

The Political Economy of European Capital Markets Union

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Introduction

In September 2015, the European Commission put forward an Action Plan for Capital Markets Union (CMU) and two legislative proposals concerning securitisation. Further legislative activity was to follow. The ‘Five Presidents Report’ of June 2015 had presented CMU as necessary to complement Banking Union and ultimately to complete Economic and Monetary Union (EMU). CMU was also considered by the Commission (2015a) as the ‘new frontier of Europe’s single market’, with the aim of reducing fragmentation in financial markets, diversifying financing sources, strengthening cross border capital flows and improving access to finance for businesses, particularly Small and Medium Enterprises. More immediately, the CMU initiative was to encourage bank and other corporate securitisation in the European Union, the level of which had plummeted since 2007 with the outbreak of the international financial crisis. CMU was also intended to boost the global competitiveness of European financial centres which, over the previous decade, had lost ground in global rankings (Deutsche Bank, 2015; FESE, 2015).

The CMU project was a potentially important development in the Single Market for two main inter-related reasons. First, full financial market integration had been a long-standing and rather elusive goal of the European Union. Second, the term Capital Market *Union* was deliberately chosen by the Commission to indicate that CMU was complementary to Banking *Union* and necessary for the completion of Economic and Monetary *Union*, which had been the focus of considerable intergovernmental debate and EU legislative activity from 2012 (Howarth and Quaglia, 2013, 2014, 2015). While it is argued below that the logic behind the link between the three unions is at best problematic, the Commission designed the CMU project to appeal to a range of EU Member States — both those in the euro area and outsiders.

This contribution undertakes a preliminary investigation of the ‘making’ of the CMU project, explaining what CMU is, its economic and political objectives, as well as its main drivers and obstacles. It is argued that the likely winners and losers of the project — both financial groups and specific Member State governments — largely formed the constituencies for and against CMU. The organisation of national financial (and specifically banking) systems largely directed Member State government preferences on CMU. The potential winners were also influential in promoting a specific form of CMU, or at least specific priorities in the construction of CMU. The analysis is organised as follows. Section I discusses the incomplete financial market integration in the EU as well as the variation in financial capitalism in its Member States, which shed light upon national preferences on CMU. Section II explains the objectives and the main features of CMU. Section III examines the promoters

of and ‘foot-draggers’ on CMU, with Member State government and economic interest group preferences gauged principally by written responses to the Commission’s consultation on CMU and other public statements. Section IV focuses on the specific element of the CMU project which was prioritised by EU policy-makers — securitisation — and was the subject of the Commission’s first explicitly CMU-linked legislative proposals of September 2015.

I. Incomplete financial market integration in the EU

The impact of the international financial crisis and then the euro area sovereign debt crisis on the single market in financial services was devastating. The fragmentation of the financial services market in turn affected the European Central Bank’s (ECB’s) ability to operate effective monetary policy (ECB, 2012). Not only had banking markets become less integrated since 2008 on a range of measures, but also the cross-border bond holdings of euro area financial companies (as a percentage of the total) declined markedly from the middle of the 2000s. In 2005, of the government and corporate bonds held by financial companies, over 40 per cent were cross-border. By 2011 this figure had dropped to 23 per cent. Similarly, the share of cross-border collateral used by euro area financial companies had dropped from over 50 per cent of the total to approximately 33 per cent. The euro area periphery (Italy, Portugal, Spain, Greece and Ireland) was most affected by this retreat to domestic debt, given the declining confidence of non-periphery banks in the value of sovereign and corporate debt issued in the periphery (Howarth and Quaglia, 2013, 2016). A destabilizing sovereign debt-domestic bank loop was created in the periphery (BIS, 2011). Higher periphery government spending and rising debt burdens increased sovereign risk (Merler and Pisani Ferry, 2012) and threatened to disrupt the collateral function of sovereign debt, with a resultant damaging effect on bank funding conditions (BIS, 2011). Banking Union was a response to this (see Howarth and Quaglia, 2013, 2014) but it did not address the problem of capital markets.

Capital markets are financial market segments not involved in bank intermediation. They include corporate bond issuance, corporate debt securitisation, private equity investment, public equity issuance and initial public offerings, venture capital, the direct purchase of loans by insurers and investment funds from banks, and credit intermediation by specialised non-bank financial firms, including leasing companies and consumer finance companies (European Commission, 2015a). Compared to the United States, European finance was considerably more bank-based.¹ In 2015, bank credit formed approximately 80 per cent of total financial assets in the EU with the remaining 20 per cent as corporate debt and equity. The reverse was the case for the US. EU public and private equity markets were approximately half the size of those in the US (in 2013 as a percentage of Gross Domestic Product (GDP)). In 2013, stock market capitalisation reached 64.5 per cent in the EU versus 138 per cent of GDP in the US. Even stock market capitalisation in China (at 74 per cent) exceeded that of the EU. EU non-financial company debt securities markets (which refers to debt issued by a government or corporation that may be traded on secondary markets, such as bonds, notes or money market instruments) was only a third as large as in the US relative to GDP (12.9 per cent of GDP in the EU). The EU markets for both private placements (a form of direct lending typically between institutional investors and mid-sized firms) and venture capital also lagged massively behind US markets in real and relative to GDP terms (European Commission, 2015a).

