Securitisation to the Rescue

The European Capital Markets Union Project, the Euro Crisis and the ECB as 'Macroeconomic Stabilizer of Last Resort'

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Abstract

The European Capital Markets Union (CMU) project is a strong political commitment to market-based finance, the new code word for shadow banking. Since securitisation, the financial innovation that triggered the Global Financial Crisis of 2008, is key for market-based credit intermediation, its revitalisation has become of strategic importance. Considering that the CMU is an important pillar of European plans to support growth and to complete the European Monetary Union (EMU), what explains that securitisation (and market-based finance) have become key for achieving these goals? Challenging arguments on regulatory capture, I claim that this outcome can be explained by not only taking the agency of financial market actors seriously, but also the agency of important EU actors, in particular the European Central Bank (ECB). In a nutshell, I argue that the political plans to strengthen securitisation and market-based finance have its roots in the ECB's efforts to stabilize the euro zone. The unique institutional setting of the EMU has forced the ECB into the role of what I shall call the 'macroeconomic stabilizer of last resort'. While in 2011-2012 economic circumstances called for a swift solution of the Southern European banking crisis through a jointly financed program of bank recapitalisation, intra-euro zone risk sharing was not a feasible political option. Yet, the weakness of the Southern European banks undermined the effectiveness of monetary policy while at the same time the ECB's (bank-based) monetary firepower reached its limits. Against this background, the ECB started deliberating on revitalising European securitisation markets in early 2013 both as an attempt to stimulate non-bank credit intermediation and to restore monetary steering capacity over the economy. The study is based on documentary analysis and expert interviews. The analysis contributes to ongoing research on 'public-private' interest alignments in the political system of the European Union and the role of the ECB in shadow markets.

Keywords: capital markets union; ECB; euro crisis; European monetary union; market-based finance; securitisation; shadow banking;

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1. Introduction

The Global Financial Crisis has once again put European financial regulation politics in the spotlight of public interest and scholarly concern. Whereas early research debated about whether the European Union's (EU) response to this financial tsunami had 'market-making or 'market-shaping' character (Quaglia 2012; Mügge 2013a), latest news from Brussels leave no doubt: with its new flagship project, the Capital Markets Union (CMU), the European Commission has launched a stimulus programme for finance. According to the Juncker-Commission, the CMU project is not only an important element of the 'Investment Plan for Europe', but a necessary component of a genuine European Monetary Union (EMU), as outlined in the 'Five Presidents' Report' published in June 2015.[1]

While at the moment a hotchpotch of proposals is discussed under the CMU label, the general direction is clearly discernible: moving the financial systems of the EU member states towards a system of market-based finance, the new code word for shadow banking. Since securitisation – the financial innovation of bundling loans and transforming them into interest-bearing securities – is key for market based credit intermediation, breathing new life into European securitisation markets stands out as the one main priority area of action in the context of the CMU project. Thus, whereas in the darkest days of 2008 securitisation was blamed to have caused the crisis (FCIC 2011), political conditions have meanwhile turned in favour of securitisation. Concretely, the Commission is about to establish a framework for 'simple, transparent and standardised' (STS) securitisations and, concomitantly, to lower regulatory capital requirements which were proposed in response to the crisis.

Scholarly debates on the CMU project and the political attempts to revitalise European securitisation markets have so far focussed on mainly two issues: on the one hand, legal scholars have discussed potential weaknesses of the proposed STS framework, pointing mainly to the problem of defining what exactly counts as simple, transparent and standardised, on issues of market supervision and the role of credit rating agencies (Bavoso 2015) as well as on the likely effects of the CMU for macroprudential regulation and financial instability (Alexander 2015; Pesendorfer 2015). Again others have discussed the CMU project in light of a possibly newly emerging form of close public-private regulatory cooperation (Dorn 2016). Political economy scholarship, on the other hand, has drawn attention to the huge discrepancies between the European Commissions' simple 'frontstage' narrative of the STS securitisation regulation and the 'backstage' legal complexity which offers the securitisation lobby enormous leeway to influence the legislative process in their own particularistic interests (Engelen/Glasmacher 2016). In this perspective, the story of the European STS securitisation regulation is one of successful industry capture.

In a nutshell, these debates centre mainly on questions of policy design and the politics shaping this very design. They do, however, not sufficiently address the question as to why the revitalisation of European securitisation markets travelled on the top of the European agenda in the first place. In other words: what explains that the revitalization of securitisation has become centre stage in a

[1] The Five Presidents' Report on 'Completing Europe's Economic and Monetary Union' was prepared by Commission President Jean-Claude Juncker in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz. According to the report, the EMU should be grounded in a genuine Economic Union, a Fiscal Union, a Political Union and a Financial Union, with the latter comprising a Banking Union and a Capital Markets Union.

political strategy to push economic growth and complete the EMU? It is important to understand the underlying political motivations for this strong political commitment to securitisation and market-based finance. In fact, the overall aim is to move towards a further marketization of finance that is widely perceived to be a precondition for financialization (Godechot 2015; Callaghan 2015). By tracing the processes that led to this outcome, this research thus contributes a further piece to the puzzle as of why the crisis did not trigger substantial changes but only reinforced the pre-crisis status quo (Helleiner 2014; Bieling 2014; Moschella/Tsingou 2013).

