sell has called for similar attention to the contingency of private sector influence over transnational policymaking as well.[944] Even beyond neo-pluralism, broader discussions about IPE as a field also advocate attention to contingency. Amin and Palan, for example, have called for an IPE which analyzes "how power is mobilized in a system of fragmented authority", point to the incredible complexity of "new forms of politico-economic rearrangement", and advocate for the appreciation of contingency by analyzing different forms of state-capital relations, "with varying outcomes in different social and cultural settings, depending on the balance of power and interest between the two players..."[945] This study has not only embraced such a view of contingency; it has revealed *particular patterns* of contingency.

As I stated at the outset of this study, claims regarding contingency are themselves empirical claims: for an outcome to be contingent, it must be contingent *on* something else. Rather than simply pointing out this contingency, I have used a variety of methods to explore just what private sector influence is contingent on. While existing studies within this literature have empirically captured the complexity and contingency of private sector influence, they have typically done so by means of either a small number of comparative case studies (such as the

942 Cerny 2010: 104:9; Falkner 2007
943 Cerny 2009; 2010, pp. 105, 117-127.
944 Sell 2000, pp. 92-93.
945 Amin and Palan 2001, pp. 568, 560, 573.

work of Falkner) or an intensive empirical narrative tracing events (such as the work of Sell).[946] There are many strengths to both of these approaches, many of which I have adopted. However it is striking that the existing literature has not made use of new methods developed within the social sciences, such as QCA, especially given its non-linear additive nature and appreciation for causal complexity and contingency. While used increasingly in comparative politics and sociology, QCA has not been applied to either IPE or studies of private sector influence. Recently, Schneider and Wagemann have discussed the uneven usage of QCA, and the fact that while originating in the United States, it has been much more widely used by scholars within Europe.[947] Whether or not, as they argue, this unevenness is due to the less pervasive methodological divides within Europe is an open question; what is more certain is that the use of such new methods might help satisfy Katzenstein's recent call for more 'analytical eclecticism' in IPE, at least in terms of employing a diversity of empirical methods.[948]

Recently Underhill has stated that "if political economy is by nature interdisciplinary...then an interdisciplinary and inter-methodological capacity can only prove positive".[949] As agreeable as this statement is, it would seem that interdisciplinarity has been taken much more seriously than the utilization of a diversity of methods, at least when across-case methods are concerned. Intellectual and cultural divisions within IPE, whether characterized by a American/British-School division or by 'Third Generation IPE'/'everyone else' are often quite starkly separated not only on ontological lines, but also along methodological ones, reflecting in many ways quantitative/qualitative divisions within political science more generally.[950] Since fsQCA represents a bridge between these two worlds – and offers to 'lure social science from the doldrums' as Ragin has recently put it[951] – those seeking to reconcile approaches would do well to utilize this new method of across-case analysis.

[946] See Falkner 2001; Falkner 2007; Sell 2000; Sell 2003.
[947] Schneider and Wagemann 2010, p. 377.
[948] Katzenstein 2009, p. 133. See also Farrell and Finnemore; Katzenstein and Sil 2008.
[949] Underhill 2009, p. 354.
[950] See for example Underhill 2009, p. 348; Cohen 2009, pp. 399-400; See also the interventions on methodological differences in Blythe 2009 and Helleiner 2009. The American/British school typology is attributable to Cohen 2007, 2008.
[951] Ragin 2006b.

Beyond Basel II

While the BCBS is one of the most important institutions in global financial governance, it is one single institution among many. Because of the focused empirical nature of this study, I have not sought to actively engage in generalizable claim-making or claim-testing beyond the cases that I have examined herein. Basel II was developed in a very particular time and place. The BCBS has institutionalized modes of procedure, and a structure which is in many ways particular to itself, and do not represent general features shared by other institutions. In this regard it must be left an open question whether or not the findings of this study are generalizable to other instances of transnational regulatory policymaking. I consider this question an empirical one, and leave it open to further research, cognizant of the fact that, as Büthe has recently observed, the study of international regulatory cooperation is still only in its infancy.[952]

The recent transformation of the Financial Stability Forum into the Financial Stability Board, and the changed participatory structure of the BCBS, mean that the configurations of country representation in formal institutions of global financial governance have changed remarkably.[953] These changes include the formal inclusion of countries such as India and China which, if their comments on the Basel II process are any indicator (to say nothing of their own domestic regulatory regimes), have not only different regulatory preferences than their G10 colleagues, but considerably different capacities as well. How exactly these differences will transform the BCBS' work remains to be seen. The sets of norms and discourses which were in place during the formation of the Basel II Accord have changed since the recent global financial crisis. Many widely accepted principles have been substantially challenged, in particular the widespread acceptance of the 'efficient market hypothesis.'[954] Relatedly, attentive publics and governments have been highly critical of what is often viewed as the demonstrable failure of regulation in light of the crisis. The standards of stringency within the context of Basel II's development are also comparatively permissive when contrasted to contemporary discussions. In this regard, the BCBS is currently attempting to construct an improved global regulatory regime for banking regulation, and has been actively consulting actively with private sector groups in the effort to construct a 'Basel III'. What will the result of this interlocution be, given the present

[952] Büthe 2008, p. 208.
[953] For a summary of many of these recent transformations, see Helleiner and Pagliari 2010.
[954] See, for example, FSA 2009.

political-economic climate? How and when will the private sector continue to exert influence in the pursuit of its preferences? Which regulatory proposals will never even make it to the floor of legislatures, or into the discussions in Basel? What role will private sector groups play in this process? These are not only fascinating questions – they are also pressing ones.

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Appendix 1
Interviews Conducted

This study involved extensive field research in which I conducted interviews with 97 different individuals who were involved in the formation of, and private sector contention around, Basel II. This Appendix provides a brief discussion of the interview methodology used and provides a list of the individuals I interviewed for the study. Interview subjects were selected on the basis that they were either 1) involved in the creation of the Basel II Accord in a regulatory function (i.e. as participants within the BCBS), or 2) were involved in the private sector efforts to influence its content. Individuals were selected on the basis of availability, rather than through a representative sampling method. Names and contact details were found through the trail of documentation left in the wake of Basel II's development, and through follow-up contacts and interviews themselves, whereby relevant contacts were given by interview subjects. Names of relevant individuals were often provided through lists of BCBS participants in BCBS documentation and studies, while private sector group participants' names were often cited in letters to the BCBS. Initial contact was usually made through a formally written letter (in English or German) or, occasionally, an email. Follow-up calls, letters and emails occurred as necessary. Because of the methods employed in the study, the selection of interview subjects followed the 'non-probability sampling' method described by Tansey, which is typical of process-tracing analysis not intending to generalize findings to particular behaviors, but rather to reconstruct events and to corroborate findings.[955]

In the manner commensurate with process tracing for 'elite interviewing', I used interview subjects primarily 1) to reconstruct a set of events as they took place, i.e. as a source of empirical material, and 2) to corroborate what has been established/claimed by other sources.[956] The interviews were semi-structured in that I had written questions ranging from very general to very specific, but there were numerous opportunities for the interview participant to casually

[955] See Tansey 2007.
[956] See Tansey 2007, pp. 766-767.

elaborate on a particular issue or event.[957] As is conventional in elite interviewing, interview subjects were found through an iterative process of using names from documentation, as well as gathering contacts as the process of interviewing proceeded.[958] I took care to cross-corroborate information about international private sector activity by spreading the interview sample though not only interviewing individuals who were involved as staff of the international associations, but also the individuals who were involved as members of these associations as well.

