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When Brussels meets shadow banking – Technical complexity, regulatory agency and the reconstruction of the shadow banking chain

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Abstract

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

Keywords

Market-based finance, European Union, financial regulation, securitization, shadow banking

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Introduction

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

The inquiry into the European political process of re-regulation of MMFs and ABCPs from its inception in 2012 to the final acts of 2017 shows what happens when the specific political and institutional setting of the European Union is confronted with the regulatory intricacies of shadow banking and to what extent the complexity of financial issues shapes interventions in these activities. The fragility and interconnectedness of the relationship between MMFs, ABCPs and regular banks, which we term ‘the shadow banking chain’, were impressively demonstrated in July 2007. At the time, the chain became infamous through the failure of Deutsche Industriebank (IKB), which brought to light banks’ engagement in arbitrage activities in capital markets.[1] While not visible on their balance sheets initially, the critical situation of ABCP conduits and MMFs forced banks or their asset management arms to step in to avert the worst (Bengtsson, 2013).

The regulation of the shadow banking chain is an insightful case for the aims and actual capacity of European regulatory agency to reshape the financial system after the crisis. In particular because the regulatory treatment of these entities and their linkages underwent considerable restructuring, from seeking to limit it to its cautious encouragement. This culminated in a novel approach to build a consistent European regulatory infrastructure[2] with the aim of enabling the orderly flow of debt into the real economy through MMFs and ABCPs.[3] In this way, the case of their regulation is exemplary for the re-orientation of European financial regulation towards building resilient market-based finance in the context of the Capital Markets Union (Braun et al., 2018; Quaglia et al., 2016). Our study hence adds new evidence to the actual effects of this rhetorical shift and gives new insights into the underlying regulatory dynamics. Against this backdrop, our paper speaks to studies of shadow banking and its fate post-crisis (Kessler and Wilhelm, 2013), in particular how it is reshaped by regulatory intervention (Ban et al., 2016; Braun, 2018; Engelen, 2018; Gabor, 2016a; Nesvetailova, 2017), but also to scholars of European regulatory agency and how the latter reshapes the European financial system (Bieling, 2014; Gabor and Vestergaard, 2018; Mertens and Thiemann, 2018; Mügge, 2013).

Based upon process tracing, 13 expert interviews[4] and an extensive document analysis, the study shows how the drafting of regulatory initiatives, mediated through Brussels’ institutional specialties, adapted to a changing macro-setting that increasingly demanded economic growth. Combining historical institutionalism (Archer, 2003; Bell, 2011) with the literature on policy networks (Mayntz, 2003; Rhodes, 1997), we illustrate how European actors sought to integrate the different national visions of the role of finance in the economy and their own and how these were absorbed in the specific European institutional context. Rather than just being a transmission belt, which allows for the translation of national interests into directives or advocates for them in international fora (Quaglia, 2013), European policymakers built up their own agency, proposing a distinctly European approach to the regulation of shadow banking. However, how this upward shift changed the purpose and capacity to craft regulation has so far been understudied.

The inquiry into the drafting processes of European attempts to regulate deeply intertwined financial institutions, their investment behaviour and their provisions to ensure financial stability provides us with three important findings. First, the complexity of regulating the shadow banking chain and the diverging national visions of its future role inhibited the formulation of an uncontested European approach. Second, throughout the process, rule-making agents attempted to cope with the technically complex subjects at hand through public–private regulatory co-habitation. Third, the time constraints inherent in European policy processes and the need to reconcile the different national negotiation stances in the specific institutional context of rule-making in Brussels strongly influenced both of these dynamics.

