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Rule Maker or Rule Taker?
Brexit, Finance and UK Regulatory Autonomy

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Abstract

Given the integration of the City of London into the single market for financial services in the European Union (EU), theories of transnational governance would expect the United Kingdom (UK) to favour close regulatory alignment with the EU27 post Brexit to maximise market access and financial stability. Surprisingly, however, the UK has consistently demanded regulatory flexibility in financial services and has accepted reduced market access. We argue that the explanation is twofold. First, UK preferences reflect the need to balance the competing demands of elected officials, the financial industry and financial regulators. Second, drawing on a bureaucratic politics perspective, we suggest that UK preferences have been partly shaped by the importance to UK regulators of retaining autonomy over high-status policy competences. This article contributes to the broader literature on the politics of financial regulation by highlighting the added value of incorporating a bureaucratic politics perspective when explaining financial regulatory preferences.

Keywords: Brexit, finance, financial regulation, City, regulators, Bank of England

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Introduction

The British referendum on continuing membership of the European Union (EU) in June 2016 represented a turning point in the relationship between the United Kingdom (UK) and the EU. The result – a small majority in favour of leaving the EU – led to the resignation of Prime Minister David Cameron. In March 2017, the British government under Prime Minister Theresa May invoked Article 50 of the Treaty on European Union, officially beginning the negotiations of UK withdrawal from the EU. At the end of January 2020, the UK left the EU. The economic and political implications of Brexit are far-reaching for the UK and the EU and warrant scholarly examination. Of particular importance are the effects of Brexit for financial services, given the fact that the UK has a large financial sector, which makes a major contribution to the national economy (see CityUK, 2016a,b). Moreover, London is a leading international financial centre and the UK is often portrayed as 'Europe's investment banker' (Carney, 2017). Given the integration of the City of London into the single market for financial services in the EU (see Kalaitzake 2020), we would expect the UK to have a powerful economic incentive to maintain close regulatory alignment with the EU27 to ensure continued market access and to underpin financial stability. Surprisingly, however, we find that throughout the Brexit negotiations the UK government consistently championed the need for regulatory flexibility and potential divergence in financial services post Brexit, even if this was at the expense of reduced market access to the EU. How can we explain this?

The few works that have examined Brexit and finance set out to explain why the financial industry, to the precise, the City, was not more influential in shaping the position of the UK government during the negotiations (James and Quaglia, 2019, 2020; Thompson, 2017a, b; for a different view see Kalaitzake 2020), or how the negotiations between the UK and the EU unfolded in a two-level game (James and Quaglia, 2018), or the 'battle for finance' between the London (Talani 2020,

2019) and other leading financial centres on the continent, mostly Frankfurt and Paris (Howarth and Quaglia, 2018; Lavery et al, 2019). However, most of these accounts tend to focus on the interests and influence of financial interests and elected officials. Hence, the 'structural interdependence' of the City of London is used as a source of power to explain the range of contingency measures to protect industry from a cliff-edge Brexit (Kalaitzake 2020). By contrast, electoral incentives and political 'statecraft' is invoked to explain the industry's limited capacity to convert 'latent' structural power into instrumental influence during the negotiations (James and Quaglia 2019). Yet, the role of financial regulators has thus far been overlooked to some extent, as their preferences tend to be derived from those of industry and/or ministers. This article sets out to address this gap in our understanding and by doing so it also contributes to the broader literatures on the politics of financial regulation and the political economy of finance.

To begin with, this article challenges the transnational governance approach that is often used to explain the preferences of the financial industry and regulators. We argue that the UK's preferences on Brexit and finance are puzzling from a transnational governance perspective, given that regulatory alignment would prevent regulatory arbitrage and would ease cross-border financial flows. Nor do we think that the UK's preferences on finance can simply be reduced to a simple functionalist logic that prioritises retaining regulatory flexibility over the City of London. On the contrary, the UK faces a fundamental trade-off in the Brexit negotiations between maintaining market access and retaining regulatory autonomy in finance: as such, its position reflects a deliberate political choice. Thus, the UK's stance is the outcome of balancing the competing demands of elected officials, the financial industry and financial regulators. Second, this article highlights the added value of incorporating a bureaucratic politics perspective when explaining financial regulatory preferences. In fact, we suggest that UK preferences have been shaped to a large extent by bureaucratic politics: namely, the importance to UK regulators of retaining regulatory autonomy and discretion over high-status policy competences.

