JCMS Journal of Common Market Studies
UACES
JCMS 2021 Volume 59. Number 6. pp. 1364–1380 DOI: 10.1111/jcms.13227

It Takes Two to Tango: The European Union and the International Governance of Securitization in Finance

LUCIA QUAGLIA
University of Bologna, Bologna

Abstract

The role of the European Union (EU) in the post-crisis international governance of securitization does not sit well with the literature that considers the EU as a 'paladin' of stringent regulation as well as a 'rule-taker' in finance. Whereas in the aftermath of the 2008 financial crisis, the United States (US) promoted more stringent rules on securitization, subsequently, the EU, but not the US, successfully sponsored less stringent rules. What accounts for this 'deviant case', that is to say, the EU as a pacesetter in trading down the regulation of securitization worldwide? After examining alternative explanations, this paper draws attention to a novel complementary explanation that can 'travel' to other cases, namely, the pivotal role of the United Kingdom (UK) and, specifically, whether the UK sides with the US or the EU in international standard-setting. It takes two to tango in regulating global finance, even more so after Brexit.

Keywords: EU; finance; securitization; capital requirements; international standards

Introduction

In the world economy, the European Union (EU) is often portrayed as a 'market power' (Damro, 2012, 2015) able to leverage the large size of its internal market and its considerable regulatory capacity in order to influence international trade negotiations and shape global market regulation (Drezner, 2007; Vogel, 2012), although with important qualifications (for example, da Conceição-Heldt and Meunier, 2014; Young, 2014a, 2015a, b). Moreover, the EU often favours stringent regulation for products and production processes (Kelemen and Vogel, 2010; Vogel, 2012). Anu Bradford (2020) coined the term the 'the Brussels effect', which occurs when the EU deliberately exports its regulations, but, also, unintentionally, as a result of the behaviour of market participants. In finance, after the international financial crisis of 2008, the EU favoured more stringent domestic and international rules on several financial services (Quaglia, 2012; Pagliari, 2013), except in the banking sector (Young, 2014b; Howarth and Quaglia, 2016). At the same time, the EU's attempts to 'trade up' international financial regulation by acting as a 'rule-maker' rather than a 'rule-taker' were met with limited success (Newman and Posner, 2015).

The EU's role in the post-crisis international governance of securitization – which is the process of creating marketable financial instruments by pooling various financial assets (for example, mortgages, loans) and selling these repackaged assets to investors - represents a 'deviant case'. It does not sit well with the literature that considers the EU as a 'paladin' of stringent regulation as well as a rule-taker in finance. In fact, whereas in the aftermath of the 2008 crisis, the United States (US) promoted more stringent domestic and international rules on securitization, half a decade or so after the crisis, the EU, but not the US, successfully sponsored less stringent domestic and international rules.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.
This is an open access article under the terms of the Creative Commons Attribution License, which permits use, distribution and reproduction in any medium, provided the original work is properly cited.

Besides being theoretically interesting, the regulation of securitization is also intrinsically important because of the large size of this market, which is part of the shadow banking system, its role in the building up of the 2008 international financial crisis, its implications for monetary policy and the provision of funding to the real economy (Engelen and Glasmacher, 2018; Braun, 2020; Montalbano, 2020). Furthermore, in the context of the covid-related economic crisis, securitization can be a way to provide additional funding to struggling companies.

What accounts for this deviant case, that is to say, the EU's role as a pace-setter in trading down the regulation of securitization worldwide? To shed light on this puzzle, after considering alternative explanations that have been teased out from the literature, this paper puts forward a novel complementary explanation that focuses on the pivotal role of the UK and, specifically, whether it sides with the US or the EU in international standard-setting negotiations. In the case of securitization, UK and EU regulators had aligned preferences and coordinated their actions at the domestic and international levels. In particular, a powerful alliance was forged by the Bank of England and the European Central bank (ECB), with the support of the European Banking Authority (EBA) and the European Commission.

This paper speaks to the literatures on the politics of regulating global finance, the role of the EU therein, and the external economic relations of the EU by pointing out the crucial role of the UK in-between the US and the EU. This explanation, which can 'travel' to other cases, has become more important after Brexit because the question of whether the UK will side with the US or the EU in international standard-setting negotiations has come to the fore. Indeed, this article contributes to better understanding the post-Brexit international configuration of standard-setting in finance and the pivotal role of the UK, especially whenever the EU and the US have strongly misaligned preferences. The material is organized as follows. Section 1 reviews the literature on the EU as a global economic actor, teasing out a variety of explanations that pertain to the international and domestic contexts, and then presents a novel explanation that focuses on the UK. Section 2 outlines the empirical pattern of interest concerning the international governance of securitization. Section 3 assesses the analytical leverage of alternative explanations against the empirical record, whereas Section 4 assesses the analytical leverage of the complementary explanation put forwards in this paper.

I. State of the Art and Research Design

The EU is generally considered as a strict regulator of products and production processes. Prominent examples are food, chemicals, data privacy, environmental and labour regulation (Kelemen and Vogel, 2010; Vogel, 2012; Bradford, 2020). Moreover, the EU has considerable market power (Damro, 2012, 2015) that ensues from the sheer size of its internal market (Drezner, 2007) and its advanced regulatory capacity, meaning the 'ability to formulate, monitor, and enforce a set of market rules' (Bach and Newman, 2007, p. 831; Posner, 2009). The EU can influence global regulation in several ways, namely: by shaping international standards, by intentionally exporting EU domestic rules to third countries, for example, as part of trade agreements and development assistance; and via market forces (da Conceição-Heldt and Meunier, 2014; Young, 2015a, b).