¹ All figures here are drawn from the Infographics produced by the Commission. Available at http://ec.europa.eu/finance/capital-markets-union/index_en.htm; accessed 1 October 2015.

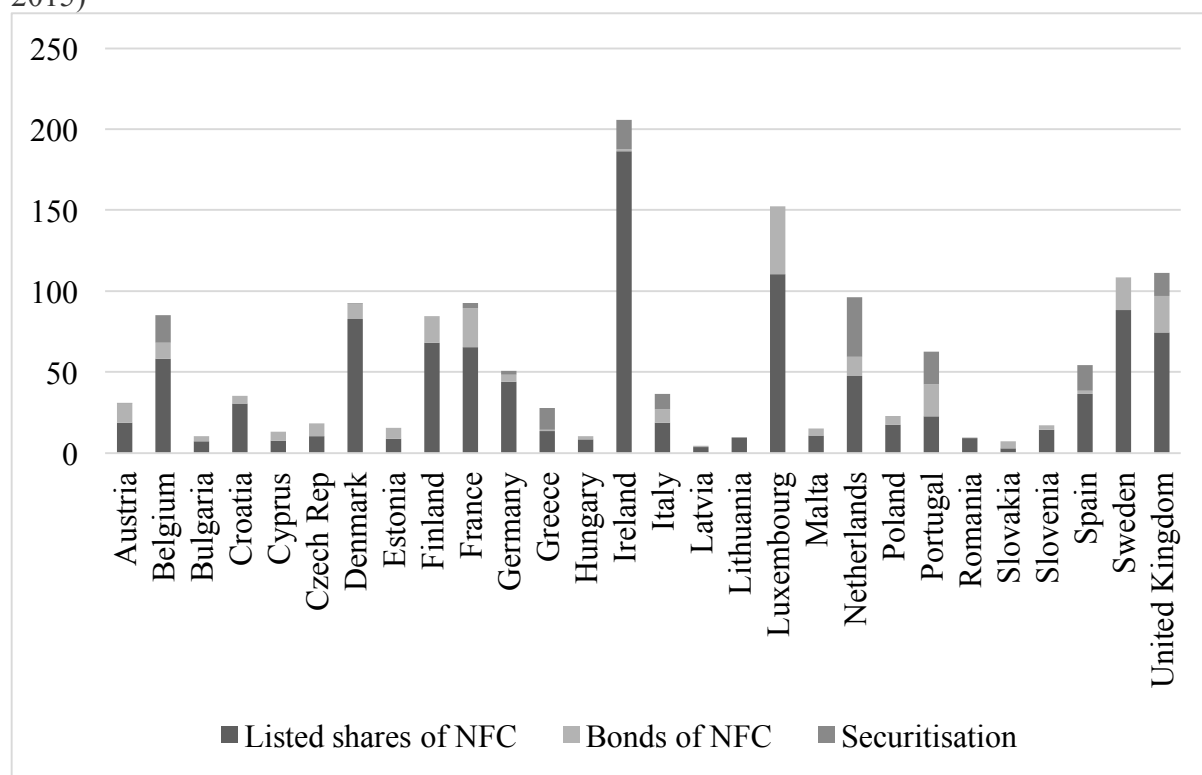
In the EU compared to the US, nonfinancial companies — especially small and medium sized enterprises (SMEs) — relied far more on bank credit and this greater dependence made the European economy more vulnerable when bank lending conditions tightened in a number of Member States during and following the international financial crisis. In the EU, there was a significant increase in corporate debt issuance by nonfinancial companies over the half decade following the crisis — which in part reflected a favourable market environment for bond issuers due to low interest rates. Bonds, however, were principally issued by large companies rather than SMEs (European Commission, 2015a). Both equity and debt markets were characterised by a strong home-country bias (prior to and after the international financial crisis). Shareholders and buyers of corporate debt rarely went beyond their national borders when they invested. Significant differences in financing conditions between Member States remained, with differing rules and market practices for products such as securitised instruments or private placements (European Commission, 2015a).

The heavy reliance on bank credit also demonstrated the importance of securitisation to stimulate bank lending in a number of EU Member States (Hardie and Howarth, 2013). However, the international financial crisis took its toll on securitisation issuance in Europe, dropping rapidly from a high of €594 billion at the end of 2007. Figures began to rise again in 2011 but remained well below the pre-crisis level, reaching €216 billion at the end of 2014. The Commission and the ECB placed great emphasis upon reviving both bank and nonfinancial company securitisation in the EU. The Commission argued that if the SME securitisation market could be revived safely, it could generate some €20 billion of additional funding (European Commission, 2015a, p. 2). Changes to international capital requirements and EU banking regulation in the aftermath of the international financial crisis also hit bank lending.

