Abstract

At the heart of the last financial crisis stood the shadow banking system, a mesh of financial activities and entities, which grew outside of bank balance sheets but with the support of the banking sector. These activities were not regulated or supervised like banks while they were characterized by high maturity mismatches and leverage. Two prime elements were Money Market Mutual Funds (MMFs) and Asset-Backed Commercial Papers (ABCPs), which jointly conducted bank-like activities. This paper sheds light on the fate of these entities post-crisis and the regulatory dynamics at play, as policymakers shifted their focus from constraining their activities to draft a European regulatory infrastructure that delivers both stability and growth. Based on expert interviews and document analysis, we show how during this shift European policy-makers opened up to private experts to learn about the technical complexity of MMFs and ABCPs, but in the end were restricted in their efforts to craft such regulation due to legislative time pressure at the European level and competing national factions. While they aimed for a European approach, the process was strongly influenced by nationally held visions about the future role of financial markets, ultimately falling back on national coalitions at pivotal moments during the negotiations. These negotiations in turn were strongly influenced by the European specific institutional set up and its electoral cycle.
1. Introduction

What drove European financial regulation of shadow banking after the financial crisis and what constrained and shaped their intervention in financial markets? Analysing regulatory reforms that affect a crucial part of the initially demonized shadow banking system, Asset-Backed Commercial Paper (ABCP) and Money Market Mutual Funds (MMFs), this paper is set out to shed light on the political and institutional constraints that European financial regulation faced since the crisis. So far, the regulation of the shadow banking system have either been analysed as effects of regulatory interventions of powerful European stakeholders, in particular the ECB (Braun 2018, Braun et al 2018), as driven by the conjectural effects of economic ideas (Engelen 2017) or as effects of politics of national governments seeking to protect their national finance industries (Hardie and Macartney 2016; Quaglia and Spendzharova 2017, Quaglia et al 2016). But this does not do justice to the substantial new legislative powers that European policy makers gained in the aftermath of the crisis, manifesting themselves in an increasing number of European regulations (Falkner 2016; Kudrna 2016). Our paper fills this gap by analysing the European-specific constraints and new capabilities to craft regulation.

The inquiry into the European political process of the re-regulation of the shadow-banking chain from its inception in 2012 to the final acts of 2017 shows what happens when the European-Union specific political and institutional setting is confronted with the regulatory intricacies of shadow banking and in how far financial issues’ technical complexity shapes interventions in these activities. The fragility and interconnectedness of the relationship between MMFs, ABCP and regular banks were impressively demonstrated in July 2007. Back then the ‘shadow banking chain’ became infamous through the failure of Deutsche Industriebank (IKB) bringing to the fore banks’ engagement in arbitrage activities in capital markets.¹ While not visible on their balance sheets initially, the critical situation of ABCP conduits and MMFs forced banks or their asset management arms to step in to advert the worst (Bengtson 2016).

The regulation of the shadow banking chain is an insightful case for the aims and actual capacity of European regulatory agency to reshape the financial system after the crisis, in particular because the regulatory treatment of these entities and their linkages underwent a considerable

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¹ When markets came under distress, IKB’s large portfolio of securitized products which the bank had placed off-balance sheet into ABCP conduits returned on the balance sheet, de facto bankrupting IKB. This return on the balance sheet was caused by the refusal to refinance them by MMFs which were the major investors into the and themselves highly prone to runs (Thiemann 2018, for an analysis of European MMFs during crisis see Bengtson 2013).
restructuring, from seeking to limit it to its cautious encouragement. This culminated in a novel approach to build a consistent European regulatory infrastructure\(^2\) that enables an orderly flow of debt into the real economy. In this way, the case of the regulation of MMFs and ABCPs is exemplary for the re-orientation of European financial regulation towards building resilient market-based finance in the context of the Capital Markets Union (Braun et al 2018; Quaglia et al 2016). Our study hence adds new evidence to the actual effects of this rhetorical shift, also giving insights into the underlying regulatory dynamics. Against this backdrop, our paper speaks to studies of shadow banking and its fate post-crisis, in particular how it is reshaped by regulatory intervention (Braun 2018, Gabor 2016a, Ban et al 2016, Engelen 2015, Nesvetailova 2017), but also to scholars of European regulatory agency post-crisis and how the latter reshapes the European financial system (SOURCES Muegge 2013).

Based upon process tracing, 15 expert interviews and an extensive document analysis the study shows how the drafting of regulatory initiatives, mediated through Brussels institutional specialities adapted to the changing macro-setting which increasingly demanded economic growth. Combining historical institutionalism (Bell 2011, Archer 2003) with the literature on policy networks (Mayntz 2003, Rhodes 1997), we illustrate how European actors sought to integrate the different national visions on the role of finance in the economy and their own and how these were absorbed in the specific European institutional context. Rather than just being a transmission belt, which allows for the translation of national interests into directives or advocates for them in international fora (Quaglia 2013), European policy makers built up their own agency, proposing a distinctly European approach to the regulation of shadow banking. However, how this upward shift changed the purpose and capacity to craft regulation has so far been understudied.

