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The waiting game: How securitization became the solution for the growth problem of the Eurozone

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Abstract
This paper takes a closer look at those parts of the European Commission's Capital Market Union (CMU) that bear upon the attempt to set up a new market for securitizations, called 'simple, transparent and standardized securitizations', in brief STS-securitization. The 'puzzle' at its heart is the discrepancy between narratives and content. While the narrative is about the construction of a US-style market-based financial system to overcome the problems of Europe's bank-based system and help medium-sized enterprises, the first legal initiative aims to create a European market for securitizations, which are a source of funding for large (mortgage) banks and as such are squarely at odds with the headline goals of the Capital Market Union. The paper discusses in detail key passages from the proposal to tease out the discrepancy between story and fact and ventures an explanation based on the identification of the interest coalitions behind the package.

Keywords
European Union, financial regulation, law, market making, securitization

> When the proposals for STS came along, I was a bit bemused as to how a set of such complex proposals could be labelled 'simple'.
>
> Rob Ford, TwentyFour Asset Management, Financial Times, 23 March 2016.

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Introduction

Europe's 'Capital Markets Union' (CMU) is rapidly gaining traction. Announced in November 2014, the new European Commission (EC) under Jean-Claude Juncker quickly capitalized on the more buoyant post-crisis mood among the member states of the European Union (EU). In that context it kick-started a series of 'public' consultations on what it deemed to be the key priorities of the set of proposals included in the original Green Paper. That paper was written under the supervision of the former British Commissioner, and former lobbyist, Jonathan Hill (EC, 2015a). Three years later the CMU figures prominently as a crucial fixture to make the Eurozone crisis proof in a May 2017 'reflection paper on the deepening of the economic and monetary union' produced by the EC. That very same paper anticipates the amendments of the securitization framework discussed in this paper, to facilitate the future securitization[1] of sovereign bonds and generate a steady supply of so-called 'safe assets' (EC, 2017; Gabor and Vestergaard, 2018).

The premise underlying the CMU is that the striking post-crisis economic performance difference between the US and the Eurozone is caused by the over-reliance of European economies on bank lending rather than market lending, as is the case in the US. This hides the role of the disastrous austerity policies enshrined in the revamped Growth and Stability Pact underlying the governance of the Eurozone in explaining its dismal post-crisis economic performance (see Stiglitz, 2016; Krugman, 2013 for many). This is a frame the Commission took straight from a private industry report, *Bridging the Growth Gap,* that Boston Consultancy Group had produced for the main Brussels-based financial lobbyist (BCG, 2014), the Association for Financial Markets in Europe (AFME).

The reasoning here is that European banks were busy rebuilding their balance sheets after the shock of 2008, which impaired their ability to finance the real economy, read: small-and-medium-sized enterprises (SMEs). Hence the need to open up an alternative financing channel, which is what the CMU formally is about. On a webpage dedicated to the CMU, under the heading 'Unlocking funding for Europe's growth', the Commission states:

> The Capital Markets Union (CMU) is a plan of the European Commission to mobilise capital in Europe. It will channel it to all companies, including SMEs, and infrastructure projects that need it to expand and create jobs. By linking savings with growth, it will offer new opportunities for savers and investors. Deeper and more integrated capital markets will lower the cost of funding and make the financial system more resilient. All 28 Member States of the EU will benefit from building a true single market for capital.[2]

To do so, the Commission aims to further integrate European capital markets; diminish red tape; introduce harmonized rule books for prospectuses, share and bond emissions and peer-to-peer lending; and, most notably, restart European securitization markets to increase the accessibility of funding for banks.

As such, the CMU is likely to further financialization of the European political economic space for two reasons. First, it aims to bring financial techniques (securitization) and financial markets (stock and bond markets) to economies where they have so far remained marginal. Germany, with its underdeveloped real estate and hence securitization markets, is a case in point (Aalbers, 2017; Wijburg and Aalbers, 2017).

And second, it perpetuates pathways of financialization that started way before the crisis of 2008 and have proven to be largely immune to political change. Securitization is the main

illustration here. Since financialized real estate markets create their own political support once they have reached a certain threshold, there are pressing political and functional reasons to resuscitate these markets post crisis. To put it otherwise: incumbents, including home owning citizens, have strong incentives to politically block any attempt to undo financialization (Engelen, 2017; Fuller, 2015).

We see both as instances of 'governing through markets', a theme which this special issue is devoted to. As Braun et al., following Quinn (2010), state in the Introduction to this issue, governing through markets is a mode of governance that aims to achieve public policy goals through indirect policy tools that induce 'another entity into action toward a desired end' (Braun et al., 2018). In the case of the CMU, the goal is a return by default to the debt-driven growth models from before the crisis by stimulating banks to further the financialization of real estate markets. The policy tool used here is a legal framework for a Europe-wide market for securitized mortgage loans, providing banks throughout the EU with access to funding which in turn will do their transformative work in variegated European real estate markets.

We see the CMU-initiative as an attempt to indirectly spur economic growth in a political conjuncture where direct public support for economic growth through budgetary expansion is blocked. Hence our title: the waiting game. Banks simply had to sit out the post-2008 storm to get their way. The CMU-initiative is a last resort attempt to kick start the economies of the Eurozone through opening up a transnational space of action for banks. That is the political backdrop to our story.