Variation in Financial Capitalism in the EU and national preferences on CMU

EU Member State financial systems largely determined national government policies on CMU. There are two main ways to measure different financial systems: categories of financial assets as a percentage of all financial assets and to GDP; and the sources of nonfinancial company external funding (Allen and Gale, 2000). There was wide variation in financial system development across EU Member States. Figure 1 considers the significance of financial intermediaries other than banks in national financial systems. On this measure, only nine Member States had non-bank financial intermediation above 50 per cent of GDP while only three — Luxembourg, Ireland and Sweden — were higher than 100 per cent. More specifically, Table 1 locates 27 Member States into groups based on the relative size of their stock market capitalisation (to national GDP) and distinguishes between larger and smaller markets (in terms of total size). Taking the extremes, at the end of 2013, domestic stock market capitalisation exceeded 125 per cent of GDP in Luxembourg and 121 per cent in the UK, compared to less than 10 per cent in Cyprus, Slovakia, Latvia and Lithuania (European Commission, 2015a). The main hypothesis tested in this contribution is that Member States with large non-bank-based financial sectors — notably, the UK, Luxembourg, Sweden, Ireland, and the Netherlands — were the most energetic in promoting CMU and supporting financial sector liberalisation more generally in the EU. Greater caution on CMU was to be expected on the part of Germany, Italy and Austria (among others). The smaller, Central and Eastern European Member States potentially had the least to gain in terms of improved market access for their smaller financial sector firms.

Figure 1: Financial intermediation in EU Member States via markets (per cent of GDP, 2015)



Source: Eurostat, ECB, European Private Equity and Venture Capital Association (EVCA), Securities Industry and Financial Markets Association (SIFMA).

Table 1: Varying Stock Market capitalisation in the European Union (as per cent of GDP, end 2013 figures, EU-27, excluding Croatia)

	High (+90 per cent)	Moderately High (60-89 per cent)	Moderate (30-59 per cent)	Low (10 to 29 per cent)	Very low (<10 per cent)
Larger economies (GDP above EU national average)	United Kingdom (121) Netherlands (98) Sweden (112)	France (81) Spain (79) Belgium (71)	Germany (51) Italy (35) Austria (38) Poland (38)		

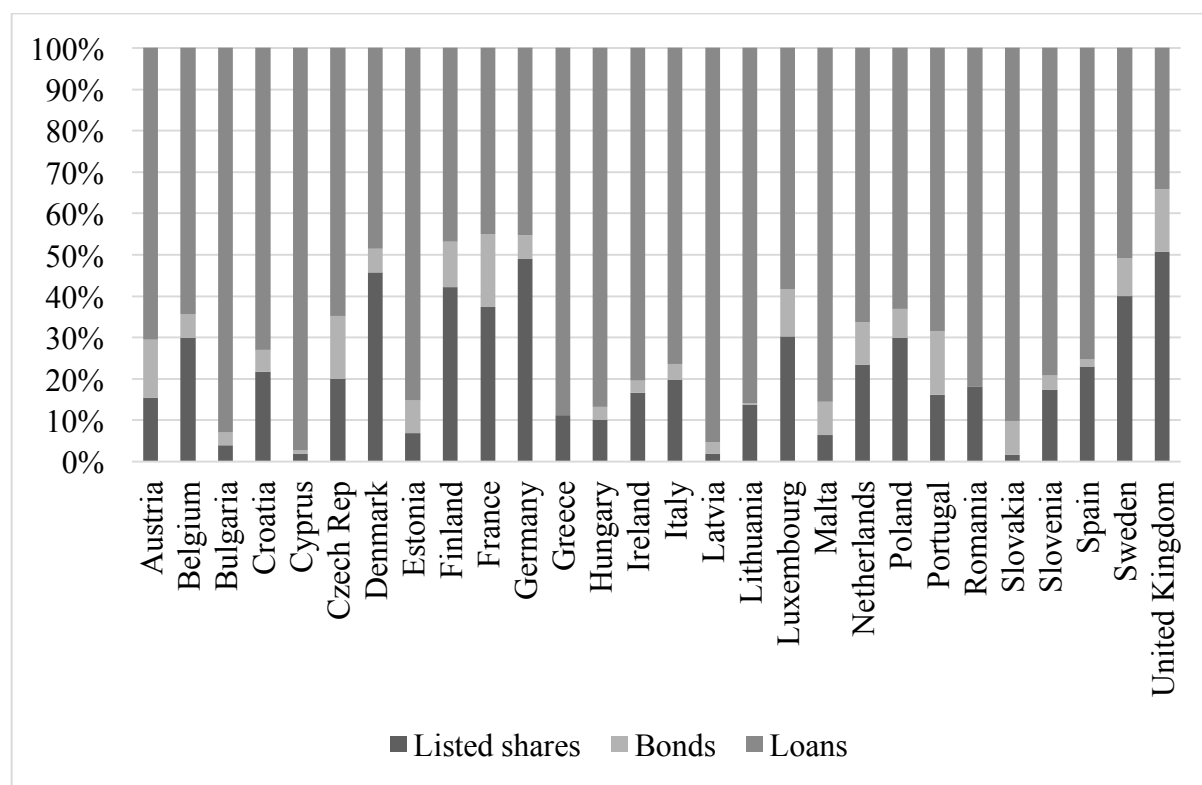
Smaller economies (GDP below EU national average)	Luxembourg (125)	Denmark (71)*	Portugal (35)	Romania (13)	Slovakia (6)
		Ireland (75)	Greece (33)	Hungary (15)	Cyprus (9)
		Finland (84)	Malta (45)	Czech Rep. (15)	Lithuania (8)
				Bulgaria (13)	Latvia (4)
				Slovenia (15)	
				Estonia (10)	