An important challenge within interviewing is to minimize 'experimenter effects' – the effects that the interviewer produces the information that they want to generate.[959] Because my research design does not entail a 'thesis' to be 'proven', I consider the severity of this problem to be minimized. I followed basic guidelines in qualitative interviewing techniques in this regard, but not 'cueing' respondents, and seeking to obtain a true account of past events as they took place. One persistent difficulty with semi-structured interviews concerning past events is the problem of individuals' memory. I accounted for this by corroborating interview-generated claims with other sources of evidence. In general, I did not consider a claim to be genuine unless it was corroborated by additional evidence, such as documentation or other claims from other interview participants. A further central challenge of interviewing for research is the unintentional misrepresentation of events.[960] This I addressed by asking questions about specific events rather than overall accounts and, at times, by asking various interview respondents to reflect on *other* factual claims of other interviewees. Furthermore I also brought up documentary sources of information in many interviews once responses were already given, by bringing up examples of events and preferences from written material such as speeches, testimony, newspaper articles, and research studies, and asked my interview subjects to give an account of whether these events and preferences were accurate or not. Most interviews lasted over an hour, and were conducted at the interview subjects current place of work.

List of Interview Participants

[957] Improvisation in this regard is key, especially for elite interviews where schedules of interview participants can be especially tight. Odendahl and Shaw 2001, p. 305

[958] See Odendahl and Shaw 2001, pp. 305-307

[959] See Weiss 1994, pp. 211-212.

[960] See Weiss 1994, pp. 147-148.

Interview participants are listed below with their name (unless they asked to be listed as anonymous), and the primary organization that they worked for during the period under investigation. To be clear, many of these individuals now work for *different* organizations: I list only the organization that they worked for during the time of interest to the study. It is important to point out that many of the interviewees listed below from specific firms were also members of associations as well. Below the name of their organization is the location where the interview was physically conducted (otherwise the telephone locations are indicated). This list is not chronological - as part of my effort to further promote the anonymity of interview-based claims made within the text (in which a source from an interview is listed as R for 'regulator or public institution' and P for 'private sector participant').

Interview Participants Involved Primarily in Public Agencies

Andrew Crockett
Director
Bank for International Settlements
New York
13 November 2007

Roger Cole
Senior Associate Director
Banking Regulation and Supervision
US Federal Reserve Board
Washington, D.C.
1 August 2008

Claes Norgren
Director of the Swedish FSA
Stockholm
12 October 2007

Oliver Page
Director, Complex Groups Division

Financial Services Authority
London
17 October 2007

Roger Ferguson, Jr.
US Federal Reserve Board
Washington, D.C.
21 November 2007

Jaime Caruana
Governor
Bank of Spain
Washington, D.C.
20 November 2007

William McDonough
Federal Reserve Bank of New York
New York
16 July 2008

Patrick de Fontnouvelle
Quantitative Analysis Unit
Federal Reserve Bank of Boston
Boston
13 May 2008

Barbara Bouchard
Federal Reserve Board
Washington, D.C.
17 May 2008

Kevin Bailey
Deputy Comptroller, Capital and Regulatory Policy
Office of the Comptroller of the Currency
Washington, D.C.
19 May 2008

William Lang
Federal Reserve Bank of Philadelphia
Philadelphia
15 July 2008

John Hawke, Jr.
Comptroller of the Currency
United States Treasury
Washington, D.C.
18 November 2008

Larry Meyer
Member of the Board of Governors
Federal Reserve Board
Washington, D.C.
31 July 2008

Anna Lee Hewco
Federal Reserve Board
Washington, D.C.
17 May 2008

John Jordan
Quantitative Analysis Unit
Federal Reserve Bank of Boston
17 July 2008

David Jones
Division of Research and Statistics
Federal Reserve Board
Washington, D.C.
31 July 2008

Kim Olson
Federal Reserve Bank of New York
New York
25 July 2008

Bradford Case
Economist
Board of Governors of the Federal Reserve System
Washington, D.C.
30 July 2008

Reinhold Vollbracht
Deutsche Bundesbank
Frankfurt
8 November 2008

Jens Conert
German Ministry of Finance
Berlin
7 November 2007

Charles Freedland
Deputy Secretary General
BCBS Secretariat
Basel
25 May 2006

Vesa Vanhanen
DG Enterprise
European Commission
Brussels
31 May 2006

Howard Davies
Director
UK Financial Services Authority
London
5 July 2007

Seregdi Laszlo
Hungarian Financial Services Authority
Budapest
20 October 2007

Carter K. McDowell
House Financial Services Committee
Washington, D.C.
17 May 2008

Jason Cave
Senior Capital Markets Specialist
Federal Deposit Insurance Corporation
Washington, D.C.
31 July 2008

Eric Rosengren
Quantitative Analysis Unit
Federal Reserve Bank of Boston
Washington, D.C. to Boston (telephone)
16 May 2008

Anonymous Regulator
Federal Reserve Board
Washington, D.C.
31 July 2008

Michael Gordy
Division of Research and Statistics
Federal Reserve Board
Washington, D.C.
31 July 2008

Tom de Swaan
Member of the Governing Board
De Nederlandsche Bank
26 November 2007

Richard Spillenkothen
Director, Division of Banking Supervision and Regulation
Federal Reserve Board
Washington, D.C.
1 August 2008

David Gibbons
Office of the Comptroller of the Currency
New York to Chicago (telephone)
15 August 2008

Marc Saidenberg
Federal Reserve Bank of New York
New York
18 August 2008

Darryll Hendricks
Senior Vice President, Bank Supervision Group
Federal Reserve Bank of New York
New York
2 September 2008

Gerhard Hoffman
Bundesbank
Berlin
13 April 2009

Daniel Nuoy
Bank of France
Paris
21 June 2009

Ruediger Gebhard
BaFin
Bonn
29 October 2007

Interview Participants Involved Primarily from Private Sector

Joseph Sabatini
JP Morgan
New York
21 July 2008

Tony Peccia
Bank of Montreal and CIBC
New York to Toronto (telephone)
23 July 2008

Arjun Mathai
Bank Gesellschaft Berlin
London
26 September 2007

Finn Rieder

Bundesverband der deutscher Banken
Berlin
2 October 2007

Harald Lob
Kreditanstalt fuer Weideraufbau
Cologne
13 September 2007

Jens Tolckmitt
Association of Foreign Banks in Germany
Frankfurt
9 October 2007

Deborah O. McKinnon
Mortgage Bankers' Association
Washington, D.C.
19 May 2008

Dan Kohlbrenner
State Street Global Advisors
Boston
28 May 2008

Wolfgang Vahldiek
Association of Foreign Banks in Germany
Frankfurt
9 October 2007

Rudolf Siebel
Bundesverband Investment and Asset Management
Frankfurt
9 October 2007

Charles Dallara
Institute of International Finance
Washington, D.C.
20 November 2007

Richard Coffmann
Institute of International Bankers
New York
14 November 2007

Rob Strand
American Bankers' Association
Washington, D.C.
15 November 2007

Robert Davis
America's Community Bankers
Washington, D.C.
19 November 2007

Ulrich Stumpp
Verband der Burgschaftsbanken
Bonn
7 November 2007

Chitra Muralikrishnan
Royal Bank of Canada
Toronto
26 June 2008

Reinhard Kudiss
Bundesverband Deutscher Industrie
Berlin
31 July 2007

Niels Oelgart
Deutscher Industrie und Handelskammertag
Berlin
1 August 2007

Norman Nelson
New York Clearing House
New York
14 August 2008

Axel Nitschke
Deutscher Industrie und Handelskammertag
Berlin
1 August 2007

Andres Portilla
Institute of International Finance

Washington, D.C.
20 November 2007

Paul Smith
American Bankers' Association
Washington, D.C.
21 November 2008

John Mingo
Risk Management Association Capital Group
(*also* Federal Reserve Board)
Cambridge to Montana (telephone)
13 May 2008