In this paper, we look in more detail at those parts of the CMU that attempt to create a new market for securitized mortgages, the so-called 'simple, transparent, standardized', or STS-securitizations. Its formal legitimation is that it would serve the credit needs of SMEs. This abbreviation appears no less than 49 times in the 2015 Green Paper, illustrating its rhetorical importance (EC, 2015a). Since the launch of the CMU, the Commission has concentrated its efforts mainly on this part. That is striking since securitization is first mentioned only at page 11 of the original Green Paper and is formally not about an alternative to bank credit but about bank funding and as such only reinforces the dependence on bank finance which the CMU sets out to correct in the first place (Aalbers and Engelen, 2015; Engelen, 2015, 2016; Hardie et al., 2013).

The results of the 'public' consultations on this part of the CMU have already been worked into a revised proposal by the EC, containing two proposals for new legal regulations and an explanatory and legitimating Memorandum laying out the rationale behind the drafts. They were formally accepted by the Council of the European Union (CEU) in December 2015. The aim was to get it through European Parliament as quickly as possible, although doubts among some Members of European Parliament, Brexit and the stepping down of Jonathan Hill as Commissioner had temporarily delayed its passing. At the time of writing (early 2018) the state of play is that the CEU has reached agreement with the European Parliament on the key details of the proposals, aiming for a fully functioning securitization market at the end of 2019 at the latest (CEU, 2017).

The documents are revealing in that they betray the extent to which the Commission has felt obliged to respond to one of the main lessons of the crisis, namely that securitization resulted in complex, opaque and risky financial products that caused the financial meltdown of 2008. On the basis of a critical reading of key passages of the documents mentioned above, we show that the proposals and memorandum are framed as being about enhancing the access to credit of SMEs whereas it is actually about lowering capital requirements for

large commercial banks. Moreover, the legal details suggest that the securitizations endorsed by the Commission are the spitting image of pre-crisis industry practices and as such are anything but 'simple', 'transparent' and 'standardized'.

The puzzle at the heart of this paper is related to the discrepancy between the 'frontstage' narratives told by the Commission and the actual content of law making 'backstage'. This is of course nothing new. Decision making in many policy domains is controlled by well-organized interest groups which tell 'trade narratives' that refer to public goods in order to obscure the private interests behind them (Bowman et al., 2017; Engelen, 2017). There is now a sizeable and growing literature that aims to explain the gap between narrative and facts as the outcome of power asymmetries. There is not only power in (policy) ideas, but also through and over them. In the latter two instances ideas are used to seduce or manipulate audiences into believing that private actions do indeed serve public values while they are actually harming them (see Carstensen and Schmidt, 2015; Engelen, 2017).

In this paper, we use this framework to trace the (private) interests behind the CMU-initiative. Our analysis is based on a critical reading of the legal documents at stake, triangulated with reports from the business press, informal conversations with some of the players and a critical tracing of the policy process from start to finish.

The discussion is structured as follows. In *Introduction*, we focus on the discrepancy between the official storyline of the CMU and the 'facts' of securitization before the crisis. In *Fact and fiction* section, we delve deeper into the legal documents to demonstrate that there is nothing 'simple', 'standardized' or 'transparent' about the securitization framework. Obviously, this raises pressing questions about what could explain the discrepancy between fact and fiction. Those questions are addressed in the following section entitled *What does 'simple, transparent and standardized' mean?* through a discussion of the coalition behind the STS securitization initiative. The paper ends with a brief summarizing conclusion, where the answer to our puzzle is laid out.

Fact and fiction

In this section, we tease out the gap between fact and fiction. We start with a description of the way in which the need for a resuscitated market for securitization is framed and how it is related to the economic conjuncture of the Eurozone.

As we stated above, the headline reads that securitization is good for the Eurozone economy. That is what the first sentence of the official Memorandum explicitly states:

> The development of a simple, transparent and standardized securitization market constitutes a building block of the Capital Markets Union and contributes to the Commission's priority objective to support job creation and a return to sustainable growth. (EC, 2015a: 2)

It is a frame that is reiterated on the webpage of the Commission dedicated to the CMU, where securitization is presented as:

> [A]n additional source of finance, particularly for SMEs and start-ups ... that would encourage integration of EU financial markets and by (sic!) make it easier to lend to households and businesses.

The same website contains a cartoonish video explaining its aims in similar terms through the fictional storyline of Anna, a promising entrepreneur looking for funding, and Paul, a wealthy saver looking to invest his money. In between them stand borders, rules and regulation, depicted in the video as dystopian walls. In comes the CMU, to break down the walls. As the video explains:

> [I]t would help Anna and other businesses to raise capital more easily and it would help Paul and other savers to get more for their money. That's the goal of the Capital Markets Union.

The same causal claim is repeated over and over again in the Memorandum itself without much empirical evidence (see also Pesendorfer, 2015). That is, securitization would help 'sustainable' economic growth and job growth. 'Sustainable' here means real economic growth rather than financialized or debt-driven growth. The suggestion is that securitization helps SMEs and hence generates 'jobs and growths'. But does it?

It pays to take a closer look at the causal claim at the heart of the CMU as well as the STS securitization-initiative. According to figures assembled by the European Securitisation Forum (ESF) before the crisis, securitization in Europe was predominantly used to finance mortgage loans, a 'fact' that suggests that the Commission is not making a 'truthful claim' but is doing something else. Before the crisis, SME-loans were only a marginal category of assets used to back securitizations. The total stock of securitized assets in Europe at the end of 2008 reached €1700 bn. Of that total, securitized mortgages accounted for over €1000 bn while asset-backed securities (ABS) made up less than €200 bn. That included securitized SME-loans, as well as car loans, student loans and credit card debts (see Table 1).