The inquiry into the drafting processes of European attempts to regulate deeply intertwined financial institutions, their investment behaviour as well as their provisions to ensure financial stability provides us with three important findings. First, the complexity of the regulation of the shadow banking chain and the diverging national visions of its future role inhibited the formulation of a common European approach. Secondly, the rule-making process itself was characterized by rule making agents becoming more knowledgeable about the technically complex subjects at hand through a process of learning facilitated through co-habitation with private actors. Thirdly, the time constraints inherent in European policy processes and the need

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\(^2\) By regulatory infrastructure we mean the legislative context consisting of single regulations and directives and their interlocking effects that allows for certain transactions to be profitable.
to reconcile the different national negotiation stances in the specific institutional context of rulemaking in Brussels strongly influenced both of these dynamics. Against this backdrop, we will argue that the European efforts to reconstruct shadow banking post-crisis were unsuccessful, but not due to insurmountable opposition by political forces seeking to constrain these activities, but due to the institutional and temporal dynamics of the European rule-making process that impeded coordination between rule-making agents and private experts.

In order to develop this argument, the paper will first review the existent literature on shadow banking, European regulatory developments post-crisis and the interference of national interests in European processes. The next part will sketch an expanded historical institutionalist perspective that allows us to underline the importance of timing and political reasoning for the evolution of reforms, which we combine with a focus on the interaction between private and public agents in regulatory networks. Then the basic functioning of ABCPs and MMFs and their interdependence will be sketched out briefly. In what follows the fundamental changes in both regulations will be analysed chronologically dividing them in three phases to point out the direction that the regulation of these entities took throughout the European regulatory process.

2. Literature review

Analyses that focus on European financial regulation since the crisis have either concentrated on interest driven explanations (Quaglia 2013, Young 2014) or ideational frameworks (Wigger und Buch-Hansen 2014, Baker 2013) to explain limited re-regulation in the EU. While Quaglia (2011) provides an overview of post-crisis reforms in European financial regulation, Hardie and Macartney (2016) show how concerns over national champions let French and German politicians to inhibit European reforms. In general, we find several assessments of the interference of national interests (Howarth and Quaglia 2016, Quaglia 2016) but only few that describe the intentional action of European regulators on its own. Exceptions are papers on the banking union that show how EU institutions use collective leadership to adapt to their constraining environment during the negotiations (Nielsen and Smeets 2017), framing the crisis as demanding supranational solutions (Epstein and Rhodes 2018), while stressing the importance of veto players in European financial regulation (Burns et al 2018).

Literature that emphasizes the role of European actors at first described how those became a ‘transmission belt’ of national interests in international matters (Quaglia 2014, Bieling 2014) and compare its power to the US (Posner 2009, Posner and Veron 2010). Furthermore, the
initial approach of European actors focused on securing the integration of European financial markets, ending their fragmentation post-crisis instead of actively designing regulation for public purposes (Posner and Véron 2010). This depiction of EU policy makers in the realm of finance as relatively weak stands in contrast to a cross-sectoral comparison at the EU level, where European activities in financial regulation are exceptionally high (Falkner 2016, Kudrna 2016) evidenced by the sheer number of regulatory initiatives (see EC 2015). Furthermore, European actors such as the Commission imprinted regulatory plans with their own concepts regarding the central dynamics of finance and managed to prioritize growth in regulatory processes (Endrejat and Thiemann 2018b).

From an issue specific lens, the literature on the timid re-regulation of shadow banking is dominated by accounts of how central elements of the shadow banking system, such as the Repo-market (Gabor and Ban 2016) are linked to the European integration project of the ECB and the infrastructural power repo-markets and the market for ABS exert over that institution (Braun 2016, Gabor 2016b, Braun and Huebner 2018). While we thereby learn much about the preference formation of the ECB, there are only very limited accounts of how the rule-making apparatus of the EU itself, that is the the European Parliament, the European Council and the European Commission, addressed the intricacies of the shadow banking system post-crisis. It is these actors that co-legislate rules for the shadow banking system, not the ECB, actors that have proven an ‘ingenious creativity’ to overcome formal legal problems when politically necessary (Ringe 2017). It is on this point that the paper aims to contribute by focusing on the re-regulation of two central pillars of the shadow banking system - MMFs and ABCP Conduits at the EU level and how the rule-makers dealt with the complexity of these entities and their interlinkages.

Doing so, we can draw on recent scholarship on the re-regulation of finance in Europe. Regarding the shifting relationship between regulators and the regulated, Dorn (2016) describes a new logic of “closer cooperation between regulators and markets” which culminates in a post-crisis project, where public and private actors come together in strategic terms. This cohabitation (ibid, p. 85) constitutes both a ‘recalibration’ of the content (appropriate design) and the mode (public-private co-production) of regulation. Furthermore, he argues that qualitative changes happened with respect to the “techniques or policy instruments” chosen but not in the “overarching goals” of regulation (Dorn 2016: 101). As put by Fernandez and Wigger (2016), policy makers seek to facilitate the shadow banking system because it is “creating the necessary regulatory infrastructure that enlarges the capacity of the wider economy to take on
more debt” (p. 409). But what determines what is deemed as the appropriate regulatory infrastructure and what determines the capacity of policy-makers to create it? To approach these questions, we need to embed the agency of rule makers in their policy and rule-making networks, as they seek to confront the changing face of finance.