Source: Eurostat

*End 2012 figure

In terms of the second measure of financial systems, the access of firms and individuals to capital markets also differed significantly. Figure 2 demonstrates considerable national variation in terms of the external funding of nonfinancial companies (equity versus bank credit as a percentage of total company liabilities). Nonfinancial company reliance on equity issuance exceeded reliance on bank credit in only the United Kingdom and Denmark. Nonfinancial company reliance on *both* equity and debt issuance exceeded reliance on bank credit in external company finance (excluding private equity) in only the UK, Denmark, Finland, France and Germany, and only exceeded thirty per cent of the total in half the Member States. Bond issuance was concentrated in larger markets and exceeded ten per cent of the total only in seven Member States (European Commission, 2015a). It is more difficult to use this factor (external funding of nonfinancial companies) to predict Member State preferences on CMU. Member States in which nonfinancial companies relied more heavily on bank credit might be expected to seek further to develop alternative sources of funding, and thus support the market liberalisation objectives of CMU.

Figure 2: Liability Structure of Nonfinancial Companies in EU Member States (end 2015) (bank credit, listed shares, bonds, as a percentage of total of the three)



Source: Eurostat

*Figures exclude other liabilities, including non-listed equity, trade credit and other.

Other financial system features were of potential relevance in terms of shaping Member State preferences on CMU: first, the openness of national banking systems might have encouraged support for CMU. On the one hand, a number of EU Member States had banking systems that were dominated by home banks and relatively closed to foreign operations (see Table 2). This was the case in all six of the largest economies, with the exception of the United Kingdom. On the other hand, in about half the EU Member States — including most of the smaller economies — the banking system was very open to the subsidiaries and branches of banks headquartered in other EU Member States, with levels rising to above 90 per cent of total bank assets in four Member States. Further, a related — but more difficult to measure — consideration is banking nationalism. Both in older EU Member States, where foreign banks had a marginal presence, and in a number of CEECs — notably Hungary and Poland — a form of banking nationalism had developed (Howarth, 2013; Barnes and Johnson 2015; Epstein 2014). The second hypothesis tested in this contribution is that the governments of Member States with more open banking systems — and thus lower levels of banking nationalism — were more likely to support financial liberalisation and diversification measures promoted by the CMU project.

Table 2: Foreign penetration into EU-27 banking systems end 2013 (per cent of total banks assets held by subsidiaries and branches of foreign EU and ‘Rest of World’ banks)

	European Union	Rest of World	Total
Very High: above 90 per cent			
Estonia	91	5	96
Slovakia	96	0	96
Luxembourg	74	18	92
High (60-89 per cent)			
Czech R.	86	5	91
Malta	26	49	75
Lithuania	72	2	74
Bulgaria	73	0	73
Romania	71	1	72
Poland	56	9	65
Belgium	51	14	65
Finland	64	0	64
Latvia	45	15	60
Moderate (30-59 per cent)			
Hungary	54	5	59
Ireland	37	11	48
United Kingdom	17	28.5	45.5
Cyprus	13	16	29
Slovenia	31	0	31
Low (10-29 per cent)			
Austria	16	6	22
Portugal	19	0	19
Denmark	16	2	18

Italy	12	0	12
Germany	9	2	11
Sweden	7	3	10
Very low (0-9 per cent)			
Netherlands	7	2	9
France	7	1	8
Spain	7	0	7
Greece	3	0	3

Source: ECB (2014); national central bank data for non euro area Member States.

II. The CMU project

In a speech to the European Parliament in May 2014, Jean-Claude Juncker – then candidate for Commission President – launched the idea of CMU (Juncker, 2014). In November 2014, the Commission’s Communication ‘An Investment Plan for Europe’ explicitly called for a European Long-term Investment Funds (ELTIF) regulation, ‘high-quality’ securitisation, standardised credit information on SMEs, the promotion of private placements markets, and the review of the Prospectus Directive. In February 2015, the Commission published the Green Paper ‘Building a Capital Markets Union’ and launched a three-month consultation on its contents, with a view to elaborating an Action Plan setting out a roadmap and timeline for establishing a CMU by 2019. The Commission’s stated objectives were to ‘promote stronger capital markets that would complement banks as a source of financing, improving access to financing for all businesses across Europe, especially for [SMEs] and infrastructure’; ‘to increase and diversify the sources of funding from investors in the EU and all over the world’; ‘to improve market efficiency, making the financial system more stable by opening up a wider range of funding sources’. Two additional consultations on ‘high-quality’ securitisation and the ‘Prospectus directive’ were also launched in February. The Commission argued that it supported market-driven solutions when they were likely to be effective, and regulatory changes only where necessary (European Commission, 2015a, pp. 4-5).

The Commission estimated that the EU needed between €1 trillion to €2 trillion to finance its infrastructure needs by 2020 (European Commission, 2015a). To this end, the Commission proposed the ELTIFs which were designed to bring together investors seeking to place their money into companies and projects for the long term with enterprises in need of “patient” long term money. As such, ELTIFs were presented as an integral part of the drive to improve the long-term funding of the EU’s economy which is embodied by the European Fund for Strategic Investments (EFSI), the creation of which was proposed by the Commission in January 2015 and adopted through a Regulation by the Council in June 2015 (European Parliament and Council, 2015; see also European Commission, 2015a).