Table 1. Total stock of securitizations in Europa ultimo 2008, in billion €.

	ABS	CDO	CMBS	RMBS	WBS	Total
Austria	0.8		0.2	2.2		**3.2**
Belgium	0.2	0	0.1	41		**41.4**
Denmark	1.6	5.4		0.3		**7.3**
France	9.9	0.6	3.5	12.9		**26.9**
Germany	35.6	13.6	17.7	20.3	0.1	**87.3**
Grecee	4.6	7.8		8.7		**21.2**
Ireland		3.3	1.5	43.9		**48.8**
Italy	56	4.4	3.8	94.7	2.4	**161.3**
Netherlands	2.6	11	7.5	181.4		**202.5**
Portugal	2.2	4.3		28.7		**35.2**
Russia	1.8			3.3		**5.1**
Spain	19.2	46.1	1.3	162.5		**229.2**
Sweden	0.1			0.6		**0.7**
Turkey	2.9					**2.9**
UK	45.6	3.2	74.5	455.8	36.4	**615.5**
Other	0.1	0.2	0	7.8	0	**8.1**
Multinational	8.7	197.8	28.1	5.5	0.7	**240.9**
Total	**192**	**297.9**	**138.4**	**1069.8**	**39.5**	**1737.5**

Source: European Securitization Forum (2008): 9.

There is a functional reason for this. The riskiness of mortgage contracts is much easier to assess than that of SME-loans, while the risk assessments of the latter are much more difficult, time-consuming and hence costly. Since the difficulty of assessing SME-loans is not addressed in the proposal (there is no regulatory attempt to standardize SME-loans for instance) mortgage lending will again be the main beneficiary of the sanitized market for securitized assets the Commission aims to set up. This implies that most of the extra funding generated by securitization will again finance already existing assets (real estate). The result will be at best asset inflation and at worst the very same housing bubbles that during the crisis proved to be such a drag on economic growth (Borio et al., 2014; Sufi and Milan, 2014). The available literature suggests that the argument for securitization is weak and it creates real estate bubbles, debt-driven growth and financial instability rather than SME financing and sustainable economic growth as claimed by the Commission.

Interestingly, former Commissioner Hill acknowledged as much during a meeting at the Brookings Institute in late February 2015 when he admitted that the link between the CMU and SMEs was weak and merely served to rally politicians behind the initiative. Here is the quote in full:

> I agree with you that this is not and must not be explained as solely a set of measures that will benefit small- and medium-sized enterprises. I think if it works properly, by increasing investment flows, there will be a whole range of beneficiaries, from people who want to save their retirement in a broader range of investment products, from businesses of all sizes that need capital to expand. So I utterly take the point that this is not solely about SMEs. I think the fact that within the European debate there feels to be an emphasis on, that is because they are seen as being such an important part of the economy and people want to rally around ideas that will enable them to be strengthened. (Hill, 2015a: 12–13)

This is bluntly accepting that since everyone is in favour of 'strengthening' SMEs, they will 'rally around' any 'idea' that can be linked to them, no matter how strong that link is. At another meeting,[3] a chief economist from the French lender BNP Paribas, explicitly 'thanked' Hill and the Commission for framing the CMU as an SME financing tool although clearly indicating that BNP Paribas was not interested in SME lending as such but much more in the opportunities for real estate finance to be opened up by the CMU.

Further, the Memorandum speaks of the function of securitization as:

> [P]roviding banks with a tool for transferring risk off their balance sheets (...) and free up more capital that can then be used to grant new credit including SMEs. (p. 11)

Again, it is hard to reconcile these claims with the lessons from a financial crisis that has demonstrated that risks were highly concentrated, raising the issue of banks being too-interconnected-to-fail. A decade later, one would have expected that any proposal to allow banks to transfer risks from their balance sheet to at least demonstrate that this time is different and that the issue of interconnectivity is solved. The stated aim is to remove the 'stigma of securitization' by constructing a legally certified market segment called 'Simple, Transparent and Standardized Securitization' (STS) that differs in key respects from the securitizations of pre-crisis period. In other words, the argument comes in two steps. First, the current 'stigma' of European securitizations is undeserved. Second, the 'stigma' nevertheless exists and it is hence of the utmost importance to create a new

securitization label that signals to end investors that European securitizations have nothing in common with the securitizations associated with the US subprime assets.

To that end the Memorandum stresses that securitization in Europe has performed (much) better than its US counterpart. Nevertheless, securitization in the US has almost fully recovered in terms of level of transactions to pre-crisis levels, unlike its counterpart in Europe. Here is a typical quote:

> Since the beginning of the financial crisis, European securitization markets have remained subdued. This is in contrast to markets in the US which have recovered. This is despite the fact that unlike the US, European securitization markets withstood the crisis relatively well with realized losses on instruments originated in the EU having been very low compared to the US. (pp. 2–3; see also p. 7, 10).

The Memorandum next presents data on default rates of different tranches of the US and EU securitizations, to show that European default rates have been much lower than the US ones. While this is factually correct, the Memorandum fails to give an explanation. The suggestion is hence that it is either due to superior risk management by European banks, higher quality of the securitization process itself, or better regulatory supervision.