The paper is organised as follows. The first section reviews the relevant theoretical literature, including transnational governance and domestic theories of international regulation, before bringing in a bureaucratic politics perspective. The analysis then examines and explains the preferences of the three main groups involved in the Brexit negotiations in the UK: the financial industry, elected officials, and financial regulators. The conclusion reflects on the added value of examining key domestic political and bureaucratic dynamics in explaining UK preferences during the Brexit negotiations.

Theoretical approaches to the politics of financial regulation

Several bodies of work in international political economy can potentially help us to explain UK preferences in finance during the Brexit negotiations. In particular, the literature on transnational governance highlights the critical role of large transnational financial groups (McKeen-Edwards and Porter, 2013; Mügge, 2010) and transgovernmental networks of regulators (Jordana, 2017; Tsingou, 2015; Stone and Ladi 2015) in shaping national preferences. According to Cerny's 'transnational neopluralism' (2010: 4-6), the most important 'movers and shakers' are no longer domestic forces, but rather 'actors that can coordinate their activities across borders'. Similarly, the 'new interdependence' approach (Farrell and Newman 2014; Newman and Posner, 2016, 2018) examines the formation of cross-border coalitions brought together by mutual interdependence.

All these works pay attention to the mobilisation of transnational networks (coalitions) of private and public actors, which act as a powerful force in defence of cross-border financial activity and the promotion of harmonised transnational financial regulation. For example, these coalitions have been instrumental in settling transatlantic regulatory disputes concerning accounting standards (Farrell and Newman, 2014) and derivatives (Newman and Posner, 2018). Since the main implications of

Brexit with reference to finance concern the disruption of cross-border financial business, we would expect theories of transnational governance to have considerable explanatory power. Indeed, Kalaitzake (2020) pointed out the 'structural interdependence', whereby, in the context of Brexit, 'policy officials on both sides came to perceive that the future prosperity and stability of their economies relied upon maintaining open trading relations in financial services'.

From this perspective, we derive two empirical expectations concerning the preferences and influence of the financial industry and financial regulators. First, we would expect transnational financial interests – meaning, large financial companies that engage in a considerable amount of cross-border business and their trade associations - to exert a significant influence over the formation of UK preferences. In particular, they should mobilise and lobby UK regulators and elected officials for a 'soft' Brexit outcome: preserving their lucrative 'passporting rights' into the single market, and minimising the risk of regulatory uncertainty and disruption, by maintaining full regulatory alignment between the UK and EU (Thompson, 2017a). Given the UK's dependency on financial services as a source of growth and employment, and the status of the City of London as an international financial centre hosting many large transnational firms, the interests of transnational finance should weigh heavily on the minds of regulators and elected officials. Indeed, there is a considerable literature on the hegemony of the City and the 'exceptionalism' of British Capitalist development (Ingham, 1984; Talani, 2012, 2019), which consider the sphere of finance in the UK as separated from the real economy and stress the peculiar ties between the City, the Treasury and the Bank of England.

Second, we would expect the preferences of UK regulators to be shaped by the wider transgovernmental regulatory networks within which they are embedded (Jordana, 2017; Tsingou, 2015; Stone and Ladi 2015). Following the financial crisis, UK regulators played a leading role in 'trading up' financial regulation through greater harmonisation at both the international and EU levels, notably with respect to bank capital standards, bank resolution and derivatives (James and Quaglia, 2020). Hence, we would expect UK regulators to favour full regulatory alignment between the UK and EU post Brexit to uphold cross-border financial flows, while preventing regulatory divergence and minimising opportunities for regulatory arbitrage with a view to safeguarding financial stability. Given the importance of technical knowledge and the considerable autonomy generally enjoyed by regulators in this policy area (as discussed next), one would expect regulators to yield considerable influence in shaping the national positions concerning finance in the Brexit negotiations.

Yet, both of these expectations are highly problematic, as we illustrate below, even though, in the short term, UK and EU regulators adopted contingency measures to avoid major disruptions to cross-border financial flows (Kalaitzake, 2020). Despite considerable lobbying from large transnational firms (particularly, US investment banks) for a soft Brexit outcome, the UK government refused to back their call for full regulatory alignment. Moreover, despite their embeddedness in transnational (particularly, pan-EU) regulatory networks and the need to regulate cross-border business, UK regulators refused the prospect of regulatory alignment with the EU after Brexit. To explain this, we draw on two domestic political economy perspectives.