I claim that an explanation of the promotion of securitisation and market-based finance must not only consider the agency of financial market participants as capture theories do, but also the agency of important EU actors, in particular the European Central Bank (ECB) and the European Commission which both act within a specific historical juncture: the ongoing euro crisis and permanent low growth. Starting from the premise that politics is 'structured in space and time' (Hall 2010) and that 'one cannot understand the interests and actions of key actors without appreciating the macrostructural environment in which they are situated' (Mahoney/Thelen 2015: 7), I argue that the institutional setting of the EMU has facilitated the push for securitisation. The EMU is historically without precedent: EMU member states agreed on pooling sovereignty over monetary matters but have maintained national responsibility over fiscal and economic policies which were only loosely coordinated prior to the euro crisis (De Grauwe 2016). While the twin euro sovereign debt and banking crisis starting in 2010 rendered obvious the functional need for further fiscal centralization and joint risk-sharing, diverging national interests in a non-optimal euro currency area and the quest for lasting national sovereignty have so far impeded any substantial progress in this direction.

As a consequence of this political gridlock, the ECB has been forced into the role of what I shall call the 'macroeconomic stabilizer of last resort'. At the height of the euro crisis in 2012, the ECB faced a number of severe problems, among them weak bank balance sheets, frozen interbank markets and the danger of a credit crunch particularly in Southern Europe. This resulted in a loss of monetary steering capacity: low policy interest rates had stopped being homogenously transmitted into low borrowing costs for firms and households across the whole euro area. Considering the key role of banks for financing the real economy, political agreement on a swift solution of the Southern European banking problem through a jointly financed program of bank recapitalisation and resolution would have helped to solve the ECB's mounting problems. However, odds were clearly against a joint euro area recapitalization of banks in autumn 2012. Against this background, the ECB started deliberating on revitalising European securitisation markets in early 2013 both as an attempt to stimulate non-bank credit intermediation and to restore its steering capacity over the economy. As the ECB became a key cheerleader for this financial innovation, political dynamics have subsequently turned in favour of securitisation and market-based finance.

By highlighting the links between the euro crisis, monetary policy and financial regulation, this paper follows recent calls to study European integration processes with special attention to political actors' 'embeddedness in the structural transformation of the European economy' (Mügge 2013b: 465). More concretely, it contributes to ongoing research on 'the role of the ECB in engaging with, and reforming shadow markets' (Gabor 2016: 16; Braun 2016).

The following analysis is based on a comprehensive assessment of various primary sources of relevant stakeholders, the financial press as well as on expert interviews. The paper is organized as follows. Section 2 justifies the focus on the EU post-crisis CMU and securitisation politics and

summarises relevant regulatory developments. In section 3, the theoretical framework that informs this study is presented. Section 4 traces relevant developments in the years between 2008 (beginning of the financial crisis) and 2015 (publication Action Plan on the CMU and legislative proposals on securitisation). In particular, it highlights the key agenda setting role of the ECB in bringing securitisation on the EU agenda. The last section concludes.

2. The turn to securitisation: a political commitment to market-based finance

The overall goal of the CMU project is to strengthen the role of markets in credit intermediation. It entails a clear commitment to market-based finance, the new code word for shadow banking (Engelen 2015). A key defining characteristic of shadow bank based credit intermediation is that it is 'carried out and priced on global markets for money and risk'. Thus, unlike the traditional textbook model of banking according to which banks give out loans that are held on balance sheet until maturity and refinance their activities through deposits, 'markets and market-making mechanisms' are crucial for this new form of credit intermediation, hence market-based finance.[2] Securitisation is key for market-based finance[3] as it is a technique that transforms sticky, non-tradable loans into tradable, interest-bearing securities; through this process of marketization, new markets for loan trading are created (for a detailed discussion see Cetorelli/Peristiani 2012).

Setting regulatory conditions that are conducive to the marketization of finance contribute to financialization (Godechot 2015; Callaghan 2015). Although the distributional implications of strongly marketized financial systems cannot be measured in strict quantitative terms, there exist a number of studies indicating that they are quite substantial: Godechot (2015) shows that it is in particular the marketization of finance that is a key contributor to inequality. Hardie et al. (2013) argue that an increased reliance on market valuations in the process of credit intermediation favours short-term oriented lending behaviour at the detriment of long-term and patient capital provision. Closely related to that, Gambacorta/Marques-Ibanez (2012) and the Bundesbank (2014) discuss the in-built pro-cyclicality of market based credit intermediation, Aquilina et al. (2016) emphasize the huge complexity of the system and Turner (2015) discusses securitisation in the context of its likely contribution to the development asset price bubbles. Besides, Bertay et al. (2015) show that securitisation-based credit intermediation biases credit extension towards mortgage and consumer loans at the expense of business loans.