The key question here is whether the claim that European securitization are in a better state of health is factually correct. The only way to answer that question is by looking at alternative explanations for the much lower default rates of European securitizations. This is what the Memorandum strikingly fails to do. One potential explanation offered by comparative legal studies highlights the differences in bankruptcy law and mortgage contracts. Whereas in the EU all mortgage loans are full recourse, meaning that the contract gives the creditor full legal protection against repayment risks, in the US many mortgage contracts are non-recourse, that is the debtor can simply walk away from his/her mortgage obligations, resulting in actual default and a rapid fall in value of the securities in question if the scale of default is widespread enough, as was the case between 2006 and 2009 in some US states (see Singer, 2015).

The US provides a kind of ‘natural experiment’ to test this claim, since some states do provide lenders with ‘recourse’ to the borrower, while others do not. In other words, the US is partly just like Europe in terms of its legal treatment of delinquencies and partly textbook US. Empirical research into the incidence of mortgage defaults as a result of whether a state does or does not provide full recourse to the lender has shown huge differences in default rates. In 2011, two economists from the Federal Reserve Bank of Richmond estimated that borrowers have been 30% more likely to default in non-recourse states than in full recourse states. Jumbo loan defaults (ranging around 500–750 thousand dollar) were even twice as high in non-recourse states than in full recourse ones (Ghent and Kudlyak, 2011). This suggests that the differences in default rates between the US and the EU could just as well be attributed to differences in bankruptcy law and may have nothing to do with the assumed ‘superiority’ of securitization standards or risk management.

More importantly, the EC, by claiming excellent market performance for European securitizations throughout the crisis, fails to acknowledge the macro-economic damage of real estate bubbles. That individual European securitizations kept their market value is not to say that securitization as such did not harm the long term interests of households, SMEs and national economies. The ‘popping’ of asset bubbles in countries like Ireland, Spain and the Netherlands has since the crisis forced a substantial portion of Dutch, Irish and Spanish

households to cut back on consumer spending to reduce the discrepancies between the nominal value of their mortgage debt and the market value of their collateral. Combined with Eurozone-wide austerity policies, this has unnecessarily extended the recession and has hurt the long term earning capacities of citizens and economies alike, as recent research by economists from the Bank of International Settlements (BIS) has shown and as 'star' economists like Krugman and Stiglitz have been arguing for some time (Borio et al., 2014; Krugman, 2013; Law and Singh, 2014; Stiglitz, 2016).

It raises awkward questions that a decade after the crisis, an official document from the EC fails to discuss these kinds of 'externalities' and reproduces the trade narrative that there is nothing wrong with European securitizations (see Engelen, 2015). From the perspective of an individual end-investor this may well be true, but from a social point of view it is not. One would have expected the EC to align itself with the latter, not the former.

What does 'simple, transparent and standardized' mean?

Now that we have looked at the narratives provided by the Commission for its initiative to set up a market for STS securitizations, we next turn to the legal details in order to assess what it means for securitizations to be 'simple', 'transparent' and 'standardized'.

To overcome the 'stigma' of securitization pre-crisis and re-open this crucial source of bank funding post-crisis, the EC wants to set up a new market niche of 'simple', 'transparent' and 'standardized' securitized assets, without hindering the regular, 'complex', 'opaque' and 'bespoke' securitizations. The message to end-investors is that they will have the possibility to invest in extra safe 'qualifying securitizations', in the language of the Bank of England (BoE) and the European Central Bank (ECB), that are ontologically different from the complex, unreliable instruments that stood at the cradle of the crisis. How does the EC want to make such a distinction legally actionable? What makes a securitized asset 'simple', 'transparent' and 'standardized'? When do securitizations 'qualify' for the 'STS'-label? And how does the Commission aim to ensure that assets that qualify are traded on markets that are 'well functioning'? These questions point to the details of market construction and governance through markets and are hence couched in a legal-technocratic language that is emphatically not meant for the public 'frontstage' and is—as we will show below—at odds with the marketing arguments for STS securitization.

We base our analysis on two key legal documents that were published on the website of the EC on 2 December 2015, which give technical details. One spells out the criteria of 'simple', 'transparent' and 'standardized' (EC, 2015b), while the other details the capital requirements for buyers of STS securitizations, aiming, in the euphemistic language of the Commission, to provide 'a more risk-sensitive regulatory treatment for STS securitisations' (EC, 2015c). The aim is to incentivize end-investors as well as structurers to buy and 'produce' STS-securitizations instead of 'regular' ones.

Our first observation is that the STS criteria only address the 'quality' of the securitization *process* (structuring, tranching, rating and distribution) and have nothing to say about the 'quality' of the 'raw material' (the mortgage contracts) that feeds the money flows going through securitization structures. This is odd, since, as the events of 2008 have amply demonstrated, the 'quality' of the securitized assets hinges crucially on the 'quality' of the underlying mortgage contracts. As the document on the criteria of STS explicitly states:

> The satisfaction of any STS requirements does not indicate anything about the credit quality underlying the securitisation. (EC, 2015b: 14)

There are for example no thresholds for loan-to-value or loan-to-income ratios for mortgages to be eligible for STS securitizations, even though these are the most important indicators for risk in mortgage lending. So legal protection from predatory lending or the prevention of socially unsustainable investment is no aim of the new STS-label.

Our second observation is that labelling any securitization as 'simple', 'transparent' and 'standardized' is misleading since it glosses over the fact that securitization is inevitably complex. In fact, the document explicitly stresses that STS securitizations are meant for professional investors only. An early draft gave as reasons for excluding retail investors from the STS market that the 'potential level of risk and complexity [of STS securitizations]' made them unsuitable for non-professional investors. This passage was crossed out in the version of the document that was sent to the European Council. The legal aides of the Commission may have wanted to avoid confusion among politicians unfamiliar with the mores of High Finance, why securitizations that were meant to be 'simple, transparent and standardized' were in the same breath described as 'risky and complex'.