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Although the EU has been willing and able to trade up global market regulation in several sectors, finance is a notable exception (Bradford, 2020). To begin with, before the international financial crisis of 2008, the EU did not pursue clear social goals in regulating finance – it exerted 'power without purpose' (Posner and Véron, 2010) – and mostly adopted a market-shaping approach spearheaded by the UK, the US and international standard-setters (Mügge, 2010; Quaglia, 2010). After the crisis, the EU favoured stringent regulation of financial services – such as credit rating agencies, hedge funds, derivatives, insurance (Quaglia, 2012; Pagliari, 2013) – embracing, at least, verbally, a market-shaping approach, even though the EU resisted stringent rules on bank capital and structure (Young, 2014b; Howarth and Quaglia, 2016). Moreover, unlike in the regulation of other global markets, the EU was hardly ever a rule-maker in finance. Before the 2008 crisis, the EU often imported rules from other jurisdictions, first and foremost the US, and from international standard setters – notable cases were accounting and auditing (Posner, 2010; Leblond, 2011; Kudrna and Müller, 2017).

After the crisis, the EU adopted several homegrown rules and attempted to exert regulatory power beyond its borders (Newman and Posner, 2015). The results were, however, limited: whereas the EU was sometimes able to deploy the equivalence provisions in EU legislation to get third countries to align their domestic rules with those of the EU (Pagliari, 2013; Quaglia, 2015), the EU's ability to affect international standard-setting remained limited. In particular, there were no cases, except in insurance, in which the EU was able to act alone – without US support – as a pacesetter of international regulation (Mügge, 2014; Quaglia, 2014). To put it another way, all the main international financial standards were sponsored by the US (Helleiner, 2014). Whenever the US did not promote certain rules (acting as a pacesetter) and/or opposed certain reforms (acting as a footdragger), international standards were not set (as in the case of rules bank structure or short selling), or remained 'thin' (as in the case of hedge funds and rating agencies).

A Deviant Case – Securitization

Yet, there is one important deviant case – the regulation of securitization – in which the EU acted as a pacesetter, successfully sponsoring less stringent rules domestically and internationally, becoming a global rule-maker. This is a deviant case because the pattern to be explained was the opposite of what most academic literature on the EU and finance would lead us to expect. 'Deviant cases are cases whose outcomes either do not conform to theoretical expectations, or do not fit the empirical patterns observed in a population of cases of which the deviant case is considered to be a member' (Bennet and Elmann, 2008, p. 505). In the case of the post-crisis regulation of securitization, the theoretical and empirical patterns from which this case study deviates is the role of the EU as a paladin of more stringent regulation and a rule-taker. 'A single deviant case can prove fruitful in identifying a new variable', 'generating new hypotheses through inductive process tracing' (George and Bennet, 2005; Bennet and Elmann, 2008, p. 505).

Explanations Derived from the Literature

The literature provides several international and domestic levels explanations for the ability of a jurisdiction, in this case, the EU, to act as a rule-maker in global markets, including finance. The first set of explanations consider the *international* context

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

(Newman and Posner, 2015; Young, 2015a), especially, the *degree of institutionalization*, namely, the characteristics of the international standard-setting bodies (Newman and Posner, 2015), including their decision-making mode (for example, unanimity or majority); and the *distribution of preferences* among the negotiating parties, in particular, whether a jurisdiction is an 'outlier' (or not), and whether it seeks to change (or not) the status quo ('revisionist' or 'conservative') (da Conceição-Heldt, 2014; Young, 2015b). In a nutshell, in a 'thickly' institutionalized international context where decisions are taken by unanimity, jurisdictions that have outlier revisionist preferences are less likely to achieve their preferred outcome in international negotiations and vice versa. Of particular interest is the position of the 'great powers' (Drezner, 2007), that is to say, jurisdictions that have large domestic markets, namely, the US and the EU, which also enjoy bargaining power symmetry (da Conceição-Heldt, 2014). Thus, if the EU and the US have aligned preferences, they are able to influence international standards. If, however, their preferences diverge, rival international standards are likely to emerge, as in the case of accounting (Posner, 2010; Leblond, 2011), or are not set at all (as in the case of bank structure).

The second set of explanations consider *domestic* sources of regulatory power, namely, *market size*, whereby jurisdictions that have large domestic markets have more regulatory clout in international economic negotiations (Drezner, 2007; Damro, 2012, 2015; Bradford, 2020) and *regulatory capacity,* whereby jurisdictions that have advanced regulatory capacity in a given sector are better able to export their domestic rules (Posner, 2009; Quaglia, 2014). A particular declination of the regulatory capacity argument has to do with sequencing and first-mover advantages, meaning that, the great power that first adopts domestic rules on a given matter is better positioned to influence international standard-setting, or affect rulemaking in third countries (Posner, 2010).

An Overlooked Explanation – The Pivotal Role of the UK in Finance

An explanation that has been overlooked by the literature so far, but that has considerable analytical leverage in finance, is the pivotal role of the UK and its coalition-building with the EU and/or the US. This explanation builds on and further develops the 'great powers' explanation, postulating that, besides the US and the UK, there is a third power, namely, the UK, that needs to be considered in the regulation of global finance. While it is true that great powers are usually equated with the US and the EU, power is largely a relative concept. Thus, it makes sense to regard the UK as a great power in the issue area under examination, given the massive size of its financial sector and the fact that it hosts a leading international financial centre, the City of London.[1] The view that the UK can act as a 'third force' in finance sometimes looms in the background in several scholarly accounts (Posner and Véron, 2010; Pagliari, 2013; Mügge, 2014; Quaglia, 2014; Young, 2014b; Howarth and Quaglia, 2016; James and Quaglia, 2020), but it has been hardly ever been explicitly considered. Of crucial importance is whether the UK sides with the US or the EU.