3. Theory: Placing policy maker’s agency in their historical context

This paper seeks to analyze the dynamics of cohabitation and regulatory agency, when and why rule makers seek to reshape markets in certain ways and what conditions this regulatory agency. To do so, we draw on an expanded historical institutionalism (Bell 2011), combined with the notion of policy networks in order to place rule-makers in their institutional and societal context (Marin and Mayntz 1991). On the one hand, we recognize that actors “cannot simply be assumed to have a fixed (and immutable) preference set” and consequently frame regulators as “strategic, seeking to realize complex, contingent and often changing goals” (Hay and Wincott 1998: 954). On the other hand, rule-makers are enabled and constrained by their institutional environment which itself is situated in a broader structural setting based on material and ideational phenomena (Bell 2011, Bell and Hindmoor 2015: 3). Such an account situates strategic agents (micro-level) in the institutional meso-level environment according to which they enjoy a bounded discretion and that mediates their relation to the wider political and social setting they are embedded in by absorbing and shaping policy discourses from the macro-level.

To capture the institutional meso-level we use the concept of policy networks, which includes public rule-makers as well as rule-takers (Marin and Mayntz 1991) and is particularly appropriate for the analysis of EU governance, which „takes place in polycentric, multilevel policy networks of public and private actors“ (Peterson 2003: 18). The governance literature using the term policy network is focusing on the veto players and coordination requirements between public and private but also between different public agents to understand the evolution of public policy. To better grasp the latter, we introduce a further distinction between the networks that are comprised of public and private agents and those in which only public agents interact with each other. Thus, we use the term rule-making network to denote the different agents involved at the EU level, the European Commission, Council and the Parliament. Contrary to that, the term policy network also includes private agents participating in the rule-making process, providing industry insights into the expected effects of regulatory changes (s. figure 1 below). This distinction is of particular importance given the regulatory sensitivity of finance, which requires for its proper functioning a well-calibrated legal framework accounting
for the interdependencies of different entities, a regulatory infrastructure that is conducive to the further expansion of finance (Fernandez and Wigger 2016).

The micro-level strategies of actors in this network are then shaped by the meso-level institutional context in which agents are situated (Moschella and Tsingou 2013, 201), in turn

Figure 1 Regulatory and Rule-Making Network
defining the way different actors’ position and relate to each other. This perspective points not only to the competencies and the timing of the rule-making process as institutional constraints, but also the sources of expertise which are drawn upon by different rule-making actors at the EU level as they prepare legislative proposals (Mudge and Vauchez 2012) and the modalities of input and influence by the private sector (Tsingou 2015). Nevertheless, in doing so they are restricted by the timing and sequence of the reform process, which decisively defines the “political trajectories by conditioning the interests of and options available to actors” (Moschella and Tsingou 2013: 20). Furthermore, the political salience and public attention are important factors shaping the course of regulation, making co-habitation much easier in case of ‘quiet politics’ (Culpepper 2011). Thus, even though legislative actors might aim at getting the regulation right their successful drafting not only depends on accessing the right sources of expertise but also on the political constellations, the electoral/legislature cycle and ultimately the willingness of rule-making actors.

Finally, regarding the structural context for analyzing regulatory action with respect to the financial sector, we take to heart the appeal of critical political economists seriously to treat finance not just like any other sector, but to take its role for “credit creation and allocation” seriously (Muegge 2013, p. 459). Capitalism in the EU just as elsewhere is increasingly driven by a finance-led growth regime (Boyer 2000), in which the expansion of finance is a substantial ingredient for growth. In this context, we argue that the central rational for European regulators is the building of regulatory infrastructures that facilitate a continuous flow of debt into the real economy. However, this vision of finance on the European level had to emerge over time through integrating the widely varying national interests and visions of the ideal form and function of the financial sector. Out of this struggle over defining the proper role of finance emerge the dominant discourses at the EU level, which structure the understanding of the challenges and goals to be pursued at the micro-level. Consequently, to analyze regulatory agency, we must understand the micro-, meso- and macro-level they are embedded in and how they dialectically define regulators market interventions.

This framework is particularly appropriate with respect to shadow banking, where positive regulatory agency requires coordination of several actors on complex and sensitive regulatory matters that are of extraordinary complex nature. On one hand, policy networks become more independent from outside influences through the use of common language and skill set as factors facilitating coordination (Peterson 2003, Seabrooke and Tsingou 2009). On the other hand, issue complexity as well as politicization are factors identified as hampering coordination.
Figure 2 below depicts how the policy network as a place where regulators can assess private agents knowledge evolves throughout the process. Decisive for this evolution is the time that private agents have to undertake their “educational work” (Interview X), because unlike other authors argue (Baker 2010), private agents’ access to the rule-making agents is not unlimited and highly depends upon the timing and the political viability (Interview X). Reconstructing the shadow banking chain implies the need for coordination on different projects to permit the interlocking of different financial instruments into one chain of financing.