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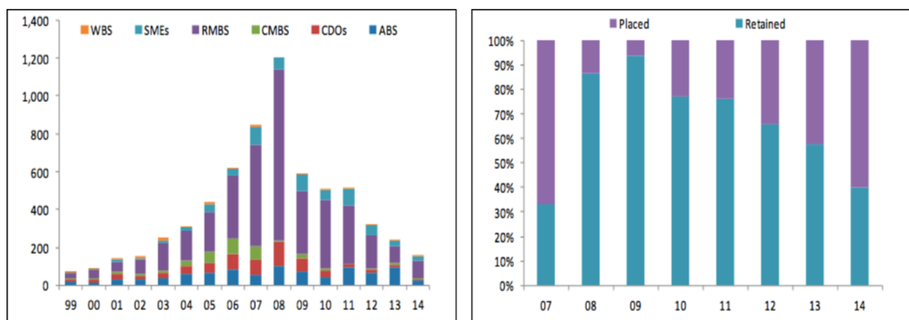
[2] According to the widely used Financial Stability Board (FSB) definition of shadow banking, the term shadow banking refers to 'the system of credit intermediation that involves entities and activities outside the regular banking system' (FSB 2011: 2). The definition includes shadow institutions, which are broadly speaking all institutions that are involved in the process of credit intermediation but are not banks, as well as shadow markets, that is securitisation and repo markets. The FSB definition, however, draws clear institutional boundary lines between banks and non-banks, thereby ignoring the fact that the former are themselves often key players in the shadows (Adrian et al. 2013; Pozsar/Singh 2011). By using the here proposed definition which focusses on the role of markets in credit intermediation, one cannot only overcome these definitional problems, but can also better link the shadow banking discussion to the closely related discussion on market-based banking. The concept of market-based banking was introduced by Hardie et al. (2013) and describes a model of banking in which both the liability as well as the asset side of banks' balance sheets are subject to market valuations.

[3] For a detailed discussion of the repo market which is another important shadow market see Gabor/Ban (2015);

Considering these distributional consequences, it is worth asking how the revitalization of securitisation has become centre stage of the European Commissions' political strategy to push economic growth and complete the EMU. Indeed, the Commission has itself strongly committed to securitisation and market-based finance. Although it would be naïve to assume that there is any (easy) way back to the simple lending model of the early post-WW II years, regulation can, however, influence the profitability of different business models and thereby encourage or discourage market-based credit intermediation (Hardie et al. 2013: 722-723). The European Commission has opted for the former.

These are good news for the securitisation industry which actually had a hard time after the Global Financial Crisis. The crisis triggered an immediate breakdown in market activity with only weak signs of recovery so far. In fact, since then the biggest share of securitised assets has not been placed with investors anymore, but has been retained and used as collateral for central bank refinancing (Segoviano et al. 2015):



Total European securitisation issuance (in billions of US dollars): placed and retained European securitisation issuance (in %) (Source: Segoviano et al. 2015: 6)

Two factors explain investors' reduced appetite for asset backed securities (ABS): post-crisis stigma and unfavourable regulation (Segoviano et al. 2013). However, since 2013 things turned in favour of securitisation in the EU with regards to both factors.

Regarding stigma, the securitisation topic has undergone a process of re-contextualization within the last few years. As summarized in the below table, up until 2012 securitisation was a topic of 'low politics' at the European Union level. Regulatory discussions on securitisation took place within the narrow realm of expert circles and was embedded in the broader context of shadow banking regulation.[4] The aim was to fix a market segment that displayed numerous regulatory flaws which were rendered obvious in the crisis of 2008. Given its crucial role as crisis trigger, the early regulatory approach towards securitisation was rather reactive with, according to Michel Barnier, then EU Commissioner for Internal Markets and Services, the overall 'aim this time around is to prevent rather than cure' (Barnier 2012). There were hardly any signs that securitisation might become the new poster child of the European Commission. Since 2013, however, securitisation is being advertised as an important tool to solve the European economic crisis with the policy approach being accordingly proactive.

[4] See the European Commissions' Green Paper 'Shadow Banking' from March 2012; http://ec.europa.eu/finance/bank/docs/shadow/green-paper_en.pdf [20-07-2016];

	2008-2012	Since 2013
Broader Context	Shadow banking	Economic growth
Modus of discussion	Technical, low politics	Broader social value (especially for SMEs), high politics
General political approach	Reactive/preventive	Proactive

Regarding regulatory action, political dynamics changed along with the change in narrative. Reviewing the EU's early post-crisis regulatory stance towards securitisation, it is important to stress two things: on the one hand, although securitisation was often branded as 'toxic waste' in public statements and in the press in the immediate aftermath of the crisis, regulators globally as well as at the European level opted from the very beginning for a 'technical fix' which was in line with the pre-crisis market-enhancing regulatory paradigm (Segoviano et al. 2013). On the other hand, however, the proposed capital charges for investments in securitised products had rather preventive character. The new proposals, drafted by the Basel Committee on Banking Supervision (BCBS), foresaw a substantial increase in the capital requirements for banks investing in securitised products compared to the pre-crisis period. In addition, the proposed capital charges for insurance companies' investments in securitisation in the context of the Solvency II regulation package took US subprime residential mortgage-backed securities as benchmark to calibrate risk across the array of securitisations issued by European institutions (Hintze 2012).