Why would the position of the UK – in particular, its alliance with the US or the EU – make a real difference in international standard-setting in finance? First, the UK has by far the largest financial sector in Europe and hosts the second main international financial centre in the world. Second, and partly related to the previous point, British regulators

[1] I wish to thank one reviewer for this point.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

have advanced expertise on financial matters; they have considerable experience in negotiating in international financial fora; and they have well-established contacts with the financial community. Hence, the UK has traditionally punched above its weight in international financial fora (James and Quaglia, 2020). Third, depending on whether the UK sides with the US or the EU, the US and the EU gain a powerful ally or face a formidable opponent, strengthening or weakening their negotiating positions at the international level. Finally, prior to Brexit, which is the period of time covered by this paper, whenever the UK sided with the rest of the EU, the EU was able to speak with one voice, even if the EU formally did not have a single representation in the relevant international fora (da Conceição-Heldt and Meunier, 2014). Furthermore, third countries were unable to use the strategy of exploiting differences amongst the member states to weaken the EU's position. Even if third parties did not deliberately do that, intra-EU disagreement sometimes played out in international financial regulatory fora (Quaglia 2014) as well as in the Group of Twenty (G20) (Moschella and Quaglia, 2016), reducing the influence of the EU).

The literature on the politics and political economy of regulating global finance suggests that in several international financial negotiations, the UK had preferences that diverged from the rest of the EU – especially, those of the other main member states (Germany, France, and Italy) – and aligned, instead, with those of the US. Thus, the US and the UK forged an alliance that enabled them to hold sway in setting international standards (James and Quaglia, 2020), even though continental European countries were able to extract concessions, or amend the US–UK proposals. For example, the US and UK acted as pacesetters in regulating the banking sector through the Basel accords (Basel I, Basel II, and Basel III), overcoming the reluctance of continental European countries (Young, 2014b; Howarth and Quaglia, 2016). By contrast, the US and the UK acted as footdraggers, successfully resisting the international regulation of credit rating agencies and hedge funds, which was promoted by continental European countries (Quaglia, 2012; Pagliari, 2013). One of the few cases in which the UK sided with the rest of the EU, in opposition to the US, was in the insurance sector, which is the most noticeable instance of the EU's influence in international standard-setting in finance (Quaglia, 2014).

II. The Empirical Pattern to Be Explained: International Standards on Securitization

In the wake of the international financial crisis, the Basel Committee on Banking Supervision (BCBS) (2009) revised in haste the Basel II accord (which dated back to 2006), agreeing on a series of reforms known as Basel 2.5 accord. Among other things, bank capital requirements for collateralized debt (the so-called 're-securitization'), which was riskier than traditional securitization, were increased. Afterward, the US and the UK were pacesetters in trading up bank capital requirements through the Basel III accord. By contrast, continental European regulators were concerned about more stringent capital rules (Young, 2014b; Howarth and Quaglia, 2016).

The Basel III accord was agreed in 2010, but the discussions on bank capital requirements for securitized products took place separately afterward, given their complexity. In 2012, under the impulse of US and UK regulators, the BCBS proposed a revised ratings-based approach and a modified supervisory formula to create a more 'prudent'

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

calibration of bank capital requirements for securitization. By contrast, continental European argued that the proposed rules were too stringent as they were calibrated on the worst-performing securitized products in the US. Yves Mersch, a member of the ECB's Executive Board, noted that it was like to 'calibrate the price of flood insurance on the experience of New Orleans for a city like Madrid' (Jones and Thompson, 2014). The financial industry was also critical of the BCBS's proposal, pointing out that it was calibrated on the worst-performing part of the US market (Global Financial Markets Association, 2013; Institute of International Finance, 2013). Similarly, the European Banking Federation argued that 'the proposed changes and the basis for calibration do not appear to reflect the characteristics of securitization instruments originated in the EU'.

Eventually, the BCBS (2014) set higher capital requirements for securitization, even though not as much as initially proposed. However, to appease those who regarded the new standards as too stringent, the Committee started to work on new capital rules for 'high quality'[2] securitization. An important turning point in the international regulatory debate taking place in the BCBS was the fact that the Bank of England and the ECB teamed up in support of securitization from 2014 onwards, as elaborated in the following section. To revive securisation markets, two sets of measures were necessary: rules to increase the transparency and standardization of securitized products, so as to create a label for 'safe' securitization, and less stringent capital rules for this type of securitization.

In response to the EU–UK proposal, the BCBS and the International Organization of Securities Commission (IOSCO) established a joint Task Force on Securitization, which was co-chaired by David Rule, a senior official at the Bank of England, and Greg Medcraft, the Chair of the IOSCO. In 2015, the BCBS and the IOSCO published *Criteria for Identifying Simple, Transparent and Comparable (STC) Securitization*, which were very similar to those discussed in the joint documents produced by the Bank of England and the ECB (2014a, b) and the paper issued by the EBA (2014). Hence, these standards had a marked 'European flavour' (Baker and McKenzie, 2014). At the same time, under the pace-setting efforts of EU and the UK regulators, the BCBS agreed to reduce capital requirements for STC securitization, although excluding, at the insistence of the US, short-term securitization. The same process was subsequently repeated for short-term securitization. Thus, the BCBS-IOSCO (2018) issued *Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitizations,* and then the BCBS revised the *Securitization Framework* for short-term securitization, which received the same reduction in capital requirements as STC securitization.

Overall, the regulatory pendulum swung back and forth (see Table 1): initially, in the wake of the 2008 crisis, the international regulation of securitization was tightened up following the pace-setting of US and UK regulators. Then, it was traded down as a consequence of the pace-setting of EU and UK regulators, notably, the ECB and the Bank of England. In the following two sections we consider next some alternative explanations for this empirical pattern.