John W. Carlson
Financial Services Roundtable
Washington, D.C.
17 May 2008

Joerg Oertgies
Bundesverband der deutscher Banken
Berlin
2 October 2007

Heiner Brockmann
Deutscher Industrie und Handelskammertag
Berlin
2 October 2007

Ute Aschenbrenner
Zentralverband der deutscher Handwerks
Berlin
4 October 2007

Paul N. Smocer
Mellon Financial
Washington, D.C.
17 May 2008

Clifton E. Rodgers, Jr.
Real Estate Roundtable
Washington, D.C.
18 May 2008

Peter D. Morgan

National Association of Realtors
Washington, D.C.
18 May 2009

David Crowe
National Association of Home Builders
Washington, D.C.
18 May 2008

David L. Ledford
National Association of Home Builders
Washington, D.C.
18 May 2008

Peter Konesny
Deutscher Sparkassen und Giroverband
Berlin
4 October 2008

Thorsten Reinicke
Bundesverband Volksbanken und Raiffenbanken
Berlin
4 October 2008

Anonymous Individual at Major US Bank
Anonymous US Bank
Location Anonymous
28 May 2008

Ashish Dev
KeyCorp
New York
2 June 2008 and 17 July 2008

Nicholas Silitch
Bank of New York
Washington, D.C.
4 June 2008

Pamela Martin
Risk Management Association
Philadelphia
9 June 2008

Michael Bleier
Mellon Financial
New York to Philadelphia (telephone)
10 June 2008

Anonymous
Canadian Bankers' Association
New York to Toronto (telephone)
25 June 2008

Charles Taylor
Risk Management Association
Philadelphia
9 June 2008

Anonymous Representative
International Swaps and Derivatives Association
London
12 November 2009

Stuart Brennan
Bank of Montreal
Toronto
26 June 2008
Kenneth Sax
Bank of America
New York to San Francisco
4 August 2008

Leane Tobias
Mortgage Bankers' Association
New York to Baltimore (telephone)
8 July 2008

Bill Bosies
New York Bankers' Association
New York
9 July 2008

Colin Church
Citigroup
London
19 June 2009

Thomas Wren
MBNA
New York to Delaware (telephone)
18 July 2009

Lyn McGowan
Royal Bank of Canada
Toronto
26 June 2008

Chris Cole
Independent Community Bankers' Association
Washington, D.C.
31 July 2008

John Walter
Bank of America
New York to San Francisco
4 August 2008

D. Wilson Ervin
Credit Suisse
New York to New York (telephone)
5 August 2008

Adam Gilbert
JP Morgan Chase
New York
6 August 2008

Anonymous
American Securitization Forum
New York
12 August 2008

Gail Haas
New York Clearing House
New York
14 August 2008

Hartmut Kaempfer
German Association of Savings and Giro banks
Berlin
17 April 2009

Simon Wills

British Bankers' Association
London and Bath
3 March 2009 and 15 June 2009

Wolfgang Kaelberer
German Association of Mortgage Banks
Brussels
2 June 2009

Appendix 2

Indicators Used for Variable Codings

Table A2.0: Four Value Fuzzy Set for 'Permissive Regulatory Policy Change'

Observable characteristics	*If Relationship Found, This Indicates:*	*Membership in set*	*Value*
Regulatory capital requirements decrease substantially, such that the change is unambiguously permissive	An instance of influence	Fully in	1
Regulatory capital requirements decrease, but not substantially, such that while change has clearly been in a permissive direction, there are still elements which did not change in this direction	Circumscribed influence	Mostly but not fully in	.67
Some elements of the policy change reflect permissiveness, but these are either 1) very modest or 2) compensated by more restrictive regulatory policy changes within the same policy	No influence, but some effect on the form of policy	Mostly but not fully out	.33
No change, or change is not in a permissive direction	No influence	Fully out	0

Table A2.1: Four Value Fuzzy Set for 'Change in Regulators' Position' (CRP)

Observable characteristics	*Membership in set*	*Value*
Regulator clearly changed their position on a policy	Fully in	1
Some evidence of regulator changing their position on a policy	Mostly but not fully in	.67
Logic would support the notion that a regulator changed their position, but there is no empirical evidence available	Mostly but not fully out	.33
No evidence of a regulator changing their position	Fully out	0

Table A2.2: Four Value Fuzzy Set for 'Value Claiming Behavior' (VCB)

Observable characteristics	*Membership in set*	*Value*
Regulator clearly engaged in value-claiming behavior	Fully in	1
Some evidence of regulator engaging in value-claiming behavior	Mostly but not fully in	.67
Some indication that the regulator may have postured toward value-claiming behavior	Mostly but not fully out	.33

No evidence of a regulator engaging in value-claiming behavior	Fully out	0

Value-Claiming Behavior

For indicators o value-claiming behavior, I draw heavily from the indicative behaviors suggested by Odell, especially under his understanding of the 'offensive' and 'defensive' variants of value-claiming behavior. Odell 2001 provides an extensive list of empirical indicators of value-claiming behavior, and I employ many of these indicators. In instances of value claiming behavior, the negotiator:

- Criticizes the other country's actions or arrangements, blames it for the problem under discussion
- Rejects or ignores demands for concessions or delays their concession
- Demands concessions for the benefit of his or her own country
- Takes steps to worsen the other's alternative to agreement and improve her own
- Attempts to exclude from the agenda issues on which her own country would probably have to make concessions
- Threatens to take action harmful to others unless they yield the desired concessions
- Threatens or imposes counter threats or sanctions

Fuzzy Set Calibrations for Explanatory Variables

The tables below provide the fuzzy-set coding scores for each of the main explanatory variables of interest described in Chapter 2. As with the main dependent variable of interest, permissive regulatory policy change, these fuzzy-sets are calibrated to 4-values, 0 (full non-membership in the set), 1 (full membership in the set), .33 (out but not fully out of the set), and .67 (partial membership in the set). The underlying basis behind of the explanatory variables are described in Chapter 2, and this list provides a guide only – fuzzy-set scores are justified on the basis of the qualitative evidence provided within each empirical Chapter (Chapters 3-9).