Yet, in its Green Paper on 'Long Term Financing of the European Economy' published in March 2013, the European Commission discussed securitisation for the first time in the context of SME financing and its positive role for supporting economic growth. As detailed out in the appendix, an array of reports on securitisation regulation has been produced by the European Supervisory Authorities since 2013. The first regulatory changes materialized in October 2014 with two delegated acts adopted by the European Commission: the Solvency II delegated act lowered capital requirements for investments in securitised products by insurance companies and the Liquidity Coverage Ratio (LCR) delegated act classified ABS as highly liquid assets.[5] Further important regulatory changes are currently on the way. In September 2015, the European Commission has brought two securitisation regulations into the legislative process that should help to establish a vibrant European securitisation market: the first proposal suggests a European framework for 'simple, transparent and standardised' (STS) securitisations. The second one grants preferential regulatory treatment for credit institutions and investment firms investing in STS products; in other words, the aim is to lower the capital requirements that were developed in response to the crisis. At the moment of writing, the two proposals are in the European Parliament for discussion with the final adoption to be planned for early 2017.

3. The EMU trap: built-in centralization bias and national interest heterogeneity in a non-optimal currency area

What explains that the revitalization of securitisation has become centre stage in a political strategy to push economic growth and complete the EMU? As has been shown in the previous section, the big

[5] The LCR is part of the Basel III regulations and should ensure that banks hold enough high quality liquid assets in their liquidity buffer to cover the difference between the expected cash outflows and the expected capped cash inflows over a 30-day stressed period (http://europa.eu/rapid/press-release_MEMO-14-579_en.htm [02-08-16]).

winner of these developments is the financial industry. Thus, it seems plausible to assume this to be the result of clever industry lobbying and cognitive capture (Engelen/Glasmacher 2016). However, although the current political climate in the EU favours the interests of finance, this must not imply that the latter were the main drivers of this change. Indeed, 'policy changes which benefit a group [must not necessarily be] made at the behest of that group' (Young 2012: 667). To assume that mere capture was at play is too simple for mainly two reasons: first, referring to industry capture cannot explain the timing of change. The financial industry, and in particular the big international banks and their respective interest associations, have for years been lobbying hard for an easing of capital requirement regulations that were proposed in reaction to the financial crisis. However, their efforts were little successful and still in 2012 there were hardly any signs that this would change soon. Second, it seems too far-stretched to assume that finance has actively pursued a strategy which closely links securitisation and market-based finance to the completion of the EMU.

By taking historical institutionalism as the baseline analytical framework which emphasizes 'the social, economic and political structures in which actors are embedded' (Hall 2010: 2), I instead argue that the current promotion of securitisation and market-based finance cannot by understood when not taking seriously the constraints prescribed by the institutional structure of the EMU. The EMU is a strange animal: while in a 'genuine' monetary union authority over monetary as well as over fiscal and economic matters is located at the same policy level, in the EMU, however, the two latter policy areas are left in the hands of national governments (De Grauwe 2016). The twin sovereign debt and banking crisis that had started in Greece in early 2010 and travelled to Ireland, Portugal and Spain shortly after laid bare the EMU's fragility and instability in its existing form. Yet despite this built-in bias in favour of an 'ever closer union' which became even more obvious since the euro crisis, divergent national interests have so far impeded a far-reaching transfer of sovereignty to the European level.[6] Instead, highly asymmetric bargaining powers between EMU members resulted in political arrangements that favoured the interests of the surplus countries. In other words, while the so-called deficit or PIIGS[7] countries had to agree on austerity and supply-side reforms which shift the burden of adjustment one-sidedly onto their shoulders, fiscal risk and burden sharing devices have so far been kicked off the negotiation table (Scharpf 2014a).

Interest and power asymmetries have likewise prevented agreement on building a genuine European Banking Union (Howarth/Quaglia 2013). Instead of being a real game changer, the Banking Union in its current form is the result of half-hearted compromises that are hardly sufficient to overcome the 'vicious circle between banks and sovereigns' (Hellwig 2014). Most importantly, the EMU members could not agree on sufficient risk and burden sharing arrangements for bank restructuring and resolution (De Grauwe 2016). Considering that in the euro zone banks have been playing an important role for real economy financing – bank loans currently account for more than 80% of corporate debt in Europe while capital markets financing is below 20% (Reichlin 2014: 391) – breaking the links between sovereigns and banks have however been considered necessary for a successful transmission of monetary policy (Constâncio 2014). As became evident during the euro crisis, the efficacy of monetary policy is indeed highly dependent on the structure and health of the

[6] I do not make any claims on whether centralizing competences at the European level is normatively desirable or not (for a discussion on potential democratic legitimacy problems coming along with a far-reaching transfer of sovereignty to the supranational level see Scharpf 2014b). I merely assert that there exists a functional need for centralization for a stable monetary union to be viable.
[7] PIIGS: Portugal, Ireland, Italy, Greece, Spain.

financial system. The euro crisis not only rendered 'obvious the crucial role performed by banks in supplying lending to the economy' (Gambacorta/ Marques-Ibanez 2012: 1), but also that a single monetary impulse stops diffusing homogenously throughout the monetary union in cases where financial conditions across a common currency area diverge (Draghi 2012).