[2]Initially, regulators used the term 'safe' or 'high quality' securitization. Afterward, they preferred to use the term 'qualifying' (that is, 'simple', 'standard' and so on) securitization in order not to attach a 'quality' label to securitized prodcuts.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Table 1: Post-crisis International and EU Regulation of Securitization

BCBS	*2009*	*Revised capital requirements on securitization*
ECB-BoE	2014 (March)	Joint paper on the impaired securitization market
ECB-BoE	2014 (May)	Joint Paper on the case for a better functioning securitization market in the EU
EBA	2014 (October)	Discussion paper on Simple Standard and Transparent securitization
European Commission	2014 (October)	Delegated acts Solvency II & Liquidity Coverage Ratio
European Commission	2014 (November)	Investment Plan for a sustainable securitization market
BCBS	2014 (December)	Revised capital requirements on securitization
European Commission	2015 (September)	Proposed directives on Simple, Transparent and Standardized Securitization and reduced capital requirements
BCBS-IOSCO	2015 (July)	Criteria for identifying Simple, Transparent and Comparable Securitization
BCBS	2016 (July)	Revised Securitization Framework (including Capital Treatment for Simple, Transparent and Comparable Securitization)
EU	2017 (December)	Directives on simple, transparent and standardized securitization and reduced capital requirements
BCBS-IOSCO	2018 (May)	Criteria for identifying Simple, Transparent and Comparable Short-term Securitization
BCBS	2018 (May)	Capital Treatment for Simple, Transparent and Comparable Short-Term Securitization

III. Assessing Alternative Explanations against the Empirics

As reviewed in Section 1, the literature suggests several factors pertaining to the international and domestic contexts that can affect the ability of a jurisdiction to influence the regulation of global markets in finance (and elsewhere) (see Table 2). As for the international context for the regulation of securitization, the *degree of institutionalization*, namely, the characteristics of the international standard-setting bodies, namely the BCBS and the IOSCO, including their decision-making modalities, did not change over time. Hence, they cannot account for the US's ability to trade up rules in the wake of the crisis and the EU's ability to trade down rules afterward. The BCBS and the IOSCO are international standard-setting bodies that bring together domestic banking and securities market regulators, respectively. These bodies work by consensus (de jure of all parties, de facto of the main jurisdictions) and issue soft law.

As for the *distribution of preferences* and the *bargaining configuration*, jurisdictions other than the US and the EU, had small securitization markets – with the partial exception of Japan and China – hence, they did not have intense preferences on this issue, these preferences did not substantially change over time and there is no evidence of major contributions to the international debate on this issue of either Japan or China. By contrast, the US and the EU had intense and misaligned preferences, as detailed in the following section: the US was initially an outliner on stringency, whereas, afterward, the EU was an outlier in leniency. Initially, the US was revisionist, seeking to change the status quo (that is, the Basel II accord), whereas the EU was revisionist afterward, seeking to change the Securitization Framework agreed in 2014. Yet, despite being outliers and revisionists,

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Table 2: Research Design and Alternative Explanations Applied to the Case Study

	Units of analysis *International rules on securitization 2009–18*			
International standards (date of adoption)	Revision Basel II (BCBS, 2009)	Basel III Securitization Framework (BCBS, 2014)	Revision Basel III – Capital rules STC securitization (BCBS, 2016) Criteria STC securitization (BCBS-IOSCO, 2015)	Revision Basel III – Capital rules short term STC securitization (BCBS, 2018) Criteria short term STC securitization (BCBS-IOSCO, 2018)
	Empirical patterns to be explained			
US & EU roles	US pacesetter trading up EU fencesitter	US pacesetter trading up EU partial foot dragger, resisting trading up	EU pacesetter trading down, US partial footdragger, resisting trading down	EU pacesetter trading down US partial footdragger, resisting trading down
US & EU influence	US high	US high EU achieve concessions	EU high US achieve concessions	EU high US achieve concessions
	International contextual explanations			
International fora (decision making mode)	BCBS (consensus)	BCBS (consensus)	BCBS BCBS-IOSCO (consensus)	BCBS BCBS-IOSCO (consensus)
Bargaining configuration	US outlier reformist EU midway	US outlier reformist EU conservative status quo	EU outlier reformist US conservative status quo	EU outlier reformist US conservative status quo
Preferences and influence other countries	Weak	Weak	Weak	Weak
	Domestic context explanations			
Market size for securitization	US>EU	US>EU	US>EU	US>EU
Regulatory capacity on securitization	EU and US rules in the making	EU and US rules in the making	EU and US rules in the making	EU and US rules in the making
	UK as a pivotal player			
UK position	UK sides with US	UK sides with US	UK-EU alliance	UK-EU alliance

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

the US first, and the EU later, were able to sway international standard-setting at different points in time.

The *market power* explanation does not have much analytical leverage because the securitization market in the EU is considerably smaller than in the US, unlike, for example, in the case of banking and insurance. At the outset of the international financial crisis, the outstanding volume of securitization in the US reached approximately $10 trillion in 2007, whereas the annual securitization issuance in Europe was $1.2 trillion. In 2017, the volume of securitization in the US reached approximately $510 billion, whereas it was $82 billion in the EU. Yet, the EU was able to influence the global regulatory debate from 2014 onward. The *regulatory capacity-first mover* explanation does not seem to fit the case of securitization either: when the US first, and the EU later, shaped international rules for securitization, they did not have domestic regulatory templates ready to project externally, they were in the process of developing them. Hence, the domestic and international regulatory processes moved in parallel and intersected with one another (see Table 1). This was particularly consequential for the EU, which sought international endorsement to relaunch securitization domestically, as elaborated in the next section.

IV. It Takes Two to Tango – the US, the EU and the UK

This section explains the preferences and actions of the US, the EU and the UK concerning the regulation of securitization. The UK was a pivotal player whose allegiance switched from the US to the EU over time. British regulators initially allied with US regulators to trade up bank capital requirements tout court via Basel III. However, as time went by, UK regulators forged an alliance with EU regulators to revive securitization markets. Particularly important were the joint efforts of the Bank of England the ECB at the domestic and international levels.