As the next section shows, regulatory agency at the EU level was conditioned by the institutional setting and the larger discourses embedding these activities, which at first, under the direct impact of the crisis sought to constrain shadow banking and later favoured economic growth through deep and liquid capital markets at all cost. This latter shift reoriented regulatory strategies to reconstruct the shadow banking chain. Yet, complexity and the need for intense coordination were obstacles which were difficult to overcome in a rushed process of negotiation at the end of the legislative process. To better understand these complexities, we will first shortly outline some of the key features of the complexity residing in this interlinkage between MMFs, ABCPs and banks. While MMFs as well as ABCP conduits engage extensively in maturity transformation and hence appear bank like, they are also very sensitive to regulatory costs, thus depending on appropriate rule sets to prosper.

4. The empirical context: the shadow banking chain and its regulation post-crisis
ABCP stands for short-term Asset-Backed commercial papers is “a form of short-term funding of the long-term assets” which are used by short-term investors as a “value container” (Lysandrou and Nesvetailova 2014: 263). MMFs are part of the cash management processes of banks and large wholesale investors, as they have a cash-like status but provide a small uptick
to cash (EP 2015: 14, see also DB Research 2015). In their search for yield, coupled with the need for liquid short-term investments, MMF managers then invest in ABCPs (redeemability usually below 30 days), which in turn invest in longer term assets, often overcollateralized or securitized loans. Banks stand by these ABCP conduits, providing their back up to these entities in case of liquidity problems and by channelling their clients’ debt into these vehicles. Thereby, banks permit access to capital markets to clients which otherwise are too small to access them on their own (Thiemann and Lepoutre 2017). Figure 3 depicts these interactions that created a fragile chain of maturity transformation pre-crisis, what we call the shadow banking chain.

![Diagram of the shadow banking chain pre-crisis](image)

*Figure 3 Shadow Banking Chain Pre-Crisis (Gorton and Metrick 2010: 264)*

Before the crisis, this intricate web of relationships did not emerge solely because of the competitive pressure within the financial sector, but it also required the appropriate regulations and hence regulatory agency to allow banks to engage in this line of business in a profitable

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3 Their cash-like status was based on the constant net asset value rule, which would force MMFs to never have the value of assets fall below their liabilities.
manner, excluding them from banks’ balance sheets (for ABCP, s. Thiemann 2012, 2014, 2018). Consequently, and due to differences in regulatory treatment across Europe we find the ABCP and MMF industries to be concentrated in few European countries, where accounting rules allowed banks to engage in ABCP trading (Thiemann 2018) or beneficial tax treatment made MMFs an attractive money market instrument (Baklanova and Tanega 2018), most notably in Ireland, France and Luxemburg. Due to specific tax rules, In Ireland and Luxemburg, the industry is dominated by Constant Net Asset Value (CNAV) MMFs, covering more than half of the European MMF market. The other half is to be found in France which is home to almost the whole European Variable Net Asset Value (VNAV) MMF industry, funds that compared to CNAV do not have the bank like character to the same extent.4

The financial crisis, described as a “run on the shadow banking system (Gorton and Metrick 2010), showed the dangers of these interlinkages, as MMFs refused to refinance ABCP, forcing the latter to return on banks’ balance sheets (Thiemann 2012). Further risks to financial stability were illustrated in the year 2011, when US MMFs refused to refinance European banks and the dependency of the latter on short-term refinancing threatened the entire European banking system (van Rixtel and Gasparini 2013). In the immediate aftermath of these crises, regulatory efforts at the European level caused a considerable restructuring of the market and while ABCPs are since the crisis fully supported by the respective bank (Interview 1, 2), the MMF industry had to consolidate due to cost pressure (DB Research 2015). Regulatory concerns at that moment bore a strong macroprudential imprint and action was dominated by transnational and US intervention (Thiemann 2018). In this context, the EU predominantly acted as ‘transmission belt’ between the national and international level (Quaglia 2015). Overall, the crisis related implosion of the chain and regulatory interventions in its aftermath mutually shaped market structures in the immediate post-crisis era.

As our case study shows, European policy makers, endowed with new competencies (Falkner 2016) soon aimed to move beyond just being a transmission belt. They sought to use their new competencies from 2012 onwards for the active creation of a regulatory infrastructure amenable to credit flows from these institutions into the real economy. However, due to the inherently different MMF industry in the respective European countries and the profound data gaps for both products their regulators were soon restricted to experts’ knowledge about their functioning. They hence changed their mode of policy-making and considerably altered the

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4 While CNAV MMFs promise to always pay 1$ and thus constitute a similar like bank deposits, VNAV have a floating value.
policy network, using private actors as a source of knowledge to achieve their objectives despite the technical complexities. In the following, we trace this political process on the level of EU legislation of MMF and ABCP from 2012 to 2017.

5. From curtailing shadow banking to making markets reach the real economy

Figure 3 below depicts the timeline for the two regulatory efforts and shows how the two reforms were adjusted over time to better account for the specificities of these markets and their mutual dependencies. This process was driven by the enhanced understanding of rule-makers about the two products and their role in enhancing the flow of real economy debt through capital markets. The analysis will also show how the political process was subject to time and political pressure, which did not allow for an exhaustive refinement of the new rules that could have ensured a proper interlocking of these two institutions in a shadow banking chain.