Against this backdrop, we will argue that the European efforts to reconstruct shadow banking post-crisis were unsuccessful, not due to insurmountable opposition by political forces seeking to constrain these activities, but because of the institutional and temporal dynamics of the European rule-making process that impeded coordination between rule-making agents and private experts. Alternative explanations would describe the many changes undertaken throughout the process as evidence of the industry's success in capturing European actors and thus watering down regulations (Kalaitzake, 2017) or emphasize the importance of national financial ecosystems (Monnet et al., 2014) and their industries' interests (Woll, 2013). However, the analysis of the MMF and ABCP regulation supports recent insights on the limits of private actors' influence (Montalbano, 2020) and adds new evidence to the importance of timing and political reasoning in the European institutional set-up, in particular in dealing with technically complex matters such as shadow banking.

In order to develop this argument, the paper will first review the existent literature on shadow banking, European regulatory developments post-crisis and the interference of national interests in European processes. The next section will sketch an expanded historical institutionalist perspective that allows us to underline the importance of timing and political reasoning for the evolution of reforms, which we combine with a focus on the interaction between private and public agents in regulatory networks. We then briefly describe the basic functioning of ABCPs and MMFs and their interdependence. This will be followed by a chronological analysis of the fundamental changes in both regulations, dividing them into three phases to indicate the direction that the regulation of these entities took throughout the European regulatory process. We conclude with a discussion of our findings.

The regulation of shadow banking after the crisis

Literature on post-crisis European financial regulation has either concentrated on interest driven explanations (Engelen and Glasmacher, 2018; Quaglia, 2013; Young, 2014) or ideational frameworks (Baker, 2013; Wigger and Buch-Hansen, 2014) to explain limited re-

regulation in the EU. While Quaglia (2011) provides an overview of post-crisis reforms in European financial regulation, Hardie and Macartney (2016) show how concerns over national champions let French and German politicians to inhibit European reforms. In general, we find several assessments of the interference of national interests (Howarth and Quaglia, 2016; Quaglia, 2014) but only few that describe the intentional action of European regulators on its own. Exceptions are papers on the banking union that show how EU institutions use collective leadership to adapt to their constraining environment during the negotiations (Nielsen and Smeets, 2018), framing the crisis as demanding supranational solutions (Epstein and Rhodes, 2016), while stressing the importance of veto players in European financial regulation (Burns et al., 2018).

Scholars emphasizing the role of European actors described them as a 'transmission belt' of national interests in international matters (Bieling, 2014; Quaglia, 2014) and compare its power to the US (Posner, 2009; Posner and Véron, 2010). Furthermore, this initial approach of European actors focused on securing the integration of European financial markets, ending their fragmentation post-crisis instead of actively designing regulation for public purposes (Posner and Véron, 2010). This depiction of EU policymakers in the realm of finance as relatively weak stands in contrast to a policy field comparison at the EU level in general, where European activities in financial regulation are exceptionally high (Falkner, 2016; Kudrna, 2016) evidenced by the sheer number of regulatory initiatives (see EC, 2015b). Furthermore, European actors such as the Commission imprinted regulatory plans with their own concepts regarding the central dynamics of finance and managed to prioritize growth in regulatory processes (Endrejat and Thiemann, 2019).

From an issue specific lens, the literature on the timid re-regulation of shadow banking is dominated by accounts of how central elements of the shadow banking system, such as the repo-market (Gabor and Ban, 2016), are linked to the European integration project of the ECB and the infrastructural power repo-markets and the market for ABS exert over that institution (Braun, 2016; Braun and Hübner, 2018; Gabor, 2016b). While we thereby learn much about the preference formation of the ECB, there are only very limited accounts of how the rule-making apparatus of the EU itself addressed the intricacies of shadow banking. Yet it has been argued, that the European Parliament, the European Council and the European Commission have proven an 'ingenious creativity' to overcome formal legal problems when politically necessary (Ringe, 2018). The paper aims to contribute to these analyses by focusing on the re-regulation of two central pillars of the shadow banking system – MMFs and ABCPs – and investigating how the rule-makers dealt with their complexity and their interlinkages.