The US

The US securitization market became severely impaired during the 2008 crisis and the US authorities provided substantial support to this market, notably, through the Term Asset-Backed Securities Loan Facility and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility. Afterward, the Dodd–Frank Act in 2010 called for more stringent rules on securitization, while introducing a preferential treatment for some classes of securitization, such as the ‘qualified’ residential mortgages. In 2011, the Securities and Exchange Commission tightened up its rules on the issuing of securitized products, in particular, prescribing greater transparency and minimum retention requirements, while US banking regulators increased the risk weight for bank capital requirements for securitized products. However, the introduction of these requirements unilaterally would have penalised the US financial industry. For instance, Tim Ryan, Chief Executive of the Securities Industry and Financial Markets Association, noted that the main issue was not how high the risk weight was, but rather the ‘difference between countries and institutions’ (Braithwaite and Masters, 2012). Thus, US regulators acted internationally as pacesetters, successfully sponsoring more stringent bank capital rules for securitization, which were set by the BCBS in 2009 and 2014.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

After the crisis, the US securitization market bounced back more quickly than that in the EU for several reasons. To begin with, the Federal Reserve had $1.7 trillion in mortgage-backed securities on its balance sheet as a result of its bond-buying programme. Moreover, the US securitization market was underpinned by two Government-Sponsored Enterprises (Fannie Mae and Freddie Mac) and large investors, such as insurers and pension funds, were buyers of asset-backed-securities in the US. Following the full recovery of the securitization market in the US, US regulators had no incentives to promote a preferential regulatory treatment for securitization. If anything, they worried that the industry had not yet learnt the lessons of the crisis. Indeed, Adam Ashcraft, a senior official at the Federal Reserve Bank of New York, cautioned that 'We haven't done anything meaningful to prevent the securitization market from doing what it just did' (Alloway and Thompson, 2014).

At the international level, US representatives in the BCBS made clear that they had little appetite for less stringent bank capital rules for safe securitization and, hence, for a bifurcation of rules for STC securitization and 'normal' securitization (Brunetti, 2015). Thus, US regulators were partial footdraggers in the discussion taking place in the BCBS. On the one hand, they did not veto the UK–EU proposal (to be precise, the Bank of England – ECB proposal). On the other hand, they managed to exclude the riskier form of securitization – short-term securitization – from the scope of the revised Basel rules in 2017. However, afterward, following the UK–EU concerted efforts, less stringent capital requirements were extended to short term STC securitization.

The EU

Securitized products in Europe performed much better than those in the US during the crisis. For instance, of more than 9,000 European asset-backed-securities issued before 2008, only 2 per cent defaulted, compared with about a fifth of US asset-backed-securities (Alloway and Thompson, 2014). Yet, as a consequence of more stringent post-crisis regulation and market reactions, the level of securitization dropped significantly in the EU. Moreover, whereas economic growth resumed quickly in the US, the EU suffered from very low economic growth and was in the throes of the sovereign debt crisis. Against this context, the EU engaged in an effort to revive securitization from 2013 onwards. Several reasons account for this move. To begin with, in Europe, which had a bank-based financial system, securitization could be used by banks to increase lending to the real economy without increasing their capital requirements (Engelen and Glasmacher, 2018). Hence, securitization could boost economic growth, allowing the transfer of risk away from the banking sector (Bank of England – ECB, 2014a, 2014b). Moreover, market-based finance – above all, securitization – was instrumental to promote higher economic growth and private risk-sharing in the absence of fiscal centralization in the euro area (Braun *et al*., 2018; Braun, 2020; Gabor and Vestergaard, 2018). Last but not the least, there was extensive lobbying by the financial industry (Montalbano, 2020), although intensive lobbying took place also in the US, but not with the same effects.

The ECB became a cheerleader of securitization. Yves Mersch (2013), a member of the Executive Board of the ECB, called for the 'revival of the securitization market by removing some key impediments to its functioning'. The ECB was concerned about securitization for several reasons. First, securitization, in particular, asset-backed securities, affected

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

the transmission mechanism of the ECB's monetary policy. In the wake of the crisis, the ECB assumed the role of 'dealer of last resort' for asset-backed-securities and piled up a sizeable amount of securitized products on its balance sheets. By taking illiquid asset-backed-securities onto its balance sheet, the ECB became dependent on a liquid asset-backed-securities market (Braun, 2020). The EBA, where both the ECB and the Bank of England were heavyweights, was also supportive of the relaunch of securitization. The EBA's (2014) *Discussion Paper on Simple Standard and Transparent Securitization* acknowledged that a one-size-fits-all regulatory approach to securitization was no longer appropriate, and there was a distinction between high-quality (that is, 'qualifying') securitization and other forms of securitization.

Last but not least, the European Commission was supportive of securitization, which was a key component of the Capital Markets Union project proposed by the Commission with the support of the member states, first and foremost, the UK (Braun *et al*., 2018). Capital Markets Union, which was a flagstone project of the Juncker Commission, was designed to increase financial sector integration in the EU and enhance the EU's position in global capital markets. High levels of securitization were regarded as instrumental in order to develop Capital Markets Union and fulfil its objectives. In 2015, two legislative proposals concerning securitization were put forward by the Commission as part of a broader set of initiatives concerning Capital Markets Union (Montalbano, 2020). First, a regulation on securitization set criteria to identify 'simple, transparent and standardized'[3] securitization – this was the expression used in the EU. At the same time, the regulation on capital requirements for banks was amended, lowering risk weights for qualifying securitization. These pieces of EU legislation were eventually adopted in 2017.

The UK

The UK had almost half of the securitization market in Europe. In the wake of the crisis, the British authorities called for more stringent rules on securitization and related bank capital requirements (see, for instance, Tucker, 2010). However, after Mark Carney took over from Mervyn King as governor of the Bank of England in 2013, the Bank began advocating the relaunch of securitization. Governor Carney, who was more 'market-friendly' than his predecessor, noted that 'a well-functioning securitization market means more efficient balance sheets for the financial sector as a whole which frees up capacity, which then can have a knock-on effect' (*Reuters*, 28 August 2016). Similarly, Andy Haldane remarked that securitization was potentially the 'the financing vehicle for all seasons' and should no longer be treated as a 'bogeyman' (cited in *The Economist*, 2014).