There were more than 400 written responses to this consultation. While unscientific, an analysis of the home Member States and sectors of these respondents suggests varying levels

of interest in CMU. Almost a quarter (22 per cent) were from the UK, 16 per cent from Belgium (Brussels), 13 per cent each from France and Germany, and 4 per cent each from Italy and the Netherlands. This pattern of responses suggests a particularly strong interest in CMU by the UK. The high figures for Belgium reflect the location of EU-level financial associations. 36 per cent of respondents were from the financial sector; 20 per cent were nonfinancial companies and their representative associations, 5 per cent were NGOs and only 1.6 per cent consumer organisations. This suggests that CMU mainly elicited the interest of the financial industry — seeking new opportunities for expansion — and less that of nonfinancial companies (including SMEs, which were actively targeted given their perceived need for improved access to external funding). Within the financial industry, the respondents were 26 per cent banks and their representative associations, 16 per cent insurers, 11 per cent pension providers, 2 per cent investment management (including hedge funds, private equity funds, venture capital funds, money market funds, and securities firms), 15 per cent market infrastructure operators (for example, Central Counter Parties (CCPs), stock exchanges), and 18 per cent other financial services (for example, advice and brokerage) (European Commission, 2015c).

The summary of the responses, which was compiled by the Commission, emphasises that the majority supported all five priorities for early action set out in the Green Paper. In addition, the respondents suggested a number of additional priorities, including: the agreement of a harmonised definition of SMEs in EU legislation; the development of crowd-funding, business angels, venture capital and loan-originating funds; the finalisation of the European Money Market Funds reform; the improvement of corporate bond market liquidity; the reduction of the capital charge for infrastructure investments by insurance undertakings under Solvency II; and the lowering of the remaining legal barriers to support efficient post-trade processes for cross-border securities transactions. In September 2015, the Commission presented an Action Plan for CMU (European Commission, 2015b) and two proposed directives on securitisation: the first legislative building-block in the construction of CMU. In his speech, the Commissioner responsible for financial services, Jonathan Hill, listed his top six priorities which largely followed those of the Green Paper with the addition of a priority specifically focused on support for venture capital and equity financing, and an assessment of existing regulation with the aim of streamlining.

III. Promoters of and ‘foot-draggers’ on CMU

The Commission and the ECB

As in earlier initiatives concerning financial market integration in the EU (see Jabko, 2006; Egan, 2001), the European Commission was the main driver of CMU, with strong support from the ECB. The new Commission president, Jean-Claude Juncker — who was both former prime minister and financial minister of Luxembourg — a country whose economy relied heavily on the financial sector — had a very good understanding of the issues at stake. The British national put in charge of the project was Jonathan Hill, who became the Commissioner ‘for Financial Stability, Financial Services and Capital Markets Union’, one of the few examples in European Union history where a Commissioner’s job title matched that of a specific project. Similarly, reflecting the great importance attached to the CMU project, the European Commission was also reshuffled to form a new ‘Directorate-General for Financial Stability, Financial Services and Capital Markets Union’. The Commission deliberately framed CMU as an initiative to complement Banking Union and ultimately to complete EMU. Hence, it was presented as a way to address the concerns of the

repercussions of ‘differentiated integration’ — linked to EMU and, more recently, Banking Union — on the single financial market. The ECB supported the project as a way to provide funding to the real economy, notably to SMEs, and to ensure the ‘smooth and homogenous transmission of monetary policy and [to] help foster financial stability’ (ECB, 2015).

The Member States

The two hypotheses outlined above largely hold with a couple of partial exceptions: those Member States with more diversified financial systems and more open banking systems were more likely to support CMU. Of all the EU Member States, the UK had the most potentially to benefit from the financial liberalisation and diversification promised in the CMU project, given the diversity of its financial sector and, in particular, the high concentration of wholesale market activity, private equity and hedge funds (Véron, 2014). CMU was enthusiastically supported by both the UK government (2015) and the City (TheCityUK, 2015). Commissioner Hill stressed the huge investment flows from UK-based banks and other financial companies to the continent (Hill, 2015b). Some commentators (for example, Ringe, 2015, p. 5) interpreted CMU, in part, as an attempt to repair the strained relations between the UK and the EU / euro area by giving ‘a political signal to strengthen the Single Market as a project of all 28 Member States’, not only to the euro area countries, and in an area where the UK had a clear competitive advantage. As predicted above, the broadly enthusiastic response of the UK government was joined principally by those Member States with the most well-developed and diversified financial sectors, including Ireland (2015), the Netherlands (2015), Sweden (2015) and Luxembourg.² However, the very low foreign bank presence in the Netherlands and Sweden contradicts the second hypothesis, and suggests that what matters most is the diversity of a countries financial sector.

In the UK, given the fact that CMU would also involve new EU regulation and further centralisation, there was some reluctance on the basis of national sovereignty (Véron 2014), which might also explain the somewhat different views of Commissioner Hill and Commission President Juncker as to the institutional content of CMU. Commissioner Hill and DG FISMA officials did not discuss institutional reform in their presentations on CMU. By contrast President Juncker in the Five Presidents Report (2015) argued that CMU ‘should lead ultimately to a single European capital markets supervisor’. However, the strong UK government opposition to further centralisation helps explain the absence of institutional measures in both the February 2015 Green Paper and the September 2015 Action Plan (Véron, 2015).