Consequently, while the ECB is a big winner of the euro crisis in terms of new competences and powers – it has turned into a 'political institution with multiple goals besides monetary policy' within only a few years (Sibert 2013: 49) – at the same time, however, the ECB was forced into the role of what I shall call the 'macroeconomic stabilizer of last resort' in the euro zone. Since risk-sharing fiscal backstops necessary to solve the euro area banking problems stayed out, the ECB had no other choice than to step in. It has chosen aggressive monetary policy measures to ease the pressures on the euro area banking system which, given banks' key role in monetary policy transmission, have been crucial for the ECB to achieve price as well as financial stability (Trichet 2010).

But what does it mean for the ECB to act as 'macroeconomic stabilizer of last resort'? As set out in more detail in Braun (2016), central bank agency is market-based simply because it achieves monetary steering capacity through direct market transactions with commercial banks. In normal times, the ECB implements its interest rate policy in the unsecured interbank money market. Assuming that 'all interest rates and asset prices were linked through arbitrage' (Blanchard et al. 2010: 5), this interest rate decision then feeds through the whole yield curve and ultimately affects the credit conditions in the economy (Praet 2012). In crisis times, however, central banks do not only rely on turning the interest rate screw, but are also tapping their unconventional monetary policy toolboxes. Yet, the number and range of instruments a central bank has at its disposal depends inter alia on the structure of the financial system (Bini Smaghi 2009). In general, unconventional policy measures can be either bank-based or market-based. Bank-based unconventional policy measures are mainly in the form of liquidity provisions to banks. In contrast, market-based unconventional measures imply direct interventions into systemically important financial markets (e.g. the sovereign bond markets) (Gabor 2012).

In light of the bank-based financial structure of the euro area as well as restrictive treaty provisions that leave little room for the ECB to intervene in sovereign bond markets (Reichlin 2014),[8] the ECB has mainly concentrated its focus on bank-based unconventional financial measures during both the Global Financial Crisis as well as during the early years of the twin European sovereign debt and banking crisis (Trichet 2010; Gabor 2012). While its early actions were fully in line with its mandate to preserve financial stability in emergency crisis situations, during the euro crisis, however, the ECB has successively broadened its role from being last-resort liquidity provider to last-resort funding provider (Pill/Reichlin 2014). Thus, in order to fulfil its role as guardian of the euro, the ECB has increasingly stretched its mandate and has pursued quasi-fiscal policies with redistributive implications, provoking critical questions on central bank accountability (Buiter 2014; Sibert 2013). Nonetheless, the ECB's bank-based firepower was slowly reaching its limits in 2012 while at the same time positive signals from the political arena of member states to solve the European banking crisis with joint fiscal forces were out of sight. It was in this context of absent political commitments, diminishing (bank-based) monetary firepower and policy legacies of the crisis years – ABS has become an important component of the ECB's balance sheets as a result of its bank-based

[8] Until late 2014, the 'Securities Markets Programme', the 'Outright Monetary Transactions' (not activated until now), as well as two covered bond programs were the only exceptions;

unconventional policy measures (Mersch 2014b) – that the ECB became increasingly interested in restarting European securitisation markets. Indeed, it has become a key part of the ECB's project to regain steering capacity over the economy and an important for extending its market-based unconventional policy toolbox.

4. Securitisation to the rescue! The euro crisis, the ECB as 'macroeconomic stabilizer of last resort' and the turn to finance

EMU in hard times: the loss of monetary governability in 2011-2012

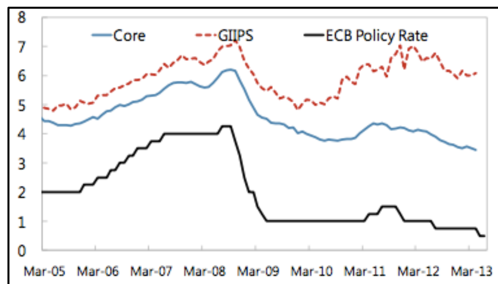
A brief history of the ECB's crisis management policies shows that it has forcefully supported the euro area financial sector throughout both the Global Financial Crisis of 2008-2010 and the following twin sovereign debt and banking crisis starting in early 2010. During the course of the euro crisis, however, the ECB had increasingly lost its steering capacity over the economy. On the one hand, although the ECB provided extensive monetary stimuli, the volume of bank lending declined substantially. In fact, while 'loan dynamics during the first euro area recession were in line with historical cyclical regularities [...] from 2011 to 2012 the rate of growth of loans was not only negative but also more strongly so than that of industrial production' (Pill/Reichlin 2014: 395). According to the joint ECB/European Commission 'Survey on the Access to Finance of SMEs in the Euro Area' published in April 2013[9], 38% of small and medium sized enterprises (SME)[10] in Greece, 25% in Spain, 24% in Ireland and 21% in Portugal mentioned 'access to finance' as the most pressing problem (compared to 8% of the SMEs in Germany and Austria).[11]