In the Bank of England's (2013) Financial Stability Report, the relaunch of a 'resilient' securitization market was identified as essential to mitigate and diversify risks deriving from rising prices in the British real estate market, the potential growth of private debt, and the relative recourse of banks to wholesale funding markets to ensure high volumes of mortgages. In practice, the Bank of England had to balance stringent banks capital requirements and the implementation of bank structural reforms in the UK, with a relaunch

[3]A bewildering range of acronyms and terms was used for the same type of 'safe' securitization: 'simple, transparent and comparable' securitization was used by the BCBS and the BCBS-IOSCO; 'simple, transparent and standardized securitization used by the European Commission and EU legislation; 'simple, standard and transparent' securitization was used by EBA; and 'qualifying' securitization was used at times by all the above.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

of securitization to ensure sufficient liquidity in the system and enable British banks to increase profit levels, which were low compared to pre-crisis levels and in comparison to US banks.

The EU–UK Alliance and the Relaunch of Securitization

The Bank of England and the ECB were in the driving set of the efforts to relaunch securitization in the EU as well as internationally. These two central banks produced a first joint document (Bank of England – ECB, 2014a) in preparation for the G20 meeting in March 2014. In May 2014, the Bank of England and the ECB (2014b) issued a longer document, *The Case for a Better Functioning Securitization Market in the European Union*. These papers noted that securitization, if appropriately structured and regulated, could complement other funding sources for the real economy. Furthermore, it could provide a diversified funding source for banks and, potentially, transfer credit risk to non-bank financial institutions, thereby providing capital relief that could be used by banks to lend to the real economy. A particular focus was on the promotion of simple structures and transparent underlying asset pools (so-called ‘high-quality’ securitization), while preventing the resurgence of the complex and opaque structures that contributed to the financial crisis.

In the BCBS, the ECB had pushed for reform of the securitization framework since 2013, but the Committee did not discuss the issue until when the ECB and the Bank of England joined forces in mid-2014. At a meeting of the International Monetary Fund in Washington, the Bank of England and the ECB and jointly made their case. Yves Mersch explained that these central banks had a ‘common analysis and a common suggestion … We have agreement on the main thrust of a policy line to propose …. We call on those who do those rules to reassess their past position, and to take [our views] into account’. If new rules failed to gain traction in international standard-setting bodies, notably, the BCBS, an EU-specific approach would be needed. ‘Either we do it at the global level, [or] if that has no prospect of going through any time quickly, we should take into account the needs of the EU and the differences we have in the EU and adjust our regulation to the environment of the EU’ (cited in Fleming and Jones, 2014). The Bank of England, the ECB, the EBA and the European Commission, all of which sits in the BCBS, were on the same page and sang from the same script in the attempt to trade down international standards.

In early 2015, at a major conference on securitization in Barcelona, a senior official of the Bank of England, David Rule (2015), noted that there was a case for some lowering of capital requirements for standardized, transparent and comparable securitization on the grounds of lower risk. Speaking shortly afterward at the same event, Fernando González, a senior official at the ECB, made the case for lowering regulatory requirements for safe securitization. A few months earlier, the European commissioner for financial services, Jonathan Hill, had emphasized the prospect of recalibrating capital requirements for securitization as part of Capital Markets Union (Hale, 2015). The domestic discussions on Capital Markets Union and the re-launch of securitization in the EU and the international discussions concerning the regulation of securitization proceeded in parallel and the latter were used to legitimise the former. In fact, Commissioner Jonathan Hill repeatedly pointed out that EU initiatives on securitization were part

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

of a broader international effort (Brunsden and Hale, 2016). There is no counterfactual, but it plausible to argue that if the UK had not sided with the EU in relaunching securitization, less stringent international standards on certain types of securitization would not have been issued.

It is also worth noting that an alliance between EU and UK regulators is not an unusual occurrence in international standard-setting in finance. For instance, the European Commission and the (then) British Financial Services Authority worked closely and effectively to shape international solvency standards for insurers (Quaglia, 2014). On derivatives, the ECB and the Bank of England worked jointly to promote international rules concerning central counterparties (Quaglia, 2020). On Money Market Funds, the ECB, the Commission and the Bank of England advocated more stringent international rules. On investment funds, the ECB-centric European Systemic Risk Board and the Bank of England, in a coordinated manner, took the unusual step of responding to the IOSCO's consultation on leverage in order to call for further international harmonization.[4]

Conclusion

Under what circumstance is the EU able to act as a global rule-maker in finance? To explain a deviant case, and specifically, why the EU was a pacesetter in trading down the regulation of securitization from 2014 onwards, this paper draws attention to one factor that has been overlooked so far, namely, the role of the UK. It takes two to tango in governing global finance, even more so after Brexit, given that the UK has become an independent actor in its own right. To be sure, this research does not deny the importance of international and domestic factors that are well-rehearsed in the literature. However, this paper adds to the existing body of scholarly work by pointing out a novel complementary explanation – the pivotal role of the UK – which can be an ally or an opponent of the EU (and the US) in international financial negotiations. Hence, to gather a full understanding of the EU's ability to influence (or not) the governance of global finance, it is important to pay attention to the preferences and actions of the UK.

Is this explanation generalizable? Prima facie, previous evidence seems to confirm it: the only notable cases – insurance and financial conglomerates (Posner, 2009; Quaglia, 2014) – in which the EU has been able to act as a pacesetter by trading up international regulation, the EU and the UK had aligned preferences, as opposed to those of the US, and coordinated their efforts. Vice versa, the EU has been the least influential in shaping global rules whenever the UK sided with the US, and these two camps had misaligned preferences, as in the case of hedge funds and rating agencies (Pagliari, 2013). Finally, there have also been instances in which the three great powers in finance had similar or, at least, compatible preferences, as in the case of international standards for reporting derivatives trades, whereby an entirely new system of global identifiers was established (Quaglia and Spendzharova, 2021).

The findings of this research have implications for the post-Brexit scenario in regulating global finance. First, the EU-27 has a reduced market size in financial services and no longer host a leading international financial centre - continental financial centres are not comparable to London, which is now a major off-shore financial centre on the EU's

[4]https://www.iosco.org/library/pubdocs/615/

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

doorstep. Second, outside the EU, the UK is not constrained by the need to conform to the agreed EU position, and does not need to reconcile its preferences with those of the EU (and its member states) when negotiating in international financial fora. Hence, the UK will be able to coordinate more extensively with the US, if their preferences are aligned. Third, the EU and the UK might have similar preferences on certain issues, hence, a UK–EU alliance is not only possible, but also likely to hold sway, especially if there is not straightforward opposition from the US.