In particular, the chronological analysis of the regulatory processes unveils how the attempts of European regulators to use the new-found power for the purpose of crafting regulation were soon impeded by the inherently different concepts of a desirable financial system, the high technical complexity of the two subjects and the generally slow pace of European regulatory processes. It furthermore brings to the fore how sensitive these developments were with respect to their timing and the concomitant political reasoning arising from the mutual constitutive constellation of micro-actor, meso-institutional and macro-discursive factors. While
immediately after the crisis the central problem of MMFs and ABCPs was seen to be their linkages to each other and to banks, over time, the attention shifted towards their importance for the financing of the real economy, defining the trade-off between its benefits as channel for debt and risks (e.g. run on MMFs).

A- Trials and Tribulations in Reframing Shadow Banking (2013/4) “A lot of educational work”

When the drafting of the MMFR took off in 2012, the regulatory discourse was dominated by the efforts to properly regulate the shadow-banking sector. The European Commission explicitly outlined MMFs and ABCP conduits as possible shadow banking activities/entities that should be contained and made more resilient (EC 2012b). Under the then Commissioner Michel Barnier and with a lot of public attention and political salience, the primary focus was placed in properly re-regulating the financial system and any effort to revive the capital market had to happen below the radar of public opinion (Interview 2). This stance also reflected the general atmosphere in Brussels (e.g. EP 2012). Thus, it is not surprising that initial reform efforts by the European Commission aimed at forcing MMFs ‘out of the shadow’ by making them subject to bank like regulation.

Yet, a more drastic intervention into the MMF-market, as suggested by the European Systemic Risk Board (ESRB 2012) was not incorporated into the regulation. The latter would have involved the forced conversion of Constant Net Asset Value Funds into Variable Net Asset Value Funds, which would have ended the deposit-like function of MMFs that was cause of macro-prudential concerns by the ESRB. Rather, the Commission suggested making bank like MMFs (CNAVs) subject to a capital buffer similar to the capital requirements of banks. Nevertheless, the Commission also focused on “the role of money market funds in the management of liquidity for investors, their engagement in the securities lending and repo markets as well as their systemic involvement in the overall financial marketplace” (EC 2012a). Thus, the capital buffer was a first concession to align the diverging national position in a long chain of compromises during the MMFRs drafting process.

The political context of the MMFR proposal was characterized by the advanced status of the legislative period. When it handed over the drafting to the Council and the Parliament in 2013, the latter already prepared for its elections in 2014, leaving only small room for deliberations. Thus, MEPs were aware that after the elections the constellation would be quite different in the
ECON while the Council was aware of the differing national positions (Interview 11). The Commission itself was preparing for its new head, Jean Claude Juncker, which proposed initiatives “to foster the supply of long-term financing” and “to improve and diversify the system of financial intermediation for long-term investment in Europe” (EC 2013b). This provided the ground for his Long-Term Financing Initiative with a strong focus on capital markets (Interview 4). Par consequent, when the Commission published its MMFR proposal this highly contentious issue was subject to heated debates, which culminated in a deadlock in the Parliament and the Council (Interview 11). Remarkably, in the Parliament the discussions were not structured according to the political program of single MEPs, but along national lines (Interview 11, 12).

In the Parliament, Luxembourgian and Irish MEPs teamed up according to the similar structure of their MMF industries to prevent such regulations. France found its partner in Germany, which was strongly in favor of making the shadow banking system subject to strict regulation, which they expressed in a letter opposing the shadow banking system and the MMFR (Interview 11). This became of importance when the Commission’s already weakened MMFR proposal was to be discussed by the Council and the Parliament, taking almost four years. In addition to the trenchant critique of the MMFR proposal, there was a broader criticism that outlined the European Commission’s latest work as being ‘schizophrenic on shadow banking’, arguing that punitive regulatory treatment eliminating CNAV stands against the goal to promote alternative sources of long-term financing (Euromoney 2013).

All to the contrary, changes in the regulatory treatment of securitisation and ABCP were not publicly discussed at this early stage. Nonetheless, they evolved in order to prevent a further punitive treatment on the international level. Therefore, European industry representatives lobbied for a regulation distinguishing between good and bad securitization (Interview 1). In line with this an High Level Expert Group of the Commission invited regulators “to consider how best to identify high-quality, simple and transparent securitisation and how this could subsequently be reflected in regulatory treatment” (HLEG 2013: VII). Furthermore, the ECONs report on long-term financing of the European economy stressed the important role of securitisation as an “efficient technique to deleverage and free up bank balance sheets” (ECON 2014: 14). However, these initiatives were about securitisation as a whole and the particularities of ABCP were not acknowledged (Interview 1, 2, 6). The problem of differentiating ABCP from other, more long term securitisation was already acknowledged earlier by the HLEG which found that “the treatment of back-up liquidity lines provided to ABCP vehicles is at best
unclear and at worst heavily penalizing transactions that have provided over time and successfully an effective answer to corporate in search of working capital funding solutions (among other objectives) to corporates” (HLEG 2013: 47).