To illustrate their inherent complexity, take the passage that stipulates the types of documents that the different parties in any securitization (originators, structurers, sponsors, the managers of the special purpose vehicles used in securitization) have to provide to investors in order to fulfil transparency requirements. This adds up to a long list indeed, covering more than four pages of the document, suggesting an ultimate file that could easily add up to more than a thousand pages, and would inevitably contain speculative assumptions about future risks, returns and macroeconomic conditions as well as open legal clauses such as 'in good faith'.

Furthermore, the document explicitly requires the inclusion of interest and foreign exchange swaps in STS securitizations to manage interest and currency risks. However, derivatives hugely complicate the risk-and-return profile of any financial product, increase counterparty-risk and hence systemic instability, and allow banks to lever up their trading and banking books. As such, the draft proposal reads as if the notion of STS securitization has been stretched to 'cover' the industry practices that had developed before the crisis (for a detailed description of Dutch practices, see Glasmacher, 2018).

The document also opens up the possibility for particularly risky types of securitizations to receive the STS label in the future. Not only synthetic securitizations based on credit default swaps (CDS), but also 'resecuritizations' (i.e. collateralized debt obligations, CDOs, backed by tranches of other securitizations) may in the future receive the STS stamp. Both of these versions of securitization had been frequently used in the US in the years leading up to the crisis, resulting in opaque crosslinking claims that turned local housing crises into a global phenomenon (see Gorton, 2010, 2012). But they had not entered into the repertoire of European banks on a significant scale due to the underdeveloped nature of most European securitization markets. Re-securitization requires a sizeable amount of 'rest material' or so-called 'equity tranches' from regular securitizations and hence a relatively well developed securitization market, which prior to the crisis only existed in the UK and the Netherlands (see Engelen, 2015). The mere fact that the document even considers to give synthetic securitizations and re-securitizations 'STS' status signals to banks and investors that creating and trading those kinds of securitizations in 5–10 years is not a priori ruled out.

Despite being over one hundred pages long, the draft proposal only spells out the broad legal framework of STS securitizations. Much of the fine-tuning still has to be worked out in trilateral meetings between the Commission, the Parliamentary Committee responsible for finance and banking and the CEU, with plenty of opportunities for industry insiders to co-determine key legal formulations. As a result the documents that were sent to the European Parliament contain many open statements such as 'power will be delegated to the Commission' to work out the details. This means that they will be delegated to legal and financial specialists operating 'backstage' and will remain largely beyond democratic control. What is more, industry insiders are explicitly invited to participate in fine-tuning the rules they will be subject to: 'the views of market participants should also be requested and taken into account to the extent possible' (Section 1(10), p. 5).

Our third observation concerns the second document, on capital requirements. It emphatically stresses the need to amend the existing rules 'on prudential requirements for credit institutions and investment firms'. This is regulatory jargon for the amount of equity end-investors have to hold per asset category (bonds, SME-loans, mortgages, shares, etc.) that they invest in, in terms of share of their total balance sheet. The document explicitly aims to lower that percentage for STS securitizations. This is attractive for insurers, banks and asset managers, which are the most important buyers of securitized assets, and are struggling to meet more stringent equity requirements while trying to revamp their profits to pre-crisis levels. The Commission speaks of 'broad support' for a more 'risk sensitive' capital charge for European securitized assets, implicitly pointing to a coalition of interests that will be discussed in more detail in the next section.

To understand what more 'risk sensitive' equity requirements means, some background on what went wrong before the crisis and what has been done since is in order. Basel 2, the regulatory regime installed just before the crisis (phased in from 2004 onward), allowed banks to assess their own risk exposure and calibrate their equity requirements accordingly. Before the crisis, European banks in particular were allowed by European regulators to minimize those requirements (and maximize their profits in terms of Return on Equity (ROE) (Bayoumi, 2017; Fligstein and Habinek, 2014). This resulted in banks being severely undercapitalized (or overleveraged) when the crisis struck. In order to strengthen banks' abilities to withstand future market volatility, the Basel Committee of Banking Supervision (BCBS) post-crisis aimed to enhance the capital charges for different asset classes and constrain the ability of banks to use proprietary risk assessment tools through Basel 3, which is currently being phased in.

This suggests a different explanation for the breakdown of European securitized asset markets than the one offered by the Commission. In the alternative storyline, breakdown happened not because of its misplaced association with US 'subprime' and its presumed 'toxicity' but because in the post-crisis regulatory environment securitization has simply become too 'expensive' in terms of capital requirements for banks to buy and produce. Lowering these costs, and hence increasing the profits from securitization, by reducing the regulatory capital charges for securitization as defined by Basle 3, is key for the resuscitation of this market. In our reading this is the key aim of the document:

> The methodology would result in a *significant* reduction of the capital charge for non-senior tranches of STS securitizations. [our emphasis] (EC, 2015c: 10).

This is to say that the originators/structurers/sellers who have to keep parts of the riskier ('non-senior' or 'equity') tranches of securitizations on their balance sheet, will face reduced capital requirements, which enhances their attractiveness. But just as crucial are the requirements for the buyers of these products. Without effective demand there can be no supply. In the next sentence, the Commission adds:

> Technical improvements will also be made to the methodology of calculation of the calibrations for the senior tranches. (EC, 2015c: 10)

This reflects explicitly the concerns of particularly those institutional investors who normally buy the most senior tranches and face their own capital adequacy issues under Solvency II. Reducing capital requirements is seen as key to provide sufficient incentives for end-investors to buy and for structurers to 'produce' STS securitizations.