Acknowledgments

I wish to thank the editors and anonymous reviewers of the JCMS for their constructive comments. I am also grateful to Daniela Gabor, David Howarth, Scott James, Giuseppe Montalbano, Manuela Moschella, Elliot Posner and Aneta Spendzharova for their feedback and joint brainstorming on some of the arguments and empirical material presented in this paper.

Correspondence:
Lucia Quaglia
Department of Political Science
University of Bologna
Palazzo Hercolani
Strada Maggiore 45, Bologna 40125
Italy.
email: lucia.quaglia@unibo.it

References

Alloway, T. and Thompson, C. (2014) 'Sliced and Diced Debt Deals Make a Comeback', *Financial Times,* 5 June.

Bach, D. and Newman, A.L. (2007) 'The European Regulatory State and Global Public Policy: Micro-institutions, Macro-influence'. *Journal of European Public Policy*, Vol. 14, No. 6, pp. 1–20.

Baker & McKenzie (2014) 'Structured Capital Markets Briefing', 14 February, London.

Bank of England (2013) *Financial Stability Report*, June, London.

Bank of England and European Central Bank (2014a) 'The Impaired Securitization Market', January, London.

Bank of England and European Central Bank (2014b) The Case for a Better Functioning of the Securitisation Market in the European Union.

Basel Committee on Banking Supervision (BCBS) (2009) *Revisions to the Basel II Market Risk Framework,* July, Basel.

Basel Committee on Banking Supervision (BCBS) (2014) *Revisions to the Securitisation Framework,* December, Basel.

Basel Committee on Banking Supervision (BCBS) (2016) *Revisions to the Securitisation Framework*, July, Basel.

Basel Committee on Banking Supervision (BCBS) (2018) *Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisations,* May, Basel.

Basel Committee on Banking Supervision (BCBS) – International Organization of Securities Commissions (IOSCO) (2015) *Criteria for Identifying Simple, Transparent and Comparable Securitizations*, March, Basel.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Basel Committee on Banking Supervision (BCBS) – International Organization of Securities Commissions (IOSCO) (2018) *Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitisations*, May, Basel.

Bennet, A. and Elmann, C. (2008) 'Case study methods'. In Reus-Smit, C. and Snidal, D. (eds) *The Oxford Handbook of International Relations* (Oxford: Oxford University Press).

Bradford, A. (2020) *The Brussels Effect: How the European Union Rules the World* (Oxford: Oxford University Press).

Braithwaite, T. and Masters, S. (2012) New Capital Framework 'Biased against US', *Financial Times*, 30 January.

Braun, B. (2020) 'Central Banking and the Infrastructural Power of Finance: The Case of ECB Support for Repo and Securitization Markets'. *Socio-Economic Review*, Vol. 18, No. 2, pp. 395–418.

Braun, B., Gabor, D. and Hubner, M. (2018) 'Governing through Financial Markets: Towards a Critical Political Economy of Capital Markets Union'. *Competition and Change*, Vol. 2, No. 2, pp. 101–16.

Brunetti, M. (2015) 'Basel-IOSCO Proposal Underwhelms ABS Industry', *Reuters,* 24 July.

Brunsden, J. and Hale, T. (2016) 'EU and US Split over Securitisation: Capital Markets', *Financial Times,* 6 January.

da Conceição-Heldt, E. (2014) 'When Speaking with a Single Voice Isn't Enough: Bargaining Power (A)symmetry and EU External Effectiveness in Global Trade Governance'. *Journal of European Public Policy*, Vol. 21, No. 7, pp. 980–95.

da Conceição-Heldt, E. and Meunier, S. (2014) 'Speaking with a Single Voice: Internal Cohesiveness and External Effectiveness of the EU in Global Governance'. *Journal of European Public Policy*, Vol. 21, No. 7, pp. 961–79.

Damro, C. (2012) 'Market Power Europe'. *Journal of European Public Policy*, Vol. 19, No. 5, pp. 182–99.

Damro, C. (2015) 'Market Power Europe: Exploring a Dynamic Conceptual Framework'. *Journal of European Public Policy*, Vol. 22, No. 9, pp. 1336–54.

Drezner, D.W. (2007) *All Politics is Global: Explaining International Regulatory Regimes* (Princeton: Princeton University Press).

Engelen, E. and Glasmacher, A. (2018) 'The Waiting Game: How Securitization became the Solution for the Growth Problem of the Eurozone'. *Competition and Change*, Vol. 22, No. 2, pp. 165–83.

European Banking Authority (EBA) (2014) Discussion Paper on Simple Standard and Transparent Securitization, 14 October, London.

Fleming, S. and Jones, C. (2014) 'Europe's Top Two Central Banks Seek to Revive 'Toxic' Assets. *Financial Times* 7 April.

Gabor, D. and Vestergaard, J. (2018) 'Chasing Unicorns: The European Single Safe Asset Project'. *Competition & Change*, Vol. 22, No. 2, pp. 139–64.

George, A.L. and Bennet, A. (2005) *Case Studies and Theory Development in the Social Sciences* (Cambridge, MA: MIT Press).

Global Financial Markets Association (2013) 'Responses to BCBS Consultation'. London. Available at https://www.bis.org/publ/bcbs236/gfma.pdf

Hale, T. (2015) 'Regulators Fuel Hopes of European Securitisation Revival', *Financial Times*, 18 June.

Helleiner, E. (2014) *The Status Quo Crisis: Global Financial Governance After the 2008 Financial Meltdown* (Oxford: Oxford University Press).

Howarth, D. and Quaglia, L. (2016) *The Political Economy of Banking Union* (Oxford: Oxford University Press).