On the other hand, low policy interest rates as well as extensive bank-based unconventional policy measures were not evenly transmitted to firms and households across the euro area. As shown in the below chart, interest rates in Northern European countries tracked the ECB policy quite well, while this was not the case in Southern Europe (Draghi 2012). Thus, firms in the GIIPS countries which were hit hardest by the crisis faced substantially higher borrowing costs than their peers from the euro area core. SMEs which play a particularly large economic role in these countries in terms of employment and value-added (compared to the euro area average) therefore were again the main victims (Al-Eyd/Berkmen 2013: 9):

[9] The 'survey on the to finance of SMEs in the Euro Area' (SAFE) was conducted 18 February and 21 March 2013. The total euro area sample size was 7,510 firms of which 6,960 (93%) had less than 250 employees. The reference period is the preceding six months, i.e. the period from October 2012 to March 2013 (ECB 2013: 1).

[10] A company is classified as a SME if it employs fewer than 250 workers and has a yearly turnover below €50 million (Belke/Verheyen 2015: 192). In 2007, SMEs represented 99.8% of the total number of enterprises (out of around 20.5 millon), more than 2/3 of employment, and almost 60% of value added in the European Union (Kraemer-Eis et al. 2010: 22).

[11] Note, however, that 'finding customers' was also mentioned as a dominant concern by 27% of euro area SMEs (ECB 2013: 4).



Euro Area Corporate Lending Rate [Core: Belgium, Germany, France, Netherlands; lending to corporations under €1 million, 1-5 years maturity] (Source: Al-Eyd/Berkmen 2013: 3)

The ECB as 'macroeconomic stabilizer of last resort'

These developments are clearly signalling a decline in monetary steering capacity notwithstanding that the ECB has been reverting to more aggressive policy measures during the euro crisis than during the preceding Global Financial Crisis. What has happened? The ECB, after it had decided on moderately increasing its policy interest rate in April and July 2011, subsequently lowered the policy rate again from 1.5% in November 2011 to 0.5% in May 2013. Moreover, the ECB has deeply dipped into its unconventional monetary toolbox: besides direct but rather small interventions in the markets for sovereign debt and covered bonds (market-based unconventional measures), it further broadened its collateral framework[12] and conducted its open market operations on a 'fixed-rate full allotment' basis which basically means that banks can borrow from the central bank as much as they demand on a fixed interest rate (bank-based unconventional measures) (Pill/Reichlin 2014).

As the euro crisis deepened in the course of 2011, euro area financial markets became increasingly disintegrated due to heightened uncertainties regarding the future of the euro zone. As a consequence, banks especially from the PIIGS countries faced mounting problems to tap the euro area interbank funding and international wholesale financial markets.[13] Since the shutdown of the wholesale funding markets had made a disordered and wide-scale bank deleveraging with uncontrollable asset fire sales and a self-reinforcing downward spiral in asset prices a looming threat (Praet 2012), the ECB stepped into the role as last-resort funding provider: it conducted two one-year long-term refinancing operations (LTROs) in October 2011 and two three year LTROs in December 2011 and early 2012 (Gabor 2012: 23).[14] The main recipients of long-term central bank funding were Southern European banks (van Rixtel/Gasperini 2013: 21) which used the cheap ECB funding primarily to buy domestic public debt. While the motivations that drove banks' behaviour may have been manifold (Crosignani 2015: 6-7), regulatory incentives have certainly played an important role, as under Basel III rules sovereign debt has a zero risk weight. Thus, the ECB effectively 'used the banking system as a conduit for supporting the sovereign sector' (Pill/Reichlin 2014: 13). While the ECB, through its unconventional bank-based policy measures, was able to prevent both a disorderly process of bank deleveraging and to alleviate sovereign funding pressures, it could, however, not

[12] Eberl/Weber (2014) provide a detailed overview over the ECB's collateral policy decisions throughout the crises.
[13] As a consequence of the de-integration of euro area interbank funding markets, the TARGET2 imbalances increased substantially (Cecioni/Ferrero 2012).
[14] According to Buiter (2014: 13), the ECB's LTROs had huge distributional implications: 'The LTROs involved a significant subsidy from the ECB to the borrowing banks, in my view at least 3.00 percent per year. With just over 1 trillion worth of LTROs undertaken, the annual subsidy would be 30 billion euros.'

tackle the underlying structural problems of banks especially in the GIIPS countries (Cœuré 2014; IMF 2012b; Reichlin 2014). Rather, what the ECB in effect did through its LTROs was to lend long-term 'to borderline insolvent banks that frequently offered as collateral debt issued by borderline insolvent euro area periphery sovereigns' (Buiter 2014: 9).