Mark the neutral terminology of 'technical improvements' for lower capital requirements. This choice of words is relevant because it indicates a new sensitivity for the public spotlight among policy makers and regulators involved in financial governance through market making. There are good reasons for not being candid about the effects of the proposed new capital requirements for STS, which is that it does not make any economic sense and may add to more macroprudential risk. They make holding mortgage loans (and other assets) in securitized form less expensive than holding them in unsecuritized form, even though securitization inevitably introduces additional risks, no matter what the quality of the securitization process is, if only because of the interest rate and FX swaps included in any securitization. The Commission thus fails to draw the only logical conclusion from its own observation, that is: securitizations should require higher not lower capital charges.

How 'significant' the reduction in capital charges will be is as yet unknown. The latest version of the proposal which dates from 26 June 2017 merely stipulates in Article 30 that the 'size of capital buffers' shall be determined by 'the competent authorities', giving discretionary powers to the European Banking Authority and the European Central Bank (CEU, 2017).

Cui bono?

The discussion in the previous section has raised pressing questions about who stands to benefit from this proposal. Our answer to that question is again based on a critical reading of the documents and a reconstruction of the policy process, which both contain traces of the interests behind the proposal for STS securitizations. Our starting point is that policy proposals are hardly ever the product of one, single, identifiable author but are mostly traceable to a contingent coalition of interests. We have taken our cue for this from a classic in the field of public administration: March and Olsen's (1989) 'garbage can'-model of public decision making.

According to this model, policy proposals are hardly ever the outcome of a rational process of policy makers trying to find solutions to well defined policy problems. Instead, discrete policy ideas often tend to circulate aimlessly within a specific policy field, like garbage in a can, until a contingent coalition of policy makers over time adopts a particular policy proposal and starts collecting policy problems to which their preferred policy idea is the 'best' solution. Coalitions, narratives, contingencies and brokering are at the heart

of this view of policy making, not rationality, problem solving, engineering and puzzling (March and Olsen, 1989).

This suggests that a policy proposal gets selected if it serves the interests of a larger interest coalition and hence is able to solve multiple 'problems' in one go – again given specific 'problem definitions' and given specific conjectural conditions. What are the 'problems' that STS securitization is meant to 'solve'? And whose 'solution' is it? And what do they stand to gain in selecting this particular 'solution'? Below we discuss the interests of the members of the coalition behind the STS-proposal which we came across while tracing the policy making process behind the STS securitization market. They run from European policy makers to national banking associations and from private banks to national and European banking regulators.

European policy makers

The first thing to note is that the wider CMU initiative, as Dorn has stressed (Dorn, 2015), fits a much older narrative shared by EU policy makers who look to the US for 'policy solutions' to European problems. The Lisbon agenda, for instance, is strongly geared towards emulating the US venture capital-model of technological innovation that has come to fruition in Silicon Valley. Similarly, the Single Market was explicitly set up as a counterpart to the integrated markets of the US, while the Services Directive of 2006 contained numerous references to the American shareholder-ideology which the EC saw as the gold standard in corporate governance. In a sense, this is true for the project of European integration as a whole; mimicking the US, with substantial US support, has always been at the core of it (see Milward, 1984 for many).

The CMU fits this mould, for it explicitly frames the economic performance differences between the US and the EU since the crisis as the outcome of underdeveloped debt and capital markets in the EU. As such, the CMU stands in a long tradition of elite attempts to transform the EU into a more integrated federation (see Dorn, 2015; Ertürk, 2015; Pesendorfer, 2015). Hence, it is no coincidence that the idea for the CMU originated from the EC and its staff, which has always been the driver towards a more federalist Europe since it would expand its power, scope and resources and shift the balance within the EU from intergovernmental institutions to federal ones. Of course, the CMU would have failed to gain traction if there was no direct or – in this case – indirect support from nationally based interests.

National banking associations

Since the mid-1990s there have been a number of initiatives in different EU member states to 'construct' a national securitization-standard or label to enhance their attractiveness to end investors. Here, we do not pretend to give a complete overview of such initiatives but merely pick and choose two extreme and hence telling cases. In Germany, True Sale International (TSI) presents itself as being 'at the heart of the German securitisation market'. Established in 2004 by 13 German banks, ranging from the state-owned Bayerische Landesbank to the commercial mammoth Deutsche Bank, the aim is to make investors as well as regulators familiar with this 'new' asset class.[4] This reflects the 'underdeveloped' nature of German financial markets and the willingness on the side of regulators, with some prodding from public and private banks, to 'modernize' the German financial system,

as was the explicit aim of the early 21st century federal financial market promotion-plan ('Finanzmarktförderplan') (Lütz, 2005).

Other attempts of a similar nature are Kreditanstalt für Wiederaufbau's (KfW) so-called 'Promise and Provide' platforms, which mainly cater to buyers of securitized SME-loans. However, these initiatives were not only relatively late in the day, but also by and large unsuccessful. While the number of SME securitizations in Germany increased sizably between 1998 and 2008, the total stock of German securitizations remained rather subdued given the size of the German economy, as illustrated in Table 1. This partially explains the absence of a real estate bubble in Germany before the crisis. However, as a result of the extremely lax monetary policy by the ECB things are in the process of changing, with rapidly rising real estate prices and sharply increasing credit flows, suggesting a future dependence of German banks on the very same sources of funding that securitization opened up to British and Dutch banks (Wijburg and Aalbers, 2017).