These clashes regarding the future of MMFs as well as the acknowledgement of the specificities ABCPs vis-à-vis other securitisation techniques occurred against the backdrop of discourses focusing on stability and the proper regulation of shadow banking. As soon as the first wave of post-crisis regulation was completed, these post-crisis discourses receded and a second macro-level dimension becomes more dominant: the widely differing visions about the future role of finance in different EU countries. While some countries like Luxembourg and Ireland were clearly in favour of a finance-led growth system, other countries like Germany and France rather wanted to limit the shadow banking system (Interview 7, 11).\(^5\) This interacted with the meso-level where the institutional set-up favoured a bias towards national interests that in the case of the MMFR was exacerbated by the lateness in the legislature period allowing for strong positions of the single rule-making agents in the parliament and in the council (Interview 12). However, rule-making agents start to get more knowledgeable and increasingly include private actors in their work for coping with the complex set up of funds and their market (Interview 7). To the contrary, regarding ABCP the closedness of the rule-making network did not allow for the acknowledgment of their specificities at the beginning making the interference of the industry later on much more difficult (Interview 15).

On the micro-level actors’ strategies are directed towards the national interests. However, some actors seek a European solution, for example Italy that tried to act as an “honest broker” and finding a compromise (interview 12). Yet these efforts are restricted by the 6 months duration of its Council’s presidency and the upcoming European parliamentary elections. Meanwhile a few European players, such as Italian MEPs, Commission officials and Attachés, tried to support the creation of a European regulatory agency, strengthening European rules and supervision. For example, the Commission cautiously supported a differentiation between good and bad securitisation (Interview 2, 15), and formulates such a request to EBA (EBA 2015). This increasing engagement with the technicalities of the process is concomitant with an expansion of the rule-making network, including private actors closely familiar with the industry. These could explain the dynamics of MMFs and ABCPs, which are technically

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\(^5\) Remarkably Luxembourg’s resistance remained until the final MMFR, passed by the Council and the Parliament.
complex and not well replicated in any kind of data base (interview 9, 10, 15). Their involvement would only grow in the next phase.

B- Coping with Technical Complexity (03/2015-07/2016): Co-habitation at its high

After the parliamentary elections and the change of the Commission in 2014 it took the newly constituted ECON only few months to overcome its deadlock in the MMFR negotiations. In 2015 it published a proposal entailing a compromise for both group of MMFs, CNAV and VNAV. This was already prepared during the Council Presidency of Italy (Interview 11), which provided the main elements for the final compromise in the fall of 2014. However, back then, the Council’s negotiations stance was inhibited by “a number of provisions of the proposal, in particular relating to the specific treatment of CNAV MMFs” which were “subject to strong reservations” by some member states (Council 2014: 2).

These were overcome by the inclusion of a new category of funds the so-called Low Volatility Net Asset Value fund (LVNAV), which would have allowed CNAVs to maintain their deposit-like status at least for a while, but also considerable leeway given to Variable NAV MMFs, appeasing also the other side of the industry. In this vein, the Parliament suggested a LVNAV with a phasing out after 5 years. It then took the Council until mid-2016 to agree that they too will support the LVNAV proposal, but in contrast to the Parliament they suggested to install it as a permanent regime. Given the similarity of LVNAVs to the current structure of CNAV MMFs, some industry representatives concluded that regulators worked out quite well the advantages of MMFs (interview 7). This compromise occurred under “political pressure from all European institutions”, which were aware that subsequent Council presidencies would have no strong interests to close the file at all; but also that the Council needed to prove in light of Brexit that it was capable of overcoming “political inclinations of member states” (Treasurer 2016).

Meanwhile, the securitization initiative was embedded in the CMU project and openly promoted by the Commission (EC 2015a). They relied on work undertaken by the EBA, but also publicly consulted on a possible framework. However, these proposals did “not cover short-term securitisation instruments, especially asset-backed commercial paper” (EC 2015b: 7-8). Rather it was the industry that undertook a lot of “educational work” (Interview 15), as for example during the hearings at EBA in 2014 to include specific requirements acknowledging the particularities of ABCP (Interview 2), e.g. the fact that the maturity
transformation and maturity of liabilities of an ABCP conduit differ strongly from other forms of securitisation (Interview 1). Thus, EBA’s final advice acknowledged that “the current market is almost exclusively focused on real-economy-related exposures mostly financed by multi-seller conduits” (EBA 2015b: 16). Thereupon the Commission published its proposal with particular criteria for ABCP (see EC 2015b). The Council agreed in record speed (EU Observer 2017), with only few adjustments, such as the enlargement of maturity limits for assets ABCP conduits could buy. This would have enlarged the capacity of the shadow banking chain to finance long-term credit. However, the Parliament was highly skeptical of such an approach (Interview 15).

Even though the ECON rapporteur gave industry representatives the possibility to come up with an own proposal, many MEPs were critical regarding securitisation in general. This made the people by whom they were briefed key to further regulatory developments (Interview 2, 12, 15). At this moment, this new form of co-habitation between the regulatory network and other agents involved reaches its peak. This allowed the industries’ concerns about the vital investor relation of MMFs for ABCPs to be heard. Already in 2013, the industry had outlined that “MMFs represent approximately 50% of all investments in Asset Backed Commercial Paper (ABCP) in Europe” (IMMFA 2013: i). In addition to that, the direct link between these two reforms was underlined: “MMFR will reduce funding of banks by MMF and impact ABCP, a key and growing source of market funding for European companies” (IMMFA 2013: iii). These lobbying efforts, undertaken jointly by the MMF industry association and lobby groups for the ABCP market (including banks and leasing entities) leads to important lobbying successes. Thus, the final MMFR is the only regulation on European level acknowledging ABCPs as liquid assets and hence incentivizing the investment of MMFs into this asset class, turning it into an important win for the industry6 (interview 15, Leaseeurop 2018).