Table A2.3: Four Value Fuzzy Set for Private Sector Mobilization

Highly concerted, oppositional campaign	Fully in	1

Campaign of opposition	Mostly but not fully in	.67
Policy commented on	More or less out	.33
No private sector mobilization	Fully out	0

Table A2.4: Four Value Fuzzy Set for Coalitions

Organized and coordinated coalition of groups	Fully in	1
Organized coalition of groups	More or less in	.67
Potential coalition of groups	More or less out	.33
No coalition	Fully out	0

Table A2.5: Four Value Fuzzy Set for Information

Strong informational content of the campaign – studies conducted, elaborate technical arguments made, exchanged with regulators	Fully in	1
Some clear informational content of the campaign – studies conducted and technical arguments made to regulators	Mostly but not fully in	.67
Some informational component to the campaign, but not extensive	More or less out	.33
No or very little informational component to the campaign – arguments are made but do not represent the communication of specific and detailed information	Fully out	0

Table A2.6: Four Value Fuzzy Set for Enemies of the Campaign

Evidence of some private sector groups both supporting the policy in question and opposing the claims of other groups	Fully in	1
Some private sector groups either support the policy in question or oppose the claims of other groups	More or less in	.67
Some indications of business conflict	More or less out	.33
No coalition	Fully out	0

Table A2.7: Four Value Fuzzy Set for Legislative Oversight

Legislative oversight is present and focused on this policy	Fully in	1
Legislative oversight is present, and this policy has been identified	Mostly but not fully in	.67
Legislative oversight is not present for this policy, but the possibility is in view	More or less out	.33
Legislative oversight is not present for this policy	Fully out	0

Appendix 3

Constructing a Population of Policies

Because there is not a ready-made list available of policies that together constitute the Basel II Accord, it is necessary to first carefully construct a population of policies from which subsequent analysis can draw from. I employ three main criteria for the collection of policies, which together help to establish the delimiting parameters for the cases that can be considered for analysis. For a policy to qualify into the total population of policies, it must fulfill the following criteria:

1) *Significance.* The regulatory policy was identified as significant by the BCBS

2) *Coherence.* The regulatory policy is of such a nature that its outcome can be relatively unambiguously understood as a coherent whole, and thus positions can be taken on it in a coherent manner.

3) *Relevance.* The development of this regulatory policy involved the presence of at least one of the explanatory or dependent variables of interest.

Collecting Policies by Significance

Defining the significance of a regulatory policy is a methodological challenge, since the qualification of 'significant' is not only highly subjective, but that subjective selection may also be systematically biased. What is significant to a regulatory might not be significant to a private sector group, and vice versa. Recognizing this challenge, significance is determined by the following criteria. A policy is deemed significant if it has been flagged by the BCBS as a significant aspect of the Accord in some way. This could be for a variety of reasons: because a change was made to this policy, because the policy was removed, because the policy was introduced, because it was controversial, etc. There are two ways in which the qualification of a policy in this way can be ascertained from the available empirical material.

The first way that policy significance can be ascertained is through the BCBS's own quantitative studies of the Accord itself. The regulatory agencies that compose the BCBS have an incentive to measure the impacts of the Accord's policies across the G10 (and beyond the G10 as well). As such they conducted several Quantitative Impact Studies (QISs), both over the course of Basel II's development, and after it was finalized as well. In each of these studies, the BCBS tried to ascertain how the Accord was going to affect the status quo in banking practices at the time. These QISs provide a good indication of the policies that the BCBS believed to be significant, because it would be senseless to measure the impact of policies which were deemed otherwise. An example of a policy case ascertained in this way is 'mortgage lending'. The fact that the BCBS saw this policy within the Accord as significant is evinced by the fact that in several QISs, they conducted a quantitative estimate of how the regulations they had developed were expected to influence the way that banks behaved in regard to mortgage lending. This QIS data reveals a number of policies of interest for the BCBS, which are summarized in Column N of Table N below, under the heading 'Quantitative Criteria'.

The second method in which the significance of a policy can be ascertained is through the reports of significant events which occurred over the course of the formation of Basel II. This requires a qualitative analysis of the documentation that the BCBS produced during this period, including its newsletter reports and updates. This method however does not involve much qualitative judgment on behalf of the researcher, in that the updates that the BCBS produced typically involved list of policies which they were either conducting work on or which they wished to report significant decisions on. These policy characteristics are summarized in Table A3.0 below.

Table A3.0:
Selection of Policies by Different Criteria

#	Policy Areas	Significance: Quantitative Criteria	Significance: Qualitative Criteria	Coherent?	Included?
1	Corporate	Yes	Yes		
2	Bank	Yes			
3	Sovereign	Yes		Yes	
4	SME Lending	Yes	Yes	Yes	Yes
5	Specialized Lending	Yes	Yes		

6	Residential Mortgages	Yes	Yes	Yes	Yes
7	Revolving	Yes	Yes	Yes	Yes
8	Other Retail	Yes	Yes		
9	Equity	Yes		Yes	No
10	Purchased Receivables	Yes			
11	Other Assets	Yes			
12	Securitization	Yes	Yes	Yes	Yes
13	Counterparty Risk	Yes		Yes	
14	Specific Risk	Yes			
15	Market Risk	Yes			
16	Related Entities	Yes			
17	Other Deductions	Yes			
18	Partial Use	Yes	Yes		
19	Operational Risk	Yes	Yes	Yes	Yes
20	Interest Rate Risk		Yes	Yes	Yes
21	W factor		Yes	Yes	Yes
22	Repos		Yes		
23	Procyclicality		Yes		
24	Maturity		Yes	Yes	No
25	Expected Losses		Yes	Yes	Yes

Selecting Policies on Coherence

As Table N illustrates, the two combined significance criteria highlighted above yields a total of 25 different policies within the Accord that are suitable for analysis based on the significance criteria. As Column 5 highlights, however, not all of these policy areas fulfill the criterion of coherence. For a policy to be coherent, a position on, and outcome within, a policy must be relatively unambiguous to understand. Coherence is important not only conceptually, but also methodologically, since the task of process-tracing changes to a final policy outcome over time is not possible if 'the policy' in question constitutes disparate elements. For example, the policy toward 'related entities' or 'other deductions' are not coherent, because they refer to a disparate number of policies, referring to different operations within other policies. Because an examination of policy development, influence, and negotiation requires specificity, a policy is only coherent if can, at least potentially, refer to a specific decision made about that policy.

Selecting Policies on Relevance

The third criterion a policy must fulfill to qualify into the total universe of policy cases to be examined is that the policy must have relevance for the study. To be relevant to the study entails that private sector groups engaged in a campaign over a given policy. This affects does not affect the population of policies already discerned above. It does however affect the total population of policies in the study, because some policies may have been excluded from selection based on the criteria above. Perhaps, for example, there are policies which private sector groups thought to be significant, but which the BCBS did not take notice of, chose to ignore, or simply chose not to discuss in their publically available documentation or in their QIS studies.

One dimension of the potential systematic bias of the policy significance criterion can be illustrated through a simple 2x2 table, as in Table A3.1 below. All policies that were significant to the BCBS would have a high likelihood of being selected (i.e. boxes (a) and (c), below). Policies which were not significant to either the BCBS or private sector groups (i.e. box (d)) might experience a systematic bias of not being selected, but this is acceptable, because no party of interest defines them as significant and they are thus irrelevant to the study.[961] However policies that were not deemed significant to the BCBS, but were deemed significant to private sector groups might also be systematically excluded (i.e. box (b)). As there is some probability that they would have been included in the QISs and publically-issued documentation of the BCBS, the chances of these kind of policies being selected is not as low as in box (d). Nevertheless, it does represent a plausible systematic bias that should be addressed.

Table A3.1: Matrix of Possible Systematic Bias due to Policy Significance Criteria

	Significant to BCBS?	
Significant to PSGs?	Yes	No
Yes	a) High	b) Medium
No	c) High	d) Low

[961] They may however be relevant to another study based on the same empirical subject, for example a normative study of what was left out of what the BCBS and private sector groups were concerned with during this period, and what they thought to be of relevance. However such considerations are not a part of this study.