As a consequence, the central bank measures not only deepened the bank-sovereign nexus (Acharya et al. 2016) but also delayed necessary political action to recapitalize banks; instead, it helped 'keeping insolvent institutions alive' (Reichlin 2014: 397). In fact, many euro area banks had not cleaned-up their balance sheets and were not sufficiently recapitalized in the period between 2008 and 2012. Rather, the share of non-performing loans (NPLs) especially in Southern European countries' bank books had increased dramatically since the start of the euro crisis (Aiyar et al. 2015).[15] Obviously, these 'zombie banks' (Moec 2013) which primarily used the ECB refinancing to invest in sovereign bonds and to evergreen their NPLs (Praet 2012) showed little appetite to lend to firms and households as this would deteriorate their risk-weighted capital ratio. Thus, although the ECB had massively supported euro area banks through its unconventional bank-based policy measures, it was still not sufficient to maintain monetary steering capacity. As outlined in the previous section, tightened credit conditions and high lending interest rates for GIIPS country borrowers were the result (Al-Eyd/Berkmen 2013).

These 'zombie-bank-type dynamics' (Praet 2012) which were undermining the effectiveness of central bank measures emerged mainly because 'there were no tools for crisis resolution at the euro area level, while the size of many banks relative to the size of their home country's state finances made it impossible for those states to bail them out' (Reichlin 2014: 390). While awareness grew in the course of the euro crisis that a common monetary union needs to be backed by a framework for joint bank supervision, and most importantly, for joint bank restructuring and resolution based on fiscal risk and burden sharing arrangements (Gros 2012; IMF 2012a), a coalition of surplus countries headed by Germany refused to agree on a framework for true ex ante risk sharing in the context of the Banking Union negotiations (Barker 2012). In autumn 2012, odds were clearly against a joint euro area recapitalization of banks. Thus, the ECB had no other choice than to continue in its role as 'macroeconomic stabilizer of last resort' trying hard to combat the 'financial, economic and sovereign debt crises' (Weidmann 2012).

The ECB's troubles and the beauty of securitisation

In a context of weak bank balance sheets, interest rates reaching the lower zero bound and absent fiscal support to alleviate the problems of the euro area banking system, revitalizing securitisation and strengthening market-based finance turned out to be an attractive solution for the ECB. As already noted by Hyman Minsky, the beauty of securitisation[16] is that 'there is no limit to bank initiative in *creating* credits for there is no recourse to bank capital, and because the credits do not absorb high-powered money [bank reserves]' (Minsky 1987: 2-3, original emphasis). In other words, it opens up the possibility for banks to grant credit to firms and households without having capital-

[15] According to recent IMF numbers, 'NPLs stood at over 9% of GDP at the end of 2014, more than double the level in 2009. NPLs are particularly elevated in some southern countries, such as Cyprus, Greece, Italy, and Portugal. And they are generally concentrated in the corporate sector, most notably among small and medium-sized enterprises.' (Aiyar et al. 2015)

[16] As already discussed in the second chapter, the possible downsides of securitisation and market-based finance can, however, be quite large.

constraining or balance sheet size effects as a bank can easily take these loans off balance-sheet (Cœuré 2013; Mersch 2014a). Thus, vibrant European securitisation markets which would allow banks to quickly shift loans off-balance sheet might incentivize banks to extend loans in particular to SMEs with overall positive effects on credit dynamics, borrowing costs and ultimately economic growth.

Moreover, restarting securitisation markets has become increasingly important for the ECB's own balance sheet management. As a legacy of its extensive liquidity provisions to euro area banks, the ECB had 307 billions of ABS collateral on its balance sheet by early 2014. Thus, the ECB has become dependent on a liquid ABS market. On the one hand, when a counterparty defaults on its obligation, the ECB gains ownership of the pledged collateral which it then wants to sell in the market without incurring any substantial losses (Mersch 2014b). On the other hand, exiting from its bank-based crisis measures in the future is likewise only viable when this asset class is traded in liquid markets. Otherwise, 'the withdrawal of exceptional liquidity support […] may leave banks unable to substitute central bank funding with market funding on similar collateral requirements' (Gabor 2012: 13).

In addition, strong securitisation markets would extend the ECB's unconventional monetary policy toolbox and thus increase its monetary firepower in the future. As outlined above, until 2013 the ECB had relied mainly on bank-based unconventional measures to combat the euro crisis. These measures, however, were slowly reaching their limits whereas deep securitisation markets would increase the ECB's capacities for further market-based unconventional actions. Considering that Southern European SMEs suffered most from a broken monetary transmission mechanism, a strong SME securitisation market would guarantee 'that any unconventional [market-based] monetary policy is more 'sectorally balanced'. […] If the ECB were to intervene in the sovereign debt market again, it would crowd out private investors who then might find it attractive to shift into this new prudently designed asset class. This would improve SMEs' funding conditions. Moreover, the ECB could directly become active in this market as part of an unconventional monetary policy measure' (Brunnermeier/Sannikov 2014: 74). It is therefore not surprising that ECB President Mario Draghi announced at one and the same press conference in early May 2013 that the Governing Council lowered the policy rate to 0.5%, decided to 'start consultations with other European institutions on initiatives to promote a functioning market for asset-backed securities collateralised by loans to non-financial corporations' and hinted vaguely to the possibility that it could directly purchase ABS in the future (Draghi 2013).