While broadly supportive of Commission efforts to improve financing to the real economy, the German and French governments demonstrated greater caution on CMU (Gouvernement français, 2015; Germany, 2015). German government reticence on CMU reflects the importance of bank credit in the country, the comparatively limited developments of alternative finance, the closed banking (and broader financial) system, the absence of a credit crunch since the outbreak of the international financial crisis and the reliable provision of credit to SMEs notably by smaller savings banks and cooperatives. French reticence is somewhat more surprising — given the country’s more developed financial sector. However, French reluctance can be explained by a long-standing policy of national champions in the banking sector (see Howarth, 2013) and the lowest foreign presence of all EU financial

² Interview with senior official from Luxembourg Ministry of Finance responsible for CMU, Luxembourg, 15 April.

systems (see Table 2). On the demand side, as in Germany, there was limited perceived need for developing alternative finance: France did not suffer a credit crunch following the outbreak of the international financial crisis. However, large banks still dominated the French financial sector. Despite the presence of private equity firms and hedge funds in both countries, there was longstanding opposition to foreign ‘alternative’ investment companies and the full liberalisation of capital markets more generally (Zimmerman, 2010; Buckley and Howarth, 2011). Most hedging activity was managed by large banks. Earlier in the decade, the French and German governments had fought to impose tough transparency and other conditions on the operation of these ‘alternative’ investment funds and their managers.

Wolfgang Schäuble and Michel Sapin, respectively the German and French finance ministers, sent a letter to Commissioner Hill in July 2015, expressing scepticism about copying the financial model of the United States (Schäuble and Sapin, 2015). They demanded that a level playing field between the various capital and bank-based financial instruments be maintained and that banks be central to all efforts to improve the provision of finance to businesses, especially SMEs. The two finance ministers also made reference to the ‘proportionality principle’, an indication that they were ready to challenge the Commission’s efforts to promote financial liberalisation and diversification if they undermined national policy preferences.

Given their more limited development, the financial sectors of Southern, Central and Eastern European Member States were generally in a weaker position to gain advantage from CMU (see Figure 1; Table 1). Nonetheless, the minority of euro area and EU periphery governments and public bodies that provided written responses to the Commission’s consultation (six of sixteen) were broadly positive — see, for example, Italy (2015). The principal interest for most of these countries was to enhance the provision of finance, especially to SMEs, the relative economic importance of which was much greater than in Northern EU Member States (TheCityUK, 2015). The Commission designed CMU to appeal to EU and euro area periphery countries, which had been hit hard by the international financial and then sovereign debt crises — with the explicit promise of improved financial flows to their economies which would help to kick-start growth and create jobs (Ringe, 2015). However, the very limited number of respondents from Southern Europe to the Commission’s consultation suggests that neither the public institutions nor the private stakeholders in these countries were heavily involved in the CMU policy debate. Furthermore, the Commission proposed ELTIFs were of particular interest to periphery countries facing years of under-investment due to high public debt burdens and forced cuts to public spending. Moreover, the French government, struggling with low growth and a rapidly rising debt burden, was similarly keen to emphasize the ‘investment’ dimension of CMU (Gouvernement français, 2015).

Economic interest groups

In terms of the positioning of different economic (and specifically financial) sectors, non-bank investors, including private equity and venture capital firms, were also likely to benefit from CMU. These firms and their representative associations were the most unreservedly positive about the CMU project in their responses to the Green Paper consultation — see, for example, the Association for Financial Markets in Europe (AFME, 2014; 2015); and the Alternative Investment Management Association (AIMA, 2015). A number of national associations representing non-bank financial firms came out strongly in favour of CMU — including the *Association Française de la Gestion financière* (AFG, 2015) and German

Bundesverband der Wertpapierfirmen (2015) which argued that ‘attractive and sustainable capital markets need a diverse “eco system” of variegated market structures and firms of different size’. A range of large EU-headquartered universal banks, which were likely to benefit substantially from CMU, were particularly supportive of the relaunch of securitisation (BNP, 2015; Société Générale, 2015; Lloyds, 2015; Intesa, 2015; Unicredit, 2015).

Other financial groups were positive but also expressed some caution. In its response to the Commission’s consultation, the European Banking Federation — which represents 32 national banking associations and a range of bank types — expressed its broad support for the CMU project (EBF, 2015). However, the EBF also expressed its concern that banks should not be placed at a disadvantage in efforts to liberalise other market sectors and that CMU should ensure a level playing field among different financial institutions.

The main ‘foot-draggers’ on CMU were smaller domestically-focused banks and protected financial ‘national champion’ market infrastructure firms in some Member States, which disliked the prospect of competition from alternative financing channels (Véron, 2014; Turner, 2015). The important position of small bank lenders in a number of EU Member States — notably Germany — contributed to national government caution. These banks and their representative associations — including the European Savings and Retail Banking Group (ESBG) and the European Association of Cooperative Banks (EACB) — were particularly critical of the CMU project, arguing that they were better suited than capital markets to provide funding to the real economy, especially to SMEs (ESBG, 2015; EACB, 2015). These banks argued for loosening the conditions that had been imposed on small banks after the crisis, like reducing leverage ratio requirements (ESBG, 2015; EACB, 2015; Turner, 2015).