A policy or policies in box (b) might be policies that private sector groups exercised a campaign over, but were unsuccessful in getting the BCBS to respond, for example. Such cases would be relevant for analysis, since they might imply a unique configuration of causal condition and outcomes. Furthermore, a pro-active campaign which was unsuccessful in its endeavors might also be in box (b). Excluding such cases would represent not just a loss of diversity in the study, but a potential distortion of its general findings as well. This possible systematic bias is, thankfully, one that can be (at least partially) corrected. Policies can be searched for which private sector groups considered of significance, but which, for whatever reason, were not identified as significant in the criteria highlighted above. Searching for such policies inevitably involves some qualitative assessment on behalf of the researcher. Such a search is also a process that is highly inductive, so such policies will have to be justified for inclusion. I have selected four policies in this regard.

The first is the policy of full internal credit risk models. As subsequent within-case analysis within Chapter 1 will affirm, the importance of this policy was highlighted in a number of semi-structured interviews with both private sector and regulatory interview participants, and has also been identified by other researchers that have examined Basel II. This greatly strengthens my confidence that the inclusion of this policy into the population of significant policy cases is supportable. Relatedly, the second policy included is the policy of employing banks' own internal risk ratings into the Accord's risk models – a practice known as the 'Internal Ratings' approach. This is probably the most broadly defined policy within the Accord, but it nevertheless is a highly important one.

The third policy I have included is the policy toward commercial real estate lending. This policy is included in the total population of policies because this is a policy which experienced legislative oversight (in Germany). This case is thus included in order to maximize the diversity of causal conditions present within cases (maximizing such diversity is critical for a test of sufficiency, for fsQCA). The fourth policy included is a policy drawn from the specialized lending category of the Accord. While specialized lending as a whole was not determined to qualify for the criterion of coherence, one subset of the specialized lending part of the Accord can be identified in which there is coherence, and in which specific policy changes can be observed over time. This subset of the specialized lending part of the Accord refers to a specific

form of real estate: 'high volatility commercial real estate', or HVCRE. As subsequent within-case analysis will affirm, this policy was not highly significant for most of the BCBS, but was highly significant for the US delegation, and for private sector groups within the US which advocated its removal.

Finally, two regulatory policies within Basel II which could have been included in this study have been excluded. These are the policy on 'Maturity' (i.e. risks associated with the length of a risk exposure), and the policy toward banks 'Equity' exposures. Systematic exploration of both of these policies has been undertaken. However campaigns associated with these policies have been excluded from the present study for two reasons. First, it is not possible within the space constraints of the present format to describe the (albeit fascinating) campaigns surrounding these policies. Second, the findings of the campaigns associated with these policies were found to be no different from the findings of the study overall, and their exclusion can be justified on this basis.

Appendix 4

Technical Terms in Bank Regulation

Like the 1988 Basel Accord, the Basel II Accord specifies a series of minimum capital adequacy requirements on banks. The percentage of total capital to assets that a bank must hold as 'regulatory capital' is 8%. However Basel II is much more complex than the original Accord in that it attempts to specify the risk associated with a wide range of bank activities, and weight the risks of these activities as a percentage of the total 8% required. Thus a bank loan to a student might be risk-weighted at 150%, meaning that for each dollar on a loan that a bank gives, it is required to hold 12 cents (8% x 1.50) as regulatory capital to buffer itself against the risks of this loan.

Basel II has many different component parts to it, and there are many different options for banks and regulators to use to abide by the Accord. It consists of three pillars: Regulatory Capital Requirements, Supervisory Review, and Market Discipline. As discussed in Chapter 2, this study focuses on the first pillar. There are also several different 'levels' or 'Approaches' within the Accord that banks and/or regulators can use depending on the level of sophistication or national regulatory discretion. The Standardized Approach is relatively simple and bases risk weights for different activities on the basis of external rating grades. The Internal Ratings-Based Approaches, however, allow banks, for some risk parameters, to estimate risks themselves. There are several key inputs (or 'risk parameters') that are part of the complex mathematical formulae of the Internal Ratings-Based Approach:

PD – Probability of Default. This is the probability that a borrower from a bank will default (i.e. not pay back) on a credit offered to them.

LGD – Loss Given Default. This is a quantitative estimate of the severity of a loss from a defaulted credit.

EAD – Exposure at Default. This parameter quantifies the size of the banks exposure when a particular credit defaults, in other words, the 'amount at risk' from that particular credit.

AVC – Asset Value Correlation. This parameter assesses the relationship between the riskiness of bank lending in relation to its probability of default. It is used to assess the extent to which loan defaults occur in waves or 'clusters' together (i.e. that credit risks are *correlated* with one another)

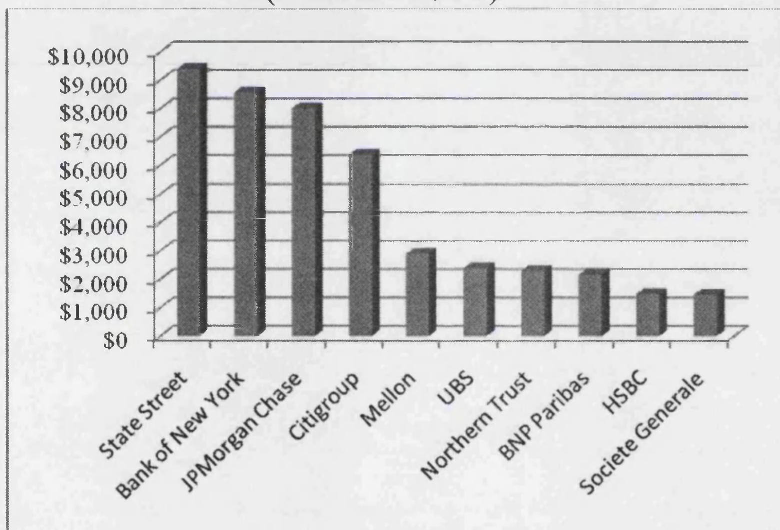
For the Foundation Internal Ratings Based Approach, banks can estimate their PD values, but other risk parameters are set within the Accord. For the Advanced Internal Ratings Based Approach, banks can estimate their PD values and (most of) their LGD values. Other risk parameters are typically employed within the risk models that the Accord specifies. There is also a plethora of special conditions and exceptions to these general rules.

Appendix 5

Empirical Dimensions of Processing Banks

The top 10 custodial banks in the world at the time are listed in Figure A5.0 below. As is evident, US banks largely dominate the high end of this market. Not only were the top 4 custodial banks all American, but 6 out of the top 10 were American.

Figure A5.0: Top 10 banks in the world by Assets under Custody (Billions of $US)[962]

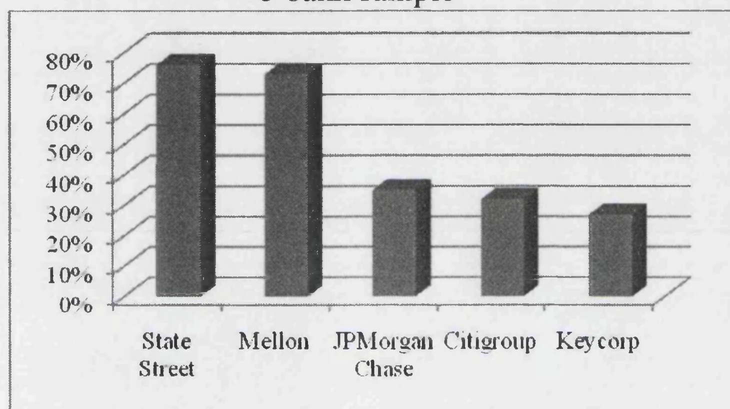


As Figure A5.0 also illustrates, however, banks such as JPMorgan Chase and Citigroup had comparably large assets under custody in comparison with State Street and Bank of New York, and considerably more than Mellon. Thus the size of a bank's assets under custody cannot explain the reaction to the operational risk policy among US banks. However, a more reliable predictor of preferences in regard to the operational risk policy is the extent to a bank relied on

[962] This data is sourced from de Fontnouvelle et. al. 2005, p. 57 (Table 3), and p. 58 (Table 4)

income from its custodial services as a core part of its business model. A good indicator of this is the simple ratio of a bank's operational income to its total income. As Figure A5.1 below illustrates, in this regard State Street and Mellon were much more reliant on operational income than their counterparts JPMC, Citigroup, and Keycorp. This might help to explain why the former group were so radically opposed to the operational risk policy, while the latter group were not.