One approach focuses on the interplay between politicians (elected officials), the business community and regulators (unelected officials). While elected officials (and their voters) demand financial stability and economic security, business favours an environment that maximizes competitiveness (and, thus, profits), and regulators seek to balance stability and competitiveness, so as to appease both politicians and private actors (Singer 2007). Yet, stability and competitiveness are frequently in contradiction in finance, posing a 'dilemma'. Regulations that promote high-risk financial activities, for example, may increase competitiveness at the expense of long-term stability. Conversely, overly-stringent regulation can stifle innovation and place domestic industry at a competitive disadvantage. The nature of this trade-off is particularly acute with respect to financial regulation in the UK. In the wake of the financial crisis, for example, the UK government explicitly alluded to the 'British dilemma' between restoring the stability of the domestic banking system and protecting the international competitiveness of the City of London (Osborne, 2010). As we explain below, the financial regulatory dilemma provides an important part of the explanation of UK preferences in finance during the Brexit negotiations. Its weakness, however, is to assume that regulators play a largely passive role.

By contrast, a bureaucratic politics approach alerts us to the fact that regulators have their own preferences and are often capable of wielding significant independent agency (Bach et al., 2016; Stone and Ladi 2015). To begin with, regulators are keen on protecting their autonomy from politicians and business (Singer 2004, 2007). This is particularly important in the financial realm, as compared to other policy areas, because autonomous financial regulators are considered more likely to deliver better policy output since they are less prone to undue influence by politicians as well as capture by the regulated industry (Coen and Thatcher, 2005; Gilardi, 2007; Maggetti, 2009; Thatcher, 2005). More generally, bureaucrats are highly protective of their particular bureaucratic 'turf', defined as an agency's distinctive 'regulatory domain' (Carpenter, 2001). In particular, theories of bureau-shaping suggest that regulators attach a high value to status-enhancing policy tasks and functions, and will seek to maximise their discretion and autonomy over them (Dunleavy, 1991: 203-4). The regulators' quest for autonomy and the defence of their bureaucratic turf apply to the domestic level (i.e. vis-a-vis elected officials, the business community and other regulatory agencies), but also come to the fore whenever domestic regulators fear that they might have to 'import' regulation on which they have little or no say.

Second, bureaucrats also have specific preferences concerning the content of regulation, in particular, its goals and instruments (Adolph, 2013: 11). These preferences are shaped by the specific mandate of regulators, their institutional legacies and past policy experience (Carpenter, 2001; Thatcher, 2005). After the devastating experience of the international financial crisis, the institutional framework for financial regulation and supervision in the UK was overhauled. In particular, the Bank of England was given new competences (including the responsibility for prudential supervision and the mandate to protect financial stability) and powers. After the crisis, UK regulators, and the Bank, in particular, used their newly acquired powers to trade up financial regulation domestically as well as at the EU and international levels (James and Quaglia, 2020). The concern of British regulators was that after Brexit and depending on the framework for the future relations between the UK and the EU, the UK would have to align its domestic financial regulation to EU rules, on which UK regulators had no say and which might not be well suited for the UK, given the distinctive configuration of the British financial system. This would reduce regulators' autonomy, impinge upon their turf and potentially affect their ability to fulfil their mandate. To avoid or mitigate this potential outcome, UK regulators, therefore, exerted their influence in the Brexit negotiations, as elaborated below.

In order to evaluate the explanatory power of the theories reviewed above, we assess their expectations (or observable implications) against the empirical record. Thus, the following sections examine the preferences and influence of the financial industry, elected officials and financial regulators in the UK during the Brexit negotiations. The empirical material was gathered through a systematic survey of press coverage, and twelve anonymised interviews conducted with regulators, industry stakeholders and elected officials based in London and Brussels. For reasons of data replicability and confidentiality, we prefer to quote public sources, whenever they confirm points made by interviewees.

The UK and the Brexit negotiations in finance

Financial industry

In the aftermath of the Brexit referendum, the main financial industry associations formulated a position with a view to limiting the damage for the City of London from the UK's withdrawal from the EU. In a series of reports published in the autumn of 2016, The CityUK (2016a, b) called for the preservation of 'access to the Single Market on terms that resemble as closely as possible the access the UK currently enjoys'. Powerful voices within the City, such as the HSBC, went further and quietly started lobbying for the UK to join the European Economic Area (EEA). Following the Government White Paper (2017) discussed below, the City authorities made the strategic decision to drop their official demand for full single market membership. Instead, they began to call for a bespoke agreement for financial services which would preserve 'passporting rights' in all but name. This would take the form of 'mutual market access', based on a framework for the 'mutual recognition' of each other's regulatory regimes, and close cooperation between UK and EU supervisory authorities (see IRSG, 2017a, b).