The impact of CMU would also likely be different amongst stock exchanges across the EU but it was clear that CMU would increase pressure to consolidate in the sector. Despite significant consolidation over the previous three decades, there remained sixteen stock exchanges in the EU — in comparison to two in the US — protected by national governments (Deutsche Bank, 2015, p. 7). Initial Public Offers (IPOs) tended to take place on domestic exchanges and smaller firms had a tendency to focus on the local stock market. The large number of exchanges had the potential effect of limiting the investor base for IPOs and for smaller companies’ stocks. Consolidated exchanges that operated in more than one country were subject to harmonised EU rules, such as the Markets in Financial Instruments Directive (MiFID), and non-harmonised national rules (often, due to gold-plating) concerning local markets. These national rules would be harmonised in CMU, reducing operational costs and encouraging consolidation among stock exchanges (Deutsche Bank, 2015). Business would likely move towards the largest and most competitive financial centres, first and foremost London, but also Frankfurt and Paris. The Federation of European Stock Exchanges (FESE, 2015) was positive on CMU and the encouragement of capital markets but also expressed caution and the need to respect the crucial role played by national exchanges, the ‘diversity of ecosystems’ (2015, p. 4) and the ‘level playing field’ between stock exchanges and other financial services.

Outside the financial sector, the main responses from the real economy came from companies’ and employers’ organisations in Germany and to a more limited extent in France. Their responses were somewhat more general than those submitted by the financial industry. The German Chamber of Commerce (*Deutscher Industrie- und Handelskammertag*, 2015) was comparatively hostile to CMU, arguing that ‘a bank-based financial system fulfilled the needs of the European economy’ and questioning the logic of building up capital markets to

replace banks.³ The Federation of German Industry, *Bundesverband der Deutschen Industrie* (BDI 2015) and its French counterpart, the *Mouvement des entreprises de France* (MEDEF 2015), placed emphasis on the need for a regulatory level playing field in the EU and internationally, with rules that were uniformly applied to all financial instruments having the same function. Despite the purported importance of improving SME financing, associations specifically representing SMEs did not respond to the Commission's consultation.

Pesendorfer (2015) argues that the consultation was framed in such a way as to marginalise more radical responses and encourage those focused on deepening capital markets, reinforcing securitisation and promoting the Commission's better regulation agenda. Later, in response to the Commission's Action Plan, twenty-nine trade unions, economic and civil society associations and think tanks prepared a critical statement on the likely effectiveness of the CMU project (Finance Watch, 2015). The statement argued that by focusing on the supply of credit — which was not perceived as a serious problem — the CMU project ignored the pressing demand-side policies that were needed to promote sustainable growth and employment in the EU. While the statement welcomed some initiatives of the CMU project, it argued that several others would create additional risks for the economy, including efforts to revive securitisation which was too complex and expensive to help SMEs raise finance without subsidies. The statement noted that the EU's biggest banks 'arguably' stood to gain the most from CMU.

IV. The first building block of CMU: securitisation

It is revealing that the first CMU-related legislative proposals officially put forward by the Commission in September 2015 concerned securitisation: a draft Regulation sets out criteria for Simple, Transparent and Standardised Securitisations; and a draft amendment to the Capital Requirements Regulation seeks to make the capital treatment of securitisations more risk-sensitive (and thus, effectively, to lower capital requirements on securitised assets) (European Commission, 2015e&f). The Commission and ECB were keen to assuage market and public concerns about securitisation, which had a bad reputation as a consequence of the crisis.⁴ In its explanatory document for the draft legislation, the Commission (2015d) distinguished between massive losses on securitised products produced by US banks and the very small losses on securitised products in the EU. The focus on securitisation reflected the reality of Europe's bank-dominated financial systems, which could use securitisation to get around tighter European capital requirements and increase lending — notably to SMEs. As noted above, the issuance of securitisation by financial firms (notably banks) in the EU had plummeted since the outbreak of the international financial crisis, although levels started rising again in 2011. However, the focus on securitisation was also about encouraging SMEs to bypass banks in their efforts to raise external funding, by securitising their own assets and selling these on corporate debt markets. The issuance level of SME securitised products was €36 billion in 2014, less than half its peak level of €77 billion, and only a small part of overall securitisation. Commission and ECB efforts to encourage nonfinancial company securitisation were also about stimulating further the development of European corporate bond markets. The focus on securitisation also reflected ongoing international, Commission and ECB efforts distinct from the CMU project (BCBS, 2011; BCBS and IOSCO, 2015; ECB

³ authors' own translation.

⁴ *The Telegraph*, 19 February 2015.

and Bank of England 2014; EBA, 2015). Commissioner Hill was at pains to point out that EU efforts were part of a broader international effort.⁵

The Commission's push on securitisation was also facilitated by national financial sector developments. In all four Member States with the highest issuance of securitised products in 2007 — the UK, Netherlands, Spain and Italy — amounts had plummeted in the aftermath of the financial crisis and were still dropping rapidly during the 2013-2015 period (Table 3). The largest absolute decline was in the UK: approximately €100 billion or 22 per cent over the two years. The governments of these four Member States were particularly keen on EU legislative developments to encourage securitisation and reverse the fall (see, for example, Netherlands (2015)). The largest absolute increases in securitisation over the two-year period were in France and Germany. In France, the issuance of securitised products reached record levels in 2015. While still far below the total and relative-to-GDP levels found in several other Member States, this significant increase suggests that the French and German governments were also open to Commission and ECB efforts to encourage securitisation — as confirmed in positive French and German government statements (*Gouvernement français*, 2015; Germany, 2015) — and that a consensus could be found among the large member states on the issue.