Figure A5.1: Ratio of Operational Income to Total Income of: 5 bank sample[963]



This division can also be seen in another way, through a metric of how many loans a bank makes with respect to its asset base. This can be measured by a ratio of the value of a banks' total loans to its total assets. As Figure A5.2 below demonstrates, once again there is a noticeable division among the 'radical opposition' and the 'supportive group' described in Chapter 6 – especially between State Street and the other banks. The significance of this metric is that it demonstrates *not what the costs* of the operational risk policy would have been to each bank, but rather the *relative benefit* that Basel II's credit risk policies would have for banks. As Figure A5.2 makes clear, banks such as State Street and Mellon had very small number of loans in comparison with their total assets (their total assets are represented in Figure A5.3, and help to illustrate the size differences in the banks as a whole). As such, they stood to gain *less* from the liberalizing advantages of Basel II's credit risk policies than other banks – even though those

[963] This data is sourced from de Fontnouvelle et. al. 2005, p. 55 (Table 1).

other banks also engaged in custodial services and would thus incur new regulatory capital costs from the operational risk policy.

Figure A5.2: Ratio of Total Loans to Total Assets:
5 Bank Sample

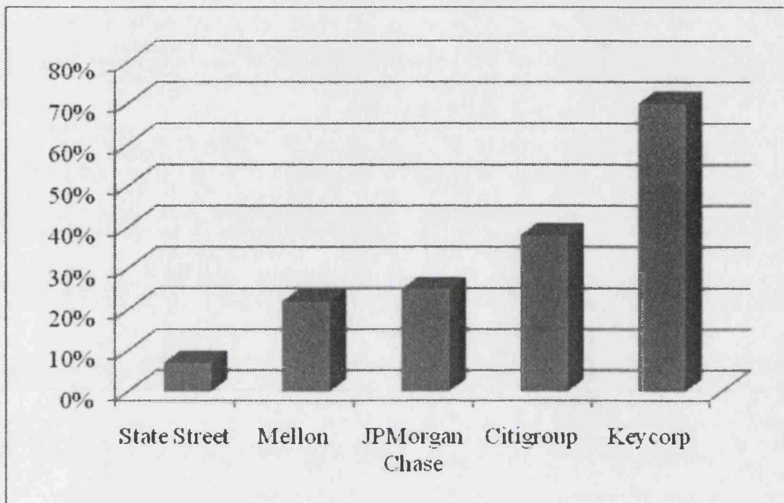
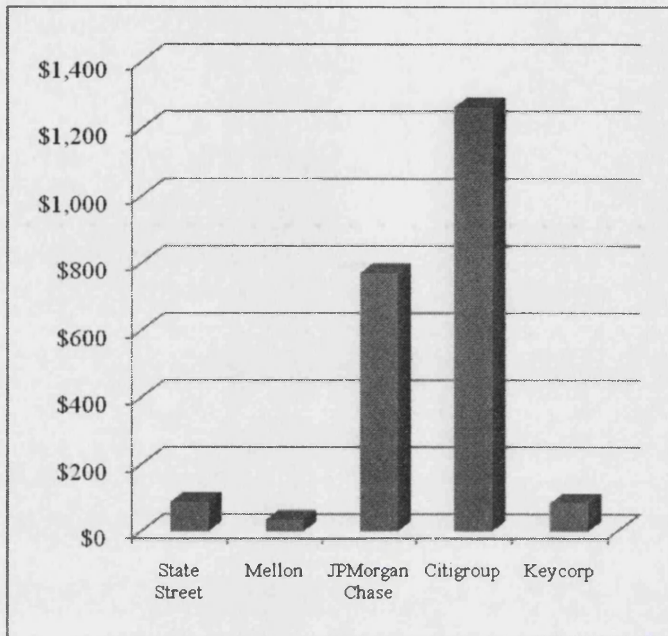


Figure A5.3: Ratio of Total Bank Assets:
5 Bank Sample

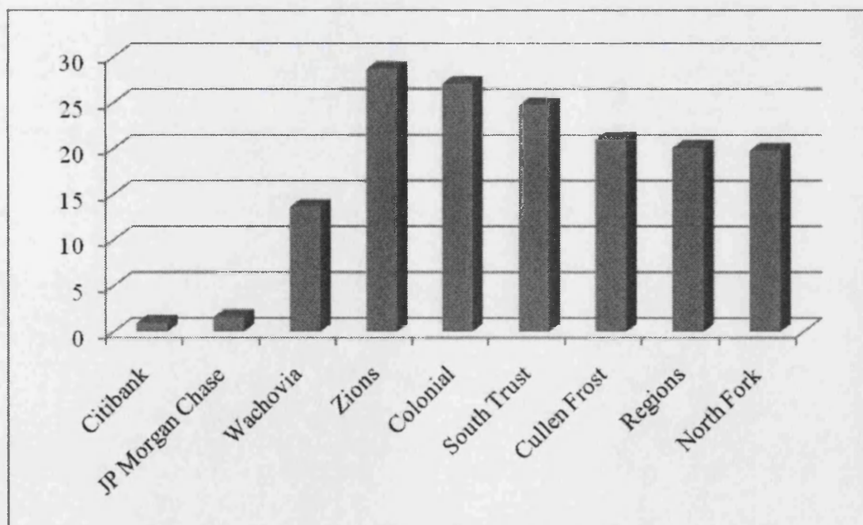

$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
State Street
Mellon
JPMorgan Chase
Citigroup
Keycorp

Appendix 6

US Commercial Real Estate Exposures

This Appendix illustrates some of the features of US commercial real estate holdings, which can be used to supplement the discussion in Chapter 7. In 2003, US holding companies with over $200 billion at the time only had 5.3% of their loan portfolio dedicated to commercial real estate. However, smaller holding companies with assets under $15 billion had double the commercial real estate exposure on average (10.7%).[964] Figure A6.0 below illustrates the relative size of commercial real estate lending in various US banks.

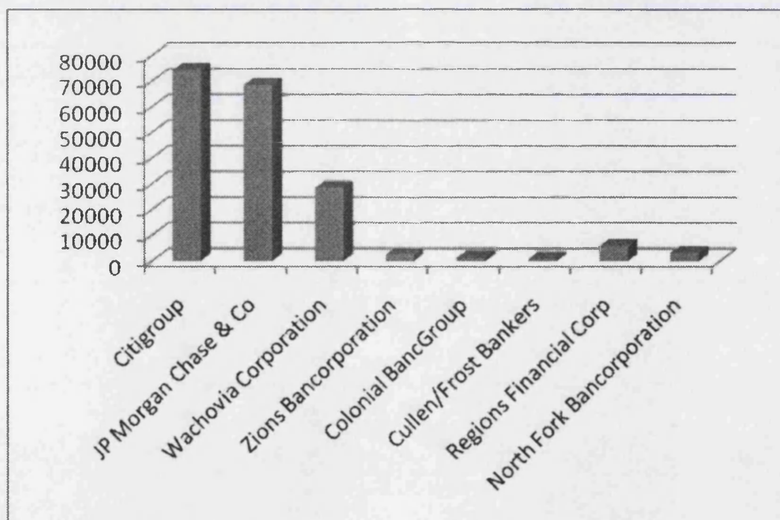
Figure A6.0:
Percentage of Commercial Real Estate Lending in Various US Banking Portfolios
(as of end-September 2002):[965]



[964] See Moore 2003, p. 8.
[965] See Moore 2003, p. 9.