Doing so, we draw on recent scholarship on the re-regulation of finance in Europe. Regarding the shifting relationship between regulators and the regulated, Dorn (2016) describes a new logic of 'closer cooperation between regulators and markets' (85). This culminates in a post-crisis project, where public and private actors do not act in separate spheres but come together in strategic terms to make financial markets work. This co-habitation constitutes both a 'recalibration' of the content (appropriate design) and the mode (public–private co-production) of regulation. This new approach is epitomized by the CMU, which 'announces an in-principle public-private symbiosis of financial markets regulation' (Dorn, 2016: 85). Thus, regulation is not separated from markets anymore and European actors invite private actors to provide insights and potential frameworks.[5] Furthermore, he argues that qualitative changes happened with respect to the 'techniques or policy instruments' but not in the 'overarching goals' of regulation (Dorn, 2016: 101). As

Fernandez and Wigger (2016) put it, policymakers seek to facilitate the shadow banking system because it is ‘creating the necessary regulatory infrastructure that enlarges the capacity of the wider economy to take on more debt’ (409). But how is the appropriate regulatory infrastructure determined, and what affects the capacity of policymakers to create it? To approach these questions, we need to embed the agency of rule-makers in their policy and rule-making networks as they seek to confront the changing face of finance.

Placing policymaker’s agency in their historical context

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

To capture the institutional meso-level we use the concept of policy networks, which includes public rule-makers as well as rule-takers (Marin and Mayntz, 1991) and is particularly appropriate for the analysis of EU governance, which ‘takes place in polycentric, multilevel policy networks of public and private actors’ (Peterson, 2003: 18). The governance literature using the term policy network aims to understand the evolution of policies by focusing on the veto players and coordination requirements between public and private but also between different public agents. To better grasp the European policy context, we introduce a further distinction between the networks that are comprised of public and private agents and those in which only public agents interact with each other. Thus, we use the term rule-making network to denote the different agents involved, the European Commission, Council and the Parliament. Contrary to that, the term policy network also includes private agents participating in the rule-making process, providing industry insights into the expected effects of regulatory changes (see Figure 1).

This distinction is of particular importance given the regulatory sensitivity of finance, which depends on a well-calibrated legal framework accounting for the interdependencies of different entities and a regulatory infrastructure that is conducive to the further expansion of finance (Fernandez and Wigger, 2016). The micro-level strategies of actors in this network are then shaped by the meso-level institutional context in which agents are situated (Moschella and Tsingou, 2013: 201), in turn defining the way different actors’ position and relate to each other. This perspective points not only to the competencies and the timing of the rule-making process as institutional constraints, but also the sources of expertise which are drawn upon by different rule-making actors at the EU level as they prepare legislative proposals (Mudge and Vauchez, 2012) and the modalities of input and influence by the private sector (Tsingou, 2015). Nevertheless, in doing so they are restricted by the