Mutual recognition means that goods and services subject to the regulatory regime of one country (e.g. the UK) can be sold cross-border in another country (e.g. the EU) without having to comply with the rules of the importing country. In financial services, once a provider is authorised in one country, it obtains a 'passport' allowing it to establish itself in another country or provides services across borders without the need for further authorisation. The mutual recognition model, as it became known, would be conditional on the UK and EU maintaining the 'broad alignment' of regulatory outcomes, either to existing international standards or 'outcome-based criteria' defined in the free trade agreement, to be overseen by a new UK/EU Forum for Regulatory Alignment. The industry also proposed a lengthy transition arrangement to give firms time to adjust to the new relationship.

In an effort to shape UK preferences, and the outcome of the negotiations, the financial industry leveraged different sources of power (James and Quaglia, 2019). Large global banks exploited their structural position by threatening to leave the UK in the event of a bad Brexit deal. To strengthen the sector's lobbying capacity, a new lobby group – the European Financial Services Chairmen's Advisory Committee – was established. At the transnational level, the City of London's Brussels office engaged with commission officials, MEPs, and key national embassies, while its special representative, the former minister Jeremy Browne, undertook a six-month tour of national capitals. The US Chamber of Commerce stepped up its engagement with UK and EU negotiators, while international trade associations, including the Global Financial Markets Association, lobbied for a long transition period (James and Quaglia, 2019).

The financial industry's key message was twofold. First, it argued that it was essential for the UK to agree a Withdrawal Agreement by the end of 2018 to avoid an economically damaging 'cliff-edge' scenario. Leading firms, like the management consultancy Oliver Wyman, and the legal firm Clifford Chance, were commissioned to produce a series of reports for this purpose. These reports painted a particularly bleak picture of life in the City if the UK failed to secure a deal and was forced to rely on WTO rules (Wyman, 2016). Second, the City authorities argued that the future UK-EU relationship had to be based on a Free Trade Agreement, which would include a comprehensive chapter on financial services. This was because the EU's existing third-country equivalence regime—whereby firms located in non-EU countries can access the single market provided that home regulation is deemed 'equivalent' to EU rules—provided a wholly inadequate basis for future UK-EU trade in financial services.

The EU's *equivalence* model would be damaging for the British financial industry because it implied the loss of passport and there were no equivalence provisions for several financial services, such as banking, asset management and insurance (IRSG, 2017a). Moreover, even for financial services for which there are equivalence provisions, such as capital markets and derivatives, the equivalence decisions are: a) unilateral and discretionary acts of the EU; b) there is no right for third countries and third-country firms to appeal; c) equivalence can be unilaterally withdrawn with short notice; d) equivalence tests have taken 2-4 years to be completed; and e) equivalence decisions can and have been politicised in the past. Notable instances of such politicisation were equivalence decisions on derivatives (specifically, trading venues and CCPs in the US), stock exchanges (in Switzerland) and hedge funds.

The preferences and mobilisation of the financial industry since the EU referendum, therefore, fits well with a transnational governance perspective (see also Kalaitzake, 2020). Many domestic-oriented financial firms remained relatively muted during the negotiations, not least because they had far less at stake. There were also significant voices in favour of Brexit, notably amongst the hedge fund community (James and Quaglia, 2019). Nonetheless, the vast majority of financial firms in the City of London – and particularly the largest and most transnationally-active banks – were highly vocal in their support for a soft Brexit outcome. More importantly, they played a critical role in shaping the official position of the main trade associations and City lobby groups, which strongly favoured regulatory continuity between the UK and EU.

Yet, a transnational perspective only provides a partial explanation. Contrary to what we would expect from this perspective, as well as from works that stressed the hegemony of the City and the 'exceptionalism of British Capitalist development', UK preferences in finance during the Brexit negotiations significantly diverged from the position of the financial industry. As Helen Thompson (2017) pointed out, the 'City of London lost at Brexit'. The compromise finally hammered out by ministers in July 2018 rejected industry's preference for the mutual recognition model in favour of a system of regulatory equivalence (see below). Predictably, the industry's response to the government's support for a looser arrangement with the EU was of shock and disappointment.

Catherine McGuiness, head of policy at the City of London Corporation, described the proposal for the future relationship to be based on equivalence as a ‘real blow’ to the financial sector (Martin 2018).