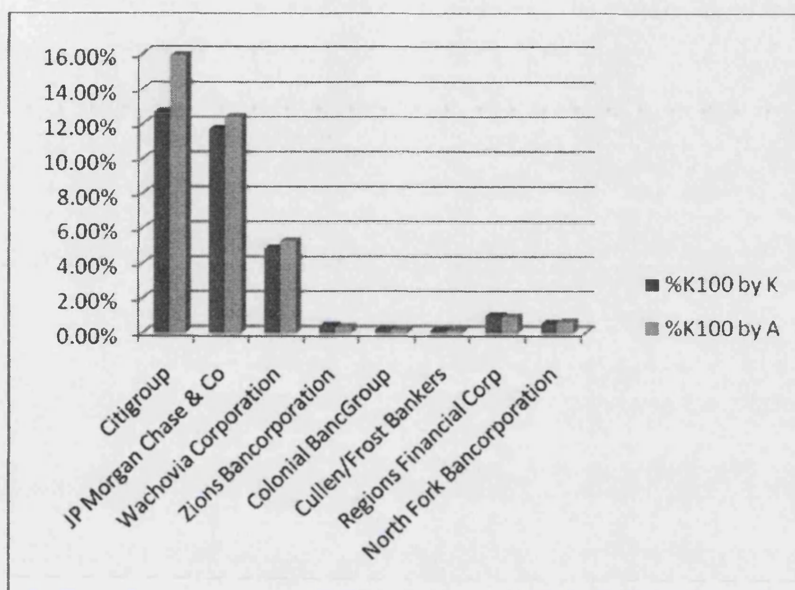
As Figure A6.0 illustrates, large US banks such as Citibank and JPMorgan Chase had few CRE exposures as a percentage of their total portfolios, while smaller US regional banks had large exposures, and thus perceived that they would be severely affected by the HVCRE policy in Basel II as it stood at the time. Of the 7 banks listed above with high percentages of commercial real estate lending, the last 5 were all based in the US Southeast.[966] While such Southeastern regional banks had substantial CRE lending exposures – especially in comparison to large US banks as Figure A6.0 above has demonstrated, their economic weight was comparatively modest. As Figure A6.1 below illustrates, Southeastern banks at the time had much less capital and assets than the largest US banks at the time. [967] Figure A6.2 demonstrates that in terms of both capital and assets, the Southeastern regional banks composed a very small fraction of the top 100 US total at the time. [968]

Figure A6.1: Comparison of Tier 1 Bank Capital (Millions of $US)



[966] Wachovia was a large US bank but has substantial exposure in the US South. North Fork was based in New York but was relatively small.
[967] Data is from The Banker database.
[968] The source data is from The Banker database, and is calculated by the author as a percentage of the largest 100 banks in the US as ranked by their total Tier 1 capital in 2003.

Figure A6.2: Comparison of The Share of Top 100 US Bank Capital, differentiated by % of Tier 1 Capital, and % of Tier 1 Assets

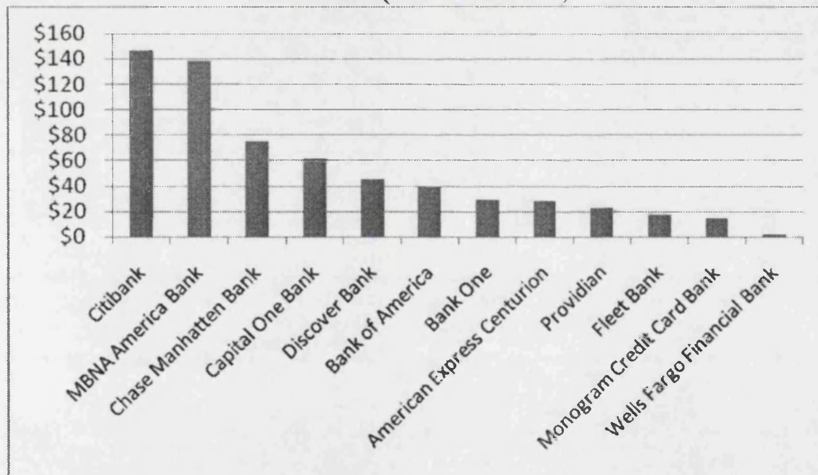


Appendix 7

US Banks' Credit Card Exposures

Figure A7.0 below illustrates the size of the assets that US credit card banks held at the time when US private sector campaigns took place, in 2003 and 2004. Figure A7.0 demonstrates that Citibank and MBNA dominated the US credit card banks in terms of total managed assets.

Figure A7.0: Total Managed Credit Card Assets of the US Credit Card Banks, June 2004 (US$ billions)[969]

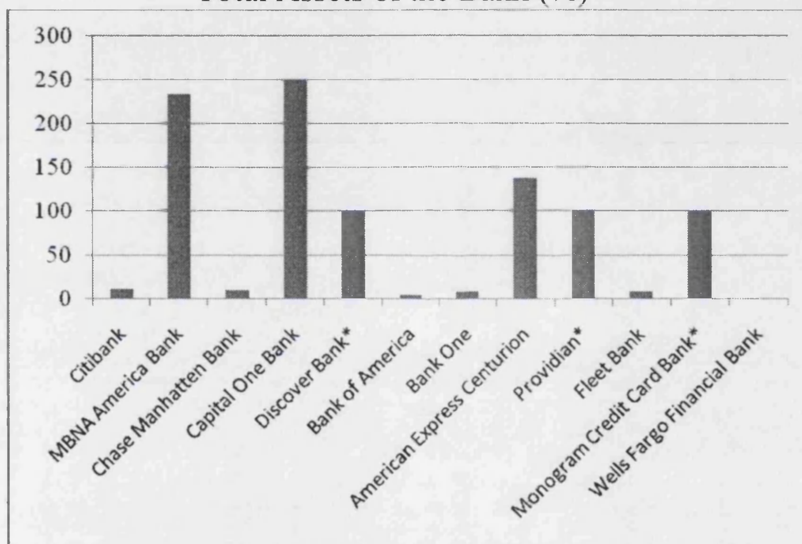


While banks like Citibank and MBNA had the largest credit card exposures, this does not mean that they such exposure weighed equally heavy on each banks' overall business. Indeed, as

[969] Data is obtained from Lang et. al. 2007, p. 37. Note that Citibank's value is calculated by the present author by taking the sum value of Citibank SD and Citibank NV.

Figure A7.1 below demonstrates, the percentage of these banks' managed credit card assets to their total assets presents a different picture to that above. This figure illustrates that, as a percentage of total bank assets the credit card business for banks like MBNA and Capital One were substantial. For banks like Citigroup, however, while it dominated the credit card market at the time, this represented a *relatively* smaller share of their total managed assets. What this meant was that 'monoline' credit card banks such as MBNA and Capital One were particularly sensitive to the Basel II credit card policy as it was proposed. Since the credit card business was their main business line, and the credit card policy was stringent, this would affect them more severely than other banks.