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Institute for International Finance (2013) 'Responses to BCBS Consultation'. Available at https://www.bis.org/publ/bcbs236/iif.pdf
James, S. and Quaglia, L. (2020) *The UK and Multi-level Financial Regulation: From Post-Crisis Reforms to Brexit* (Oxford: Oxford University Press).
Jones, C. and Thompson, C. (2014) 'Back from Disgrace: Asset-Backed Securities'. *Financial Times*, 1 October.
Kelemen, R.D. and Vogel, D. (2010) 'Trading Places: The Role of the United States and the European Union in International Environmental Politics'. *Comparative Political Studies*, Vol. 43, No. 4, pp. 427–56.
Kudrna, Z. and Müller, P. (2017) 'Harmonizing Internationally to Harmonize Internally: Accounting for a Global Exit from the EU's Decision Trap'. *Journal of Common Market Studies*, Vol. 55, No. 4, pp. 815–31.
Leblond, P. (2011) 'EU, US and International Accounting Standards: A Delicate Balancing Act in Governing Global Finance'. *Journal of European Public Policy*, Vol. 18, No. 3, pp. 443–61.
Mersch, Y. (2013) 'SMEs, Banking Union, and Securitisation – Exploring the Nexus: Speech'. 13 November, Frankfurt. Available at http://www.ecb.europa.eu/press/key/date/2013/html/sp131113.en.htm
Montalbano, G. (2020) 'Policy Entrepreneurship and the Influence of the Transnational Financial Industry in the EU Reform of Securitization'. *Business and Politics*, Vol. 22, No. 1, pp. 85–112.
Moschella, M. and Quaglia, L. (2016) 'To agree or not to agree? Explaining the cohesiveness of the European Union in the Group of Twenty'. *Journal of European Public Policy*, Vol. 23, No. 6, pp. 906–24. http://doi.org/10.1080/13501763.2015.1073341
Mügge, D. (2010) *Widen the Market, Narrow the Competition: Banker Interests and the Making of a European Capital Market* (Colchester: ECPR).
Mügge, D. (ed.) (2014) *Europe and the Governance of Global Finance* (Oxford: Oxford University Press).
Newman, A.L. and Posner, E. (2015) 'Putting the EU in its Place: Policy Strategies and the Global Regulatory Context'. *Journal of European Public Policy*, Vol. 22, No. 9, pp. 1316–35.
Pagliari, S. (2013) 'A wall around Europe?: The European Regulatory Response to the Global Financial Crisis and the Turn in Transatlantic Relations'. *Journal of European Integration*, Vol. 35, No. 4, pp. 391–408.
Phua, P. (2020) 'Structured Finance and Securitisation in China', *Thomson Reuters*. Available at https://uk.practicallaw.thomsonreuters.com/1-501-1427?transitionType=Default&contextData=(sc.Default)&firstPage=true
Posner, E. (2009) 'Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millennium'. *International Organization*, Vol. 63, No. 4, pp. 665–99.
Posner, E. (2010) 'Sequence as Explanation: The International Politics of Accounting Standards'. *Review of International Political Economy*, Vol. 14, No. 4, pp. 639–64.
Posner, E. and Véron, N. (2010) 'The EU and Financial Regulation: Power without Purpose?' *Journal of European Public Policy*, Vol. 17, No. 3, pp. 400–15.
Quaglia, L. (2010) *Governing Financial Services in the European Union: Banking, Securities and Post-Trading* (London: Routledge).
Quaglia, L. (2012) 'The "Old" and "New" Politics of Financial Services Regulation in the European Union'. *New Political Economy*, Vol. 17, No. 4, pp. 515–35.
Quaglia, L. (2014) *The European Union and Global Financial Regulation* (Oxford: Oxford University Press).
Quaglia, L. (2015) 'The Politics of 'Third Country Equivalence' in Post-Crisis Financial Services Regulation in the European Union'. *West European Politics*, Vol. 38, No. 1, pp. 167–84. http://doi.org/10.1080/01402382.2014.920984

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.

Quaglia, L. (2020) *The Politics of Regime Complexity in International Derivatives Regulation* (Oxford: Oxford University Press).
Quaglia, L. and Spendzharova, A. (2021) 'Regime complexity and managing financial data streams: The orchestration of trade reporting for derivatives'. *Regulation & Governance*, http://doi.org/10.1111/rego.12377
Reuters (2016) 'Highlights – Bank of England Governor Carney speaks'. https://www.reuters.com/article/uk-britain-economy-carney-highlights-idUKBRE97R0Q920130828
Rule, D. (2015) 'Simple, Transparent and Comparable Securitisation: Speech'. 17 June, Barcelona. Available at https://www.bis.org/review/r150716c.htm
The Economist (2014) 'The Return of Securitization: Back from the Dead'. 11 January.
Tucker, P. (2010) 'Shadow Banking, Financing Markets and Financial Stability - Speech, Bank of England'. 21 January, London. Available online at: http://www.bis.org/review/r100126d.pdf
Vogel, D. (2012) *The Politics of Precaution: Regulating Health, Safety, and Environmental Risks in Europe and the United States* (Princeton, NJ: Princeton University Press).
Young, A.R. (2014a) 'Europe as a Global Regulator? The Limits of EU Influence in International Food Safety Standards'. *Journal of European Public Policy*, Vol. 21, No. 6, pp. 904–22.
Young, A.R. (2015a) 'The European Union as a Global Regulator? Context and Comparison'. *Journal of European Public Policy*, Vol. 22, No. 9, pp. 1233–52.
Young, A.R. (2015b) 'Liberalizing Trade, not Exporting Rules: The Limits to Regulatory Co-ordination in the EU's 'New Generation' Preferential Trade Agreements'. *Journal of European Public Policy*, Vol. 22, No. 9, pp. 1253–74.
Young, K.L. (2014b) 'Losing Abroad but Winning at Home: European Financial Industry Groups in Global Financial Governance since the Crisis'. *Journal of European Public Policy*, Vol. 21, No. 3, pp. 367–88.

© 2021 The Authors. JCMS: Journal of Common Market Studies published by University Association for Contemporary European Studies and John Wiley & Sons Ltd.