May’s failure to secure parliamentary support for her Withdrawal Agreement, and her replacement as Prime Minister by Boris Johnson in July 2019, did little to improve relations. Tellingly, in response to Johnson’s attempt to renegotiate the UK’s withdrawal, prominent business leaders representing key sectors voiced their concern for the first time at the prospect of the UK dropping existing commitments to maintain regulatory alignment. In particular, they argued that regulatory alignment was a ‘critical element’ of the future UK-EU relationship, and warned of the ‘damage which would be done by the current approach on regulatory divergence’ (Islam, 2019). On the one hand, the City engaged in ‘pragmatic adaptation’ (Talani, 2019), once Brexit went ahead, by partially relocating some activities to the EU, seeking to increase business with third countries, and lobbying for selective deregulation of certain financial service (notably, hedge funds). Yet, pragmatic adaptation would entail pursuing a ‘Singapore-on-Thames’ model for which there seems to be little electoral or regulatory support and several parts of the City continue to favour regulatory alignment with the EU, so as to ease cross-border trade. To understand this significant divergence in preferences, we next consider the preferences of elected officials and regulators themselves.

Elected officials

After the referendum in June 2016, Prime Minister David Cameron resigned and Theresa May became the new Prime Minister. In January 2017, May’s Lancaster House speech explicitly ruled out membership of the single market and customs union after Brexit (HM Government, 2017a) (hence, de facto opting for a hard Brexit). The Government White Paper published in February 2017 confirmed that the government intended to seek a ‘bold and ambitious’ free trade agreement with the EU, which would include key sectors like financial services (HM Government, 2017b: 42). After the general elections in June 2017, recognising that its position had alienated many Remain voters (Heath and Goodwin, 2017), the government deliberately toned down its rhetoric and quietly began to search for a compromise with the EU (HM Government, 2017c).

In March 2018, UK and EU negotiator reached agreement over the transition period to 31st December 2020, protecting the City's access to the EU market until at least December 2020. Problematically, however, the EU's Chief Negotiator, Michel Barnier, continued to rule out a 'special deal' for finance, as well as the prospect of mutual recognition, which was regarded as integral to the single market. Instead, he insisted that the UK ultimately had to choose between remaining in the single market (through EEA membership), or accepting more limited access, based on the EU's third-country equivalence regime for financial regulation. Having ruled out a soft Brexit outcome in January 2017, the government therefore quietly abandoned its support for the mutual recognition model. Instead, it began to signal that it now favoured a looser arrangement that would seek to build on and strengthen the EU's existing equivalence rules: the so-called 'enhanced equivalence' model. *Enhanced equivalence* sought to import elements of a mutual recognition regime into the equivalence regime agreed with the EU. Notably, the UK proposed an independent arbitration mechanism, grandfathering clauses and a wider set of products to be covered by equivalence (Reynolds 2017).

At the Chequers' summit in July 2018, the Prime Minister was able to hammer out an agreement amongst the cabinet. Shortly afterward, the UK government published its White Paper on the UK's future relationship with the EU (HM Government, 2018a). This document set out a vision for an overarching UK–EU Association Agreement, which would include a deep and comprehensive free trade agreement. However, it made no mention of the mutual recognition model for finance, and, instead, proposed a looser 'economic and regulatory arrangement', which would leave trade in services—including financial services—outside the single market. Importantly, the White Paper explicitly acknowledged that the future relationship ‘could not replicate the EU’s passporting regime’, and so the UK and EU ‘would not have current levels of access to each other’s markets’. Instead, the government proposed that there should be a ‘bilateral framework of treaty-based commitments’.

In November 2018, UK and EU agreed the draft text of the Withdrawal Agreement, followed by the (non-binding) Political Declaration on the Framework for the Future Relationship. While the Declaration provided a lengthy and detailed statement about future arrangements for trade in goods, it only included three paragraphs on financial services (HM Government, 2018b). It recognised that the future relationship will be based on a framework of regulatory and supervisory equivalence, rather than a bespoke treaty-based deal founded on mutual recognition. The declaration committed to respecting the ‘regulatory and decision-making autonomy’ of the UK and EU, their ‘ability to take equivalence decisions in their own interest’, and ‘without prejudice to the Parties’ ability to adopt or maintain any measure where necessary for prudential reasons’.

May’s resignation as Prime Minister in May 2019 led to the hardening of the Conservative party’s Brexit position. The ability of the UK to substantially diverge from future EU regulation became a key demand in the Johnson government’s attempt to renegotiate May’s Withdrawal Agreement. The new deal negotiated by the Johnson government in October 2019 differs significantly from that agreed by Theresa May which made a legal commitment not to roll back EU regulatory standards. By contrast, Johnson’s deal gives the UK the freedom to set its own regulatory standards from the end of the post-Brexit transition period, which runs to the end of 2022 at the latest.