Figure A7.1: Ratio of Managed Credit Card Assets to Total Assets of the Bank (%)[970]



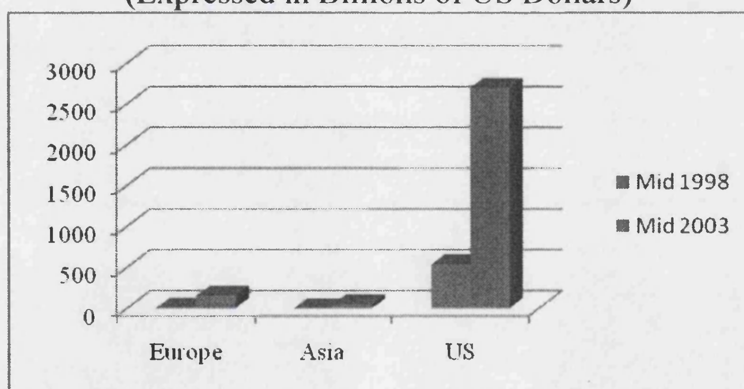
[970] Data is obtained from Lang et. al. 2007, p. 37. Note that Citibank's value is calculated by the present author by taking the sum value of Citibank SD and Citibank NV.

Appendix 8

Securitization Markets in the G10

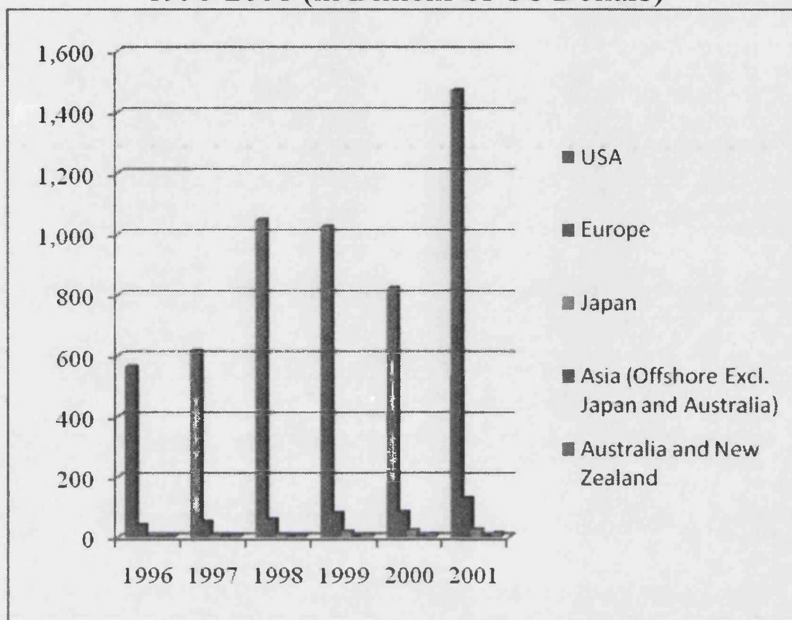
This Appendix is used to supplement the claims made in Chapter 9 on the structural importance of securitization and of securitization activity in the US economy specifically. During the period under study, there were increases in the size of securitization markets reaching 510 fold in Asia (with most activity centered in Japan), 20-fold in Europe, and 5-fold in the USA during this period. However the size of securitization markets in the USA unambiguously dwarfed those of elsewhere. In the USA, the securitization market was estimated to value at $2.7 trillion, as pointed out by Figure A8.0 below.[971] Not only was this market large, but it was also expanding at a rapid pace. The actual issuance of new securitization instruments was much greater in value in the US as compared to other countries and regions of the world, as illustrated by Figure A8.1.

Figure A8.0: Comparative Estimations of Securitization Market Size in 1998 and 2003, Europe, Asia, and the USA Compared (Expressed in Billions of US Dollars)



[971] Data is from Green 2003.

Figure A8.1: New Issuances of Securitizations, Various Regions, 1996-2001 (in Billions of US Dollars)



Notably, the differences in these values are not due solely to the respective size of the financial markets in each of these countries. The average percentage (by value) of securitization instruments within the portfolio of large banks in the G10 at the time was 2%. The average percentage (by value) of securitization instruments within the portfolio of large banks in the US was over 7%.[972]

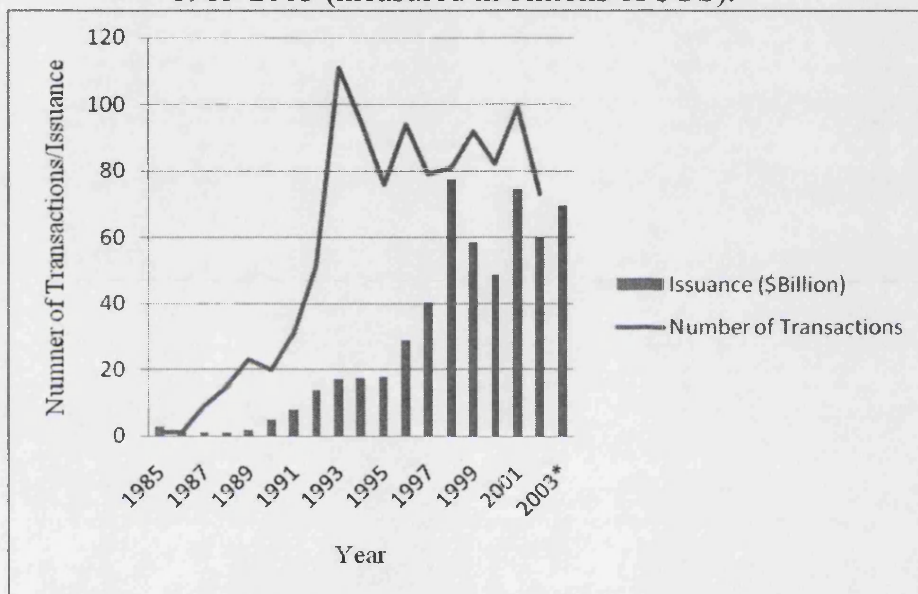
Commercial Mortgage-Backed Securities (CMBS)

The CMBS market within the United States during the period under study was very large, and played a vital role in US debt markets and the US real estate industry generally, at the time. Nearly 14% of all US commercial real estate debt and 40% of commercial real estate equity was being securitized at the time – and this was done primarily through CMBS instruments.[973] The CMBS market had begun in the US in the mid- 1980s and had grown to a $550 billion

[972] See BCBS June 2006, p. 22, Table 11; OCC et. al., p. 7, Table 4. Note that US Figure is from 2004, and G10 average figure is for 2003.
[973] Also through REIT vehicles – Real Estate Investment Trusts

securitization market, all backed by US real estate mortgage loans.[974] By 2003, the US had the vast majority of the global share of this market in with 82% of new issuances that year emerging from the US.[975] As Figure A8.2 below illustrates, the size of the CMBS market in the US was very large – while it had tapered off since the late 1990s, it still represented a substantial absolute value.

Figure A8.2: Size of the CMBS Market in the USA, 1985-2003 (measured in billions of $US).[976]



[974] See RER and CMSA November 2003, p. 3.

[975] Author's calculation, based on an estimated $11.5 billion in international issuances and $52.3 billion in US issuances in the first three quarters of 2003. Source for data: RER and CMSA November 2003, p. 3.

[976] Data is from RER and CMBS November 2003, p. 3. Originally sourced at 'Commercial Mortgage Alert'. Note: 2003 figure is implied, as first 9 months had $52.5 in new CMBS issuance, which was calculated by 1.333 to equal an implied issuance for 2003 of $69.73 Billion. Calculation by present author.