While the MMFR is substantially modified according to MMF industry proposals, the regulatory process to design STS securitization is opened up to appreciate the particularities of ABCPs in contrast to longer-term securitization. Apart from that, rule-makers also started to acknowledge the importance of their deeply intertwined relations for these institutions’ role as channel for real economy debt. In other words, they got ‘more knowledgeable’ about the interlinkages within the financial system (Interview 7) and they attempted to gain “a clearer

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7 This for example let the Commission to publish a Call for evidence on the EU regulatory framework for financial services that aimed at analyzing “Rules affecting the ability of the economy to finance itself and growth; Unnecessary regulatory burdens; Interactions, inconsistencies and gaps; Rules giving rise to unintended consequences” (EC 2015).
understanding of the interaction of the individual rules and cumulative impact of the legislation as a whole including potential overlaps, inconsistencies and gaps” (EC 2015). This also happened against the backdrop of the rising discourse about the need for alternative funding models and ‘overbankedness’ in Europe (e.g. Pagano 2014, Langfield and Pagano 2016).

Although the important changes in the first phase were to be found on the macro-level, in this second phase the support for a resilient market-based finance system grew. This culminated in the rediscovery of the importance of money market instruments’ liquidity voiced throughout the discussion on alternative funding channel next to banks. Here the micro-level interaction between key actors is important: the newly elected Parliament had a new rapporteur for the MMFR favoring market driven solutions. She listened to the industry, thus aiming to “keep the best of both worlds” (interview 11), while several rule-making agents opened up and strongly interacted with private agents in the policy network. Thus, the stalemate in the MMF is resolved through the LVNAV, which was altered in the rule-making network in such a way that it became politically viable (interview 12).

However, on the institutional side, actors faced time constraints, which did not allow for a full reworking and coordination of the different negotiation stances. The European schedule of elections and EU Council presidencies also was the reason why the MMFR finally entered the trilogue negotiations at this point in time. The negotiating parties were aware that the next two Presidencies after the Luxembourgian would not prioritize the MMFR. The threatening standstill and the already long negotiation process put the Council under pressure to resolve the stalemate (iTreasurer 2016, interview 8). But while rule-makers were willing to adjust the regulation towards the market structure for an orderly flow of debt, their openness towards private agents’ advice decreased at this point in time, as they were seeking to close the deal (interview 15). Thus, it is no surprise that rule makers and private actors could in principle align their strategies regarding securitization and MMF, but their work to “finetune the regulation” is insufficient given the time constraints.

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7 This for example let the Commission to publish a Call for evidence on the EU regulatory framework for financial services that aimed at analyzing “Rules affecting the ability of the economy to finance itself and growth; Unnecessary regulatory burdens; Interactions, inconsistencies and gaps; Rules giving rise to unintended consequences” (EC 2015).
C- Final Modification and the Fish Market (07/2016-01/2017): Co-habitation closed

In the final phase, the trilogue negotiation take place in an environment, where the openness of the rule-making agents towards the advices of private actor’s declines rapidly. Figure 4 depicts the full evolvement of the two reform processes. It illustrates how the three different phases were characterized by the way regulators tried to overcome the technical complexity by opening up to the private agents’ expertise and how the openness slowly declined until in this final phase rule-makers interacted predominantly among themselves. Ultimately, timing constraints inhibited a full embrace of the market structures, letting private agents to conclude that they managed to deal with 80% of the problematic parts of the initial proposal (Interview 16).

Figure 5 developments in the regulatory network

Throughout the negotiations rule makers try to reconcile their differences and they openly pursue the strategy of designing a European regulatory infrastructure. The MMF and ABCP industry shall be sustained for the sake of preserving it as transmission mechanism of debt into the real economy. However, the regulation shall also provide the appropriate rules to guard against market downturns. Thus, for example the Council describes the goal of the MMFR as “to ensure the smooth operation of the short-term financing market” (Council 2017). Notwithstanding the intentions to cultivate markets to this effect, the tedious process of drafting the MMFR, which already lasted 4 years and the pressure to deliver results regarding securitisation and the CMU certainly shaped the trilogues.

For the MMFR regulation, an industry lobbyist stated, that in trying to keep up with the reality of markets, “regulators worked out quite well the advantages of MMF”, while in the details they did not do such a good job (Interview 7). Once it became overly politicized, it culminated in a rather “perverse result” (Interview 12) which relates inter alia to the sheer scale of the regulation. Regarding ABCPs, the regulatory refinement of regulation also was insufficient
implying adverse results for the industry (Interview 1, 2, 4)\(^8\). In general, the trilogue negotiations for the STS proposal resembled a “fish market”, being not so much focused on drafting a workable regulation, but instead to find a politically viable solution. The Commission wanted a 5% risk retention instead of the Parliament’s proposed 20% and the Parliament a trade repository while the Council argued for a reversal in the hierarchy of approaches for calculating capital. Notwithstanding the extreme sensitivity of the technicalities discussed for the market dynamics, the time pressure did not allow for the ultimate refinement of the different positions. It also led to actors adopting new strategies, introducing significant changes to the draft in the last minute. One prime example is the reversal in the hierarchy of accounting approaches for ABCP, which was only introduced during the trilogues (Interview 6).