Domestic theories of international regulation would appear to shed important light on the divergent preferences of government and industry. From this perspective, we would expect elected officials and financial firms to have competing preferences, thereby generating a regulatory dilemma between financial stability and competitiveness (Singer, 2004, 2007). Puzzlingly, however, the preferences we observe around Brexit are in important respects the reverse of what we would expect. Hence, rather than pushing for a rollback of EU financial regulation, the City of London's main associations and largest firms strongly supported full regulatory alignment with the EU after Brexit to maximise financial stability. By contrast, elected officials demonstrated a much weaker commitment to regulatory alignment. To explain why preferences for a hard Brexit without regulatory alignment have taken precedence over those for a soft Brexit, we need to consider the preferences of another key group: financial regulators, which contributed to shaping the UK negotiating positions.

Financial regulators

UK regulators sought to maintain a healthy distance from the political fallout from the Brexit vote, following criticism that they had failed to remain impartial during the referendum campaign. The Bank of England's immediate priority was to manage the financial stability implications of Brexit by ensuring that the UK financial industry was prepared for the failure of the UK and EU to reach a deal, either on withdrawal or the future relationship. In December 2017, the Governor announced that it would allow EU banks to maintain their UK operations under current rules following Brexit, assuming that a 'high degree of supervisory cooperation with the EU' would continue after Brexit (Inman and Ranking, 2017). However, branches that were considered to pose a systemic risk to London's financial centre could be forced to convert into subsidiaries. Importantly, the Bank also implied that it reserved the right to withdraw this provision unless it was reciprocated by Brussels. At the same time, the Financial Conduct Authority (FCA) announced temporary waivers for over 8000 EU financial firms to enable them to continue operating in the UK after Brexit under existing rules, even in the absence of an agreement covering financial services. This was interpreted as a gesture of goodwill by UK financial regulators with a view to persuading the EU regulators to adopt a similar policy towards UK-based banks operating in the EU. However, this move was not reciprocated.

As the Brexit negotiations got underway, however, senior UK regulators made a series of guarded statements in an effort to shape the wider policy debate. Shortly after May's Lancaster House speech in January 2017, Governor Carney set out the Bank of England's position in evidence to the Treasury Select Committee. Carney highlighted the significant financial stability and economic risks if the UK failed to agree a transition period and a final Brexit deal. He also suggested that the short-term risks would be greater for the EU than for the UK, given the reliance of European households, corporations, and banks on access to the City (which was, in his word, was 'Europe's investment banker'). The Governor, therefore, concluded that it was 'absolutely in the interests of all parties that some arrangement can be found to maintain market access' (Carney, 2017).

Importantly, these economic imperatives were balanced by a bureaucratic concern to ensure that the role and autonomy of UK regulators would not be undermined by Brexit. On the future UK–EU relationship, the Governor warned explicitly against any arrangement that would leave UK regulators as 'rule-takers', forced to implement EU financial regulation over which they would have no scope for influence: 'We do not want to be a rule-taker as an authority' (Carney, 2017). He cautioned that 'once we are not there [in the EU], one would expect increasingly rules with which we do not agree and which may cause risks to financial stability' (Carney, 2017). From the Bank's perspective, the future UK–EU relationship depended fundamentally on what basis financial regulation would be deemed equivalent. Having to 'basically cut, copy and paste any change that is made in Europe' to maintain equivalence was unacceptable (Carney, 2017).

Throughout the Brexit negotiations, senior Bank officials repeatedly argued that, given that the size and importance of the City of London, UK regulators needed sufficient autonomy to manage these financial risks. Testifying before the House of Commons Treasury Committee in December 2018, Carney repeated that 'We would be uncomfortable not having some flexibility…From a financial stability perspective, it's highly undesirable to be a rule-taker and to lose supervisory autonomy.' (*Reuters*, 2018). Deputy Governor Jon Cunliffe explained the Bank's rationale for opposing automatic regulatory alignment: 'Our financial sector is about 20 times bigger than Norway's. It's much more complex…I think for a financial sector this large, this complicated, would be quite uncomfortable.' Autonomy in this sense means the ability of UK regulators to continue 'goldplating' EU regulation by applying higher capital standards than required under EU or international rules. Hence, the Bank warned against any attempt to use Brexit to undertake a 'bonfire of regulation' to boost the competitiveness of the City and attract new business (Binham, and Jenkins, 2018). Similarly, the head of the PRA pledged to maintain regulatory standards 'at least as high as those we have today', therefore criticising the so-called 'Singapore-on-Thames' strategy advocated by some within government and industry.