By contrast, in both the UK and the Netherlands, securitization had by 2008 become a widely used financial technique, predominantly to fund residential mortgages. Regulators and politicians in a process of national 'governing through markets' that predated the European story of the CMU had over time adapted the legal framework to make large scale securitization possible in an attempt to transform their housing markets from social renting dominated markets to owner-occupied markets. This clearly reflected the preferences of the largest mortgage banks in both the Netherlands and the UK. Since it resulted in large real estate bubbles which had sizeable macroeconomic effects as a result of household attempts to deleverage, the industry practice was in need of a new legitimating narrative post crisis (Aalbers et al., 2011; Chang and Jones, 2013; Engelen, 2015; Hardie et al., 2013; Wainwright, 2009).

This is nicely illustrated by the fate of the Dutch Securitization Association (DSA). This organization was established in September 2012 by a consortium of banks, law firms and trust companies involved in Dutch markets for securitized assets and operated in close collaboration with the Dutch Banking Association (NBV). Its mission statement reads:

> [T]he promotion of the interests of both issuers of and investors in Dutch securitisation transactions. Its ultimate objective is to create a healthy and well functioning market for Dutch securitisation transactions.[5]

In this case, the aim is not so much the 'establishment' of a market for securitized assets, as in Germany, but rather the rebranding of securitization after the crisis as a safe and reliable ('healthy', 'well functioning') financial product. Of course, this has everything to do with the large scale dependence of Dutch banks on securitization as a funding tool, which had developed between 1995 and 2008. Prior to the crisis, well over one-third of all Dutch mortgages have been securitized (Engelen, 2015). Since these securitized assets on average reach maturity between 5 and 7 years, there is a growing 'wall' of maturing securitizations that has to be 'rolled over' in the upcoming years that need to be matched by increasing 'demand' from end investors.

In our view, this explains the urgency on the side of European banking associations in their dealings with the Commission and European Parliament to push through the CMU initiative in general and the STS proposal in particular. This comes clearly to the fore in urgent calls in for instance the Financial Times from industry insiders halfway the policy

process to speed up the legislative process, using words like 'need', 'accelerate', 'urge', 'concerned', 'urge', 'swift', 'frustration' (Engelen and Glasmacher, 2016).

Some envisioned the CMU as a carrier for long-term national plans to set up a market for securitized assets. Others saw it as the best way to resuscitate a market on which their banks had become strongly dependent, in order to solve their future refinancing problems and keep their economies on the debt-driven growth trajectory which they had come to rely on before the crisis. It is no surprise that the latter were much more visible during the policy making process, as is demonstrated in *Regulators* section.

Central bankers

Giving their mandate and the experiences during the crisis, central banks have been much more concerned with financial stability post-crisis than pre-crisis. While initially most of the re-regulatory push has focused on making the asset side of banks' balance sheets safe (hence the increase in capital requirement), more recently liability or funding issues have risen on the regulatory agenda. This is where securitization fits in. The refinancing problem in financialized banking systems mentioned above, is for now temporarily 'solved' or pushed forward in time, by the ECB providing short-term funding through repo-transactions using 'retained' securitized assets as collateral. Any return to 'normal' monetary governance will thus have to involve the construction of a working European market for securitized assets. This in our view explains the strong interest of central bankers, especially from the side of Dutch and British central bankers, in the STS securitization proposal.

Take the joint May 2014 Bank of England/ECB Discussion Paper, titled: 'The case for a better functioning securitisation market in the European Union'. While the document critically discusses the role of securitization in the crisis, the focus is squarely on negligent risk management rather than on concerns such as misallocation of credit, asset bubbles and other macroprudential issues. As the title indicates, the two central banks do not question securitization per se but merely want to take away the causes of its malfunctioning pre-crisis through better regulation. Telling is the following quote, where the paper talks about the 'potential benefits of securitization':

> As a funding tool, securitisation can contribute to a well-diversified funding base, in terms of maturity, investor type and currency. [...] Looking ahead, the banking system is likely to need access to a wider range of funding sources. The revival of the ABS (Asset Backed Securities) market can therefore play a useful role in ensuring that there is not a renewed build-up of systemic risk, including from excessive reliance upon any single source of financing. (BoE/ECB, 2014: 3)

Note that the BoE and the ECB seem to be anticipating a post-crisis world where a revamped market for securitized assets will again allow banks to diversify their funding sources and end the current 'excessive reliance upon any single source of financing'. This can not only be read as proposing an alternative to traditional bank based financing. It is also an implicit reference to the quantitative easing and liquidity provisioning programs of the ECB and the BoE (which serve as the dominant funding sources for European banks) which are perceived by both institutions as undesirable and unsustainable in the long run.[6]

This is the third 'problem' STS securitization is meant to 'solve'. That is, in order to allow central banks to end the exceptional monetary measures embarked upon since the crisis,

the resuscitation of European market for securitized assets is crucial, provided they are 'safe', 'transparent' and 'simple' or, in the terminology used by the BoE/ECB paper: 'qualifying securitisations' that are traded on 'well functioning' RMBS markets. Apparently, macro prudential considerations, of the sort discussed in the *Fact and Fiction* section of this paper, are not taken into serious consideration. It is the funding needs of banks together with the wish to end monetary exceptionalism that almost exclusively informs the thinking of the BoE and the ECB.