Table 3: Securitisation Outstanding by Country of Collateral*, 2013-2015 (third quarter, € billions)

Member State	2013	2014	2015	Change 2013-15 (percentage)
Austria	2.1	2.2	1.8	-14.3
Belgium	85.2	76.6	65.8	-22.8
Finland	0.2	0.8	1.0	+500
France	37.8	69.3	69.6	+84.1
Germany	78.2	74	88.2	+12.8
Greece	29.3	25.1	21.4	-27.0
Ireland	44	35.3	33.5	-23.9
Italy	189.4	164.4	153.1	-19.2
Netherlands	281.6	258.2	240.3	-14.7
Portugal	39.5	35.8	32.1	-18.7
Spain	181.6	167.6	162.9	-10.3
United Kingdom	447.5	402.2	347.3	-22.4

Source: AFME (2015)

*Only EU Member States with outstanding issuance over €1 billion.

⁵ *Euractive*, 19 February 2015

The Commission received 120 written responses to its consultation on securitisation launched in February 2015, with almost a quarter from the UK and almost a half from financial companies. The relatively limited response from nonfinancial companies (including associations representing SMEs) suggests again a significant imbalance in interest. UK-based companies led the way on securitisation in the EU (almost a quarter of the EU total issuance in 2014) and UK-based investors provided almost half of total EU investment in securitised products (UK government, 2015) (see also Table 3). These UK-based companies had a strong interest in improving their access to other EU Member State markets. On the whole, the respondents to the consultation indicated that the priority should be to develop an EU-wide framework for simple, transparent and standardised securitisation. Furthermore, many respondents to the Commission's consultation (including the UK government (2015)) argued that to promote securitisation, the disparity in regulatory treatment between securitisation and other asset classes should be reduced.

Conclusion

Although the Commission presented Capital Market Union as complementary to Banking Union, there were very few similarities and three main differences between these two projects. First, with regard to CMU the term 'union' was somewhat misleading because, *de facto*, the project involved 'an incremental improvement of the existing regulatory framework governing the integration' of different EU Member State capital markets (Ringe, 2015, p. 6). Second, Banking Union applied not to the entire EU, but only to EMU Member States and others that decided to opt in. No euro area outsider by spring 2016 had opted into Banking Union. CMU applied to all EU Member States. Third, and most important, while Banking Union centralised banking supervision and resolution for euro area Member States, in CMU centralisation was not the main objective. On the contrary, Commissioner Hill (2015a) pointed out that CMU involved building 'a single market for capital from the *bottom up*, identifying barriers and knocking them down one by one' (italics added). However, some 'centralisation' or harmonisation through EU re-regulation would be needed in the CMU project, as in the case of previous initiatives designed to promote financial market integration in the EU. Véron (2014) argues that: '[a]n EU-wide approach [was] the best way to overcome entrenched political economy constraints that [had] repressed the development of capital markets and non-bank finance'. Indeed, many of the measures proposed in the Commission's Green Paper were not bottom up, they involved top down EU legislation concerning the harmonisation of certain EU capital market rules (Ringe, 2015). The main intersection between Banking Union and CMU was that the consolidation of supervision and resolution policies in the Banking Union area created a spill-over dynamic encouraging policy integration in related activities — for example accounting and auditing policies — which fell within the CMU remit (Véron, 2014).⁶

This contribution examined the politics and political economy of the CMU project, which was still very much in progress at the time of writing in spring 2016. It argues that — up to the end of 2015 at least — CMU was a lot of hype surrounding a policy — namely the promotion of securitisation — which was difficult to sell to sceptical European publics in the

⁶ A number of powerful economic interests and the German federal government (Germany, 2015) were explicit in their ongoing opposition to the harmonisation of accounting and auditing policies.

years following the financial crisis. The Commission and the ECB argued that securitisation was a policy that was essential to re-start the flow of credit to the real economy in the EU, especially given the limited development of financial services other than banking in most Member State financial systems and the heavy reliance of nonfinancial companies (notably SMEs) on bank credit. The CMU project and the financial liberalisation and diversification that it promised had likely winners and losers — both Member States and specific sectors of the economy — which therefore acted as pace-setters or ‘foot-draggers’ in discussions and negotiations on the project. The main winners were the City of London — with its diverse financial sector — and specifically alternative investment companies. Some big internationally active universal banks — especially those engaged in investment banking activities — would also likely do well out of the liberalisation of EU financial markets. The main losers were likely to be the less competitive, domestically-oriented parts of the financial sector and the less competitive market infrastructures (notably stock exchanges) found in several EU Member States. Thus, the UK, Irish, Swedish, Netherlands, and Luxembourg governments unambiguously supported the market liberalisation agenda in CMU, whereas the main continental Member States — notably France and Germany — expressed their reservations. The French and German governments supported the CMU project, while stressing the importance of banks to European economies and rejecting both the inherent desirability of the US financial model — promoted by the Commission and the ECB — as inappropriate for the EU.

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