As an alternative to maintaining full regulatory alignment with the EU, Carney instead advocated a more flexible approach based on 'equivalent outcomes in terms of safety, soundness and consumer protection', which would permit 'different approaches', provided that they achieved 'roughly the same outcome'. Senior regulators in both the Bank of England and the FCA noted that this could be achieved by demonstrating equivalence to international standards (dubbed the 'super-equivalence' model) (FCA, 2017). According to the Governor, the UK and EU were well-positioned to 'provide a template for trade in financial services' based on deference to each other's regulations, supported by a commitment to common global standards and open supervisory cooperation. This position was echoed by Andrew Bailey, head of the FCA, who argued that 'common recognition of higher-level global standards' for core prudential requirements could provide 'broad global standards of equivalence' upon which market access could be based (FCA, 2017). UK regulators' appeal to non-binding global standards as the basis for post-Brexit equivalence deliberately played to the UK's traditional strengths in shaping international financial rules, often in alliance with the US (James and Quaglia, 2020). Importantly, given the prominent role delegated to financial regulators in global regulatory fora like the Basel Committee and Financial Stability Board, it would also potentially strengthen the autonomy and influence of the Bank of England in shaping the future UK-EU regulatory arrangements.

The Bank of England was broadly supportive of the mutual recognition model for UK–EU trade in financial services, as advocated by the financial industry and endorsed by the UK government in February 2018. This was because it promised to maintain current levels of market access for the City, whilst retaining a significant degree of autonomy for UK regulators. However, this consensus proved short-lived. From March 2018 onwards, as the UK government shifted its position in favour of third-country equivalence, UK regulators became increasingly alarmed. Senior Bank officials worried that the Treasury was pursuing a compromise that would prioritise market access over regulatory autonomy, and made known their concerns to ministers (Parker and Giles, 2018). In response, the UK government White Paper published in July 2018 argued that because of the importance of financial services to financial stability, it was essential for the UK and EU to retain 'regulatory flexibility' and 'autonomy of decision making'. Significantly, the White Paper alluded to the bureaucratic imperatives of the Bank by explicitly stating that UK regulators should have the ability to 'impose higher than global standards' to manage the financial stability exposure of the City of London. By contrast, there was little reference to the competitiveness concerns of prominent elected officials or the possibility that financial regulatory burdens would be reduced post Brexit.

Following the commencement of the future relationship negotiations in January 2020, senior Bank officials reiterated their calls for UK regulators to retain autonomy and independence. For example, the outgoing Governor, Mark Carney, argued that 'It is not desirable at all to align our approaches, to tie our hands and to outsource regulation and effectively supervision of the world's leading complex financial system to another jurisdiction' (Laurent, 2020). Similarly, the new Governor, Andrew Bailey, added that post-Brexit there should be a mechanism to enable the UK to diverge from EU rules without 'a metaphorical punch-up every time'. In setting out the Bank's 'ideal post-EU regulatory framework' on 10 March 2020, head of Prudential Policy, Victoria Saporta, reiterated regulators' call for the UK to have 'regulatory independence' (Bank of England, 2020). These arguments were echoed in the UK government's (2020) negotiating mandate which called for 'regulatory cooperation arrangements' between 'autonomous systems of regulation'. In response, the EU (2020) stressed that the key instrument that will be used to regulate interactions between the EU and the UK financial systems would be unilateral equivalence.

The preferences of UK regulators accord to some extent with theories of transnational governance. For example, the importance of maintaining access to the EU financial markets, together with an extended transition period and/or regulatory waivers, all point to the importance of transgovernmental (EU and international) networks in shaping the Bank of England's preference for financial stability. Nonetheless, these economic imperatives were qualified by a bureaucratic concern to preserve (and, potentially, enhance) the role and autonomy of UK regulators post-Brexit. Crucially, this meant explicitly opposing any soft Brexit outcome, such as EEA membership, which would necessitate the full and automatic alignment of UK and EU financial rules. To reconcile these competing demands, the Bank sought to appeal to international standards as the basis of evaluating regulatory equivalence, not least because this was an arena in which UK regulators traditionally punched above their weight. Importantly, quiet lobbying by senior Bank officials was pivotal in shaping the UK government's position, as reflected in the July 2018 White Paper and its negotiating position for the future relationship talks.