Regulators

The fourth constituent of our interest coalition is the new European banking regulator, the European Banking Authority (EBA), established in 2011, which has been mandated to guarantee the solvency of the largest European banks as well as the quality of their credits. Its position on securitization nicely illustrates the extent to which regulators post-crisis still identify with the banking industry. Take its background paper on securitization, which stresses the benefits of securitization (EBA, 2014: 46), failing to mention its role in causing real estate bubbles. It copies trade narratives in its list of lessons to be drawn from the crisis, which focuses on a limited set of technical issues such as leverage, originate-to-distribute, maturity transformation and transparency (EBA, 2014: 48).

Even before the EC invented the 'STS'-label, the report endorsed the industry initiative to establish a European securitization standard by the Prime Collateralised Securities initiative (PCS) as a 'solution' to the 'problem' of the current securitization market crunch. It is a well-chosen monicker: the adjective 'prime' suggests a strong contrast with the 'subprime' mortgages in the US that have become linked to the crisis in the public eye and have, according to the industry, 'undeservedly defiled' European securitizations. 'Collateralized' suggest that the end-investor buys a financial product whose value is 'secured' by the value of the underlying 'collateral' (mainly real estate). In combination with the substantive 'securities' – a reference to the legally protected status of the financial title, 'guaranteeing' a fixed income, a fixed maturity date and a legally protected place in the cue of claimants in the case of default – it suggests a double form of 'securedness'. The report describes PCS as:

> [A]n *independent not-for-profit initiative* set up to reinforce the asset-backed securities market in Europe as a key to generating robust and sustainable economic growth for the region. At the heart of the PCS initiative is the PCS Label designed to enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market. (2014: 48) [our emphasis]

This is a copy-and-paste job from the mission statement of PCS itself that was meant to obscure its true lineage. For PCS is anything but 'an independent not-for-profit initiative'. Instead it is a well connected lobbying organization with strong British and Dutch backing (among others, the Dutch Securitisation Association – see above), which pushes for the formal recognition of its PCS-label and hence for something which very much looks like the STS securitization market the EC aims to erect.

PCS was established in 2012 by AFME and the European Financial Services Roundtable (EFR), the two most powerful lobbying organizations for the financial services sector in Brussels (see Engelen, 2015), and is thus hardly 'independent'. Its lineage used to be explicitly mentioned on its website but has since been erased from its 'history' and 'mission' pages.[7] Instead its mission statement now includes the rider that not only the sector itself

believes 'that a strong and resilient asset backed market is an indispensable part of European growth and prosperity' but so 'do many policy makers'. Which seems a fair assessment of the current state of play, given the willingness of EBA to gloss over PCS' origins and present it as an 'independent' initiative.

Since the main concerns of the EBA are related to the asset side of banks' balance sheets, not the funding side, their willingness to adopt the perspective of banks should not come as a surprise. Regulators perceive funding issues primarily through a solvency lens, as the famous quip that 'if you are illiquid long enough you will ultimately go bankrupt' indicates. If solvency is perceived to be key to maintain financial stability, regulators can be expected to endorse any political initiative that is meant to broaden the funding possibilities for banks. This is exactly what has happened here; maximizing liquidity was the regulators' main concern, while the kind of broader macroprudential issues stressed in this paper clearly come in second place.

Conclusion

We started this paper with a puzzle: why is the CMU presented 'frontstage' as an alternative to bank credit, while 'backstage' it appears to be mainly concerned with constructing a new source of funding for banks? The answer we have provided is that behind the STS initiative there is a diverse set of agents who all, albeit for different reasons, have strong incentives to believe that STS-securitization is the best 'solution' to the different 'problems' they face. Given this interest coalition, described and discussed in the *Cui bono* section, it becomes understandable that the very same financial instruments which stood at the cradle of the crisis are again in the process of being treated as low risk assets by European regulators.

This is to ensure that:

1. banks can again kick-start their securitization desks and can 'roll over' the large wall of securitizations on the horizon;
2. ensure that asset managers and insurers can reap a little bit of yield over and above sovereign bonds in the current low yielding environment;
3. the regulator can be sure that banks in time have access to independent sources of funding;
4. the ECB can gradually move to a new normal in terms of monetary governance without having to consider the consequences for bank funding.

Add a political conjuncture in which the policy instruments to aid the slow recovery in the Eurozone are either blunt (take, e.g. quantitative easing) or have been a political taboo (fiscal stimulus) (see Braun and Hübner, 2018), the conclusion is that what we have here is an almost perfect example of how a 'problem' becomes a 'solution' if only one is able to wait long enough. This is what European banks apparently have been able to do, thanks to the liberal monetary policies pursued by the ECB since 2008, and the austerity policies pursued by the member states of the Eurozone.

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Notes

1. In this paper, we have followed the US spelling of securitization. We have kept the British usage of securitisation in the quotes alone.
2. See http://ec.europa.eu/finance/capitalmarkets-union/index_en.htm.
3. Organized by Euromoney and co-hosted by the Royal Bank of Scotland, the International Capital Market Association (ICMA) and AFME, among others, in Brussels in December 2016.
4. See www.true-saleinternational.de.
5. See www.dutchsecuritisation.nl/mission
6. See Braun and Hübner (2018) for a similar argument. Braun (forthcoming) even goes as far to say that 'no other public agency has done more for the European securitisation market than the ECB'.
7. Compare the quote given above with is now on its website: pcsmarket.org.

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