By latest mid-2013, the decision was definite: the ECB wants securitisation back. As soon as the ECB became an active and politically important promoter of securitisation, things started to change in favour of securitisation. While the ECB supported the securitisation segment early on, it had, however, played only a background role until 2013: together with the European Investment Bank (EIB) it supported the market-led 'Prime Collateralised Securities' initiative that defines standards of best practice in the European securitisation market (Kraemer-Eis et al. 2010). Moreover, the ECB was strongly involved in the creation of the European DataWarehouse GmbH which serves as a centralised European platform for ABS loan level data (Braun 2016; González-Páramo 2010). Yet, in 2013 the interest of the ECB became more substantial and direct; in fact, the ECB has increasingly conceived a vibrant securitisation market as structurally important to meet its monetary policy goals. Consequently, in early 2013 ECB President Draghi as well as central bank board members started to position themselves in favour of securitisation (Atkins 2013a; Atkins 2013b). Since the ECB identified

the capital charges for securitised products laid down in the Capital Requirements Regulation (CRR) and in the Solvency II proposals as likely to impede a future market revival, it positioned itself in favour of a regulatory differentiation between high-quality and low-quality securitisations (ECB 2013: 49-50). In the words of executive board member Yves Mersch, the European securitisation regulation 'is like calibrating the price of flood insurance on the experience of New Orleans for a city like Madrid' (Mersch 2013). Moreover, in May 2013 the ECB started consultations with the EIB and the European Commission on how to strengthen the credit supply for SME's in Southern Europe, focussing particularly on SME securitisation (EIB 2013). Hence, the ECB was early on in close exchange with other important European stakeholders, in particular the Commission which it needed as a partner to bring regulatory changes into the legislative process. In May 2014, the ECB finally joined forces with the Bank of England (BoE): together, they published a discussion paper titled 'The Case for a Better Functioning Securitisation Market in the European Union' which stresses the 'potential benefits of securitisation and outlines various impediments that may currently be preventing the emergence of a robust securitisation market' (BoE/ECB 2014: 3). Hence, two of the world's most important central banks sent a clear signal that securitisation needs to receive stronger political support.

5. Conclusion

This paper shows that the political support for securitisation and market-based finance in the context of the European CMU project can only be understood when taking seriously the constraints prescribed in the institutional structure of the EMU. Absent institutional arrangements for intra-euro area risk and burden sharing, the euro crisis has forced the ECB into the role as 'macroeconomic stabilizer of last resort'. As the ECB's bank-based unconventional monetary policy measures reached their limits by end-2012, the ECB turned its focus on securitisation as a further attempt to stabilize the euro zone. On a normative level, the ECB's cheerleading for securitisation shows that the euro crisis has transformed the ECB into a political institution. In fact, considering the distributional implications of market-based credit intermediation, the ECB's lobbying for securitisation must raise serious questions about central bank independence and accountability in the current historical juncture.

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Appendix: EU regulatory developments, 2013-2015

EU Developments 2013-2015
03/2013: Green Paper 'Long Term Financing of the European Economy'
12/2013: European Commission calls EBA for advise, potential ways of promoting safe and stable securitisation markets
05/2014: Joint ECB/BoE Policy Paper 'The Case for a Better Functioning Securitisation Market in the EU'
09/2014: Announcement ECB ABS Purchase Program
09/2014: EIOPA Technical Report on Standard Formula Design and Calibration for certain Long Term Investments, Revised Version (Solvency II) --> lowering of capital charges for 'type 1' securitisations
10/2014: Liquidity Coverage Ratio Delegated Act --> Recognition of certain securitisations as 'high quality liquid assets' for the purposes of the LCR liquidity buffer (eligible for inclusion at Level 2B)
10/2014: Solvency II Delegated Act --> Lower capital requirements for high-quality securitisations
10/2014: EBA Discussion Paper on Simple, Standard and Transparent Securitisations - Response to the Commission's call for advice of December 2013 related to the merits of, and the potential ways of, promoting a safe and stable securitisation market
02/2015: Green Paper 'Capital Markets Union'
02/2015: Consultation Paper 'High-Quality Securitisations'
07/2015: EBA Report on Qualifying Securitisation - Response to the Commissions' call for advice of January 2014 on long-term financing
09/2015: Action Plan on Building a Capital Markets Union
09/2015: Proposal for a Regulation of the EP and of the Council laying down rules on securitisation on creating a European framework for simple, transparent and standardised securitisation
09/2015: Proposal for a Regulation of the EP and of the Council amending Regulation No 575/2013 on prudential requirements for credit institutions and investment firms