Conclusion

This paper set out to explain UK preferences in finance during the Brexit negotiations, which are puzzling from a transnational governance perspective. On the one hand, an emphasis on transnational alliance-building (McKeen-Edwards and Porter, 2013; Mügge, 2010) would predict the formation of a powerful cross-border coalition of financial interests capable of shaping UK preferences in favour of continued single market access through full regulatory alignment. On the other hand, from a transgovernmental perspective (Jordana, 2017; Tsingou, 2015; Stone and Ladi, 2015) we would expect UK regulators to support regulatory continuity to preserve financial stability, rooted in the shared technical expertise and epistemological views of international and EU regulatory networks. Surprisingly, however, we find that the empirical record does not match these expectations: on the contrary, the UK government accepted reduced market access for financial services post Brexit as the price for retaining regulatory flexibility.

We argue that the explanation is twofold. To being with, drawing on domestic theories of international regulation (Singer, 2004, 2007), we suggest that the UK's position reflected the need to balance the competing demands of elected officials with the financial industry. However, the preferences of these groups were the opposite of what the existing literature would predict. Hence, while financial lobby groups championed regulatory alignment post-Brexit to guarantee market access, senior ministers demanded regulatory flexibility for financial services to protect the competitiveness of the City. Furthermore, we argue that UK preferences were shaped to a large extent by bureaucratic politics (e.g. Bach et al., 2016; Carpenter 2001; Dunleavy, 1991): namely, pressure from UK regulators to retain regulatory autonomy and discretion over high status policy competences. This led UK regulators to rule out any deal necessitating full regulatory alignment with the EU, and instead to push for a system of regulatory equivalence based on international standards.

This article makes a significant contribution to the literature on financial regulation, which has implications beyond Brexit and finance. We make three concluding points. First, the article highlights the importance of contextualising financial regulatory preferences. Hence, in a highly politicised and volatile domestic context, as we find in the UK after 2016, elected officials and regulators are confronted with powerful electoral and bureaucratic incentives capable of over-riding the concerns of even the best organised economic sector (see also Thompson 2017b). Furthermore, unpacking the domestic context helps to explain why the preferences of the UK financial industry and elected officials appear to challenge domestic theories of international regulation. Contrary to what this literature would expect, large transnational financial firms conducting business across multiple states generally prefer regulatory certainty and alignment to regulatory discretion and divergence. By contrast, in the face of parliamentary gridlock, pro-Brexit Conservative ministers were keen to appeal to voters by stressing the potential competitiveness gains of Brexit that could be achieved through regulatory flexibility.

Second, this article demonstrates the added value of incorporating a bureaucratic politics perspective when explaining financial regulatory preferences. We argue that it provides a more accurate account of UK preferences in at least two respects. On the one hand, a functionalist account cannot by itself provide an answer to the fundamental trade-off between maintaining market access and retaining regulatory flexibility confronting the UK. Rather, this can only reflect a deliberate normative choice on the part of UK negotiators, shaped by political and bureaucratic imperatives. On the other hand, explanations rooted in theories of business power (Lindblom, 1982; Culpepper, 2011) and regulatory capture (Stigler, 1971) fail to explain how UK regulators – and, by extension, the UK government – resisted pressure from a key economic sector. We suggest that a bureaucratic politics perspective is valuable in assigning regulators with both agency and motivation through which to explain their behaviour.

Finally, the study sheds light on the particular conditions under which retaining policy autonomy takes precedence over regulatory continuity. In particular, our findings suggest that the position of UK regulators cannot be reduced to a simple preference for being a 'rule-maker' over being a 'rule taker'. On the contrary, the UK was frequently a rule-taker on some aspects of post-crisis EU financial regulation – notably, with respect to hedge fund regulation – because France and Germany were often able to muster a coalition of states capable of outvoting the UK (see James and Quaglia, 2020). The UK will also remain a rule-taker of sorts if forced to rely on the EU's third country equivalence regime for market access after Brexit. Moreover, the fact that UK regulators have renewed their call for greater regulatory harmonisation at the international level in response to Brexit suggests that the priority accorded to regulatory autonomy is not absolute. As such, we conclude that UK regulators' preference for international over EU rules is driven in large part by bureaucratic imperatives: namely, the prominent role and status traditionally assigned to senior UK regulators in international fora, and the greater flexibility and discretion afforded to national regulators by non-binding international 'soft law' standards. Future research would benefit greatly from extending this bureaucratic politics perspective to provide further specification of these conditions.

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