Similarly, under „a lot of political pressure to close the file” (Pensions & Investments 2016), the MMFR trilogue negotiations came to an end in mid-2017, bringing together “elements of oversight which have previously been afforded not just by the previous regulations, but also by industry codes of praxis, rating agency requirements and prudent practices” (Treasury Today 2017). Just like an industry representative forecasted in 2016, the few requirements that were unworkable in the initial draft had been largely removed in the process (Pensions & Investments 2016). With the design of the LVNAV funds, regulators had picked up the current market sentiments and “those going down the LVNAV route should continue to operate in a similar manner as they currently do, as they used to do, which means there will hopefully not be too much disruption to the industry” (Treasury Today 2017). Even more, the MMFR is also considered to set the right framework to overcome current negative market dynamics. As another industry representative put it, “the LVNAV model has addressed the need for greater transparency, higher liquidity and for different type of product due to the fragmentation of investors in Europe and the breadth of jurisdictions they operate in” (Pension and Investment 2016).

However, while for the MMFR the influence on market structures is unclear, described as a regulation where “the devil lies in the details” (Interview 7), the STS is finally “a most of, not best of” text so strict that probably no ABCP program will attain the preferential status of STS, thwarting initial intentions of rule-makers. This shows how in the final phase, everything important has been negotiated in the realm of the political, where there has been no space for co-habitation and technical reasoning but considerations such as changes in the presidency or

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\(^8\) It is estimated that less than half of ABCP conduits will gain the STS label and even less of the transactions (Interview 10).
showing the capability to act. Even more, during the informal negotiation processes at the end when new policies and strategies were debated, the process was not only highly restricted to rule-making agents, excluding private agents, it was also very fragmented between the different regulators and policymakers (interview 3, 15).

6. **Discussion and conclusion: Politics, time pressure and the complexity of the legal package**

The European regulation of MMF and ABCP are a prime example of the dynamics at work when the institutional and political convolutedness of Brussels meets the technicalities of finance. Even more, it shows how such processes are shaped by their timing and the prevailing political discourses. When European regulators attempted to use their newly crafted regulatory power to draft a truly European shadow banking regulation it unveiled the diverging national visions on the future role of the financial system and their defense of home country markets. Therefore, some of the key actors were not willing to hand over the regulation and supervision of these institutions. As key member states could not agree on the future direction of the European financial system a technical compromise was rendered impossible and lead to exhaustive negotiations on the political level. In the end, the central role of the financial system to the economies (credit creation and allocation) let questions around MMF and ABCP become a matter of national interest and were against all conventions negotiated along national lines.

It is at this point were the importance of timing and political reasoning becomes most evident. At first, there was a strong support to find a compromise as for example in the case of the MMFR by the honest broker Italy. However, at the same point of time the ABCP regulation was designed and the MMFR proposal was handed over to the Council and the Parliament in a time of transition at the end of the electoral cycle with the Parliament elections forthcoming. It’s partly restructuring afterwards as well as the Commission’s new president’s prioritization of growth allowed for substantial modifications of the legislative proposals instead of the typical watering down. The learning and negotiation process that the rule-making network underwent is mirrored in the creation of the LVNAV as well as the concessions towards ABCPs allowing for their special treatment in the securitisation regulations. These processes took also part in the wider policy network. Here European rule-makers increasingly relied on industry representatives to design regulation that would “sustain the orderly flow of debt” (for a similar argument see Fernandez and Wigger 2017) while rule-makers exchange their new insights
through informal talks between for example attachés of the Council, MEPs and the Commission (Interview 3, 13).

However, as the legislature period and the duration of the negotiations advanced, the political willingness to understand the intricacies of finance and to translate these into negotiating positions faded constantly. Thus, while the co-habituative mode between rule-making agents and private actors within the policy network enabled the modification in the first place, over time private actors became less capable of finding a sympathetic ear. This culminated in two regulations that are described as ‘most of, not best of’ (Interview 2), where ‘the devil lies in the detail’ (Interview 7). They reflect perfectly how public agents’ willingness to get them right were cut short by the particular time-dimension of the European legislative process. These findings can only be explained by considering the mutual constitution of the micro, meso and macro factors shaping the process.

Thus, we find that under Commissioner Barnier in the beginning of the process shadow banking was treated with a certain rigor. Here, the diverging national visions on the role of finance intermediated by the institutionally built-in bias towards national interests in the European institutions, let agents align with national positions, leading to a policy stalemate. Over time, the shift in the macro discourse towards growth and the emphasized positive role of finance for growth let to the common European goal of creating resilient market-based finance. This shift was strongly supported by the new European Commission, which was seeking a compromise that provided for an orderly flow of debt throughout the European space. Yet, the final regulations did not allow for a successful reconstruction of the shadow banking chain. In the end, the material was too complex and full of unwieldy details, which the European policy network could not deal with in the context of a charged European legislative calendar. In this sense, our study shows how time pressure and the complexity of the material impeded the coordination necessary to reconstruct the chain.
References


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Appendix

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