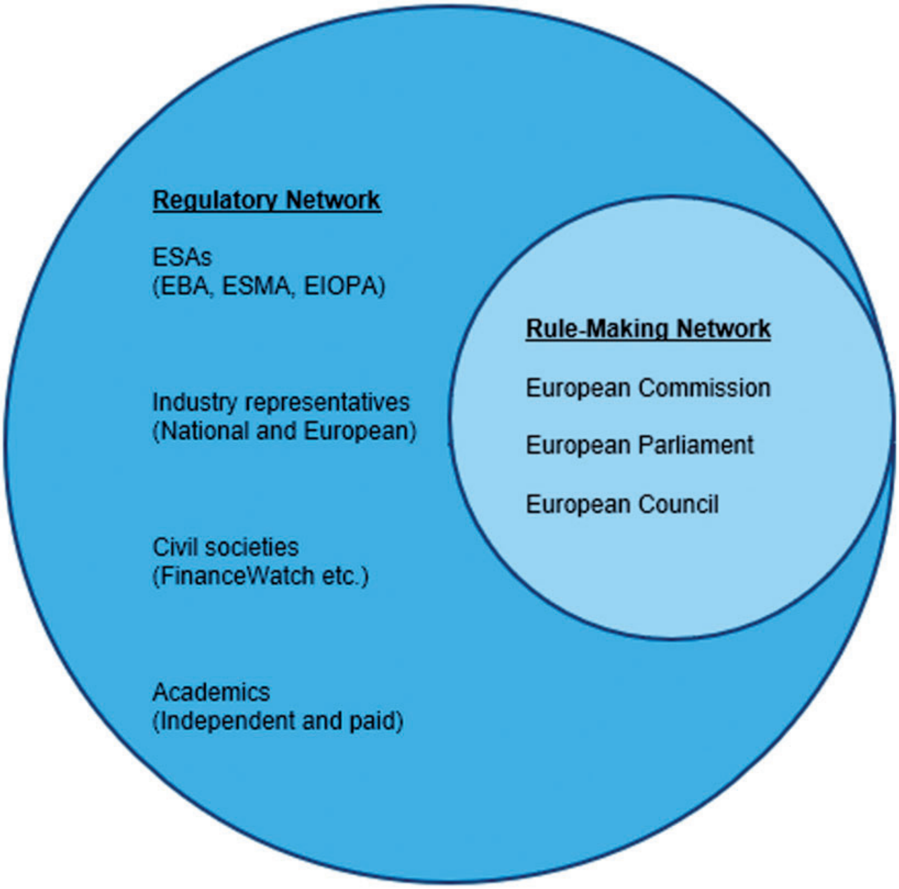
Regulatory Network
ESAs
(EBA, ESMA, EIOPA)
Industry representatives
(National and European)
Civil societies
(FinanceWatch etc.)
Academics
(Independent and paid)
Rule-Making Network
European Commission
European Parliament
European Council

Figure 1. Regulatory and rule-making network. EBA: European Banking Authority; EIOPA: The European Insurance and Occupational Pensions Authority; ESA: European Supervisory Authorities; ESMA: European Securities and Markets Authority.

timing and sequence of the reform process, which decisively defines the ‘political trajectories by conditioning the interests of and options available to actors’ (Moschella and Tsingou, 2013: 20). Furthermore, the political salience and public attention are important factors shaping the course of regulation, making co-habitation much easier in times of ‘quiet politics’ (Culpepper, 2011). Thus, even though legislative actors might aim at getting the regulation right their successful drafting not only depends on accessing the right sources of expertise but also on the political constellations, the electoral/legislature cycle and ultimately the willingness of rule-making actors.

Finally, regarding the structural context for analysing regulatory action with respect to the financial sector, we take the appeal of critical political economists seriously to treat finance not just like any other sector, but to mind its role for ‘credit creation and allocation’ (Mügge, 2013: 459). Capitalism in the EU just as elsewhere is increasingly driven by a finance-led growth regime (Boyer, 2000), in which the expansion of finance is a substantial

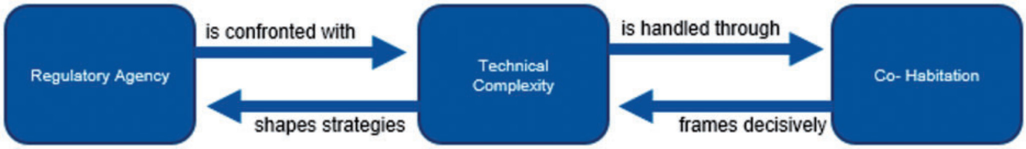

Figure 2. Regulatory agency, technical complexity and co-habitation.

ingredient for growth. Against this backdrop, we argue that the central rational for European regulators is to build regulatory infrastructures that facilitate a continuous flow of debt into the real economy. However, this vision of finance emerged over time through integrating the widely varying national interests and visions of the ideal form and function of the financial sector. Out of the struggle to define the role of finance emerged the dominant discourses at the EU level, which structured the understanding of challenges and goals to be pursued at the micro-level. Concisely put, to analyse regulatory agency, we must understand the meso- and macro-level they are embedded in and how they dialectically define regulators market interventions.

This threefold framework is particularly appropriate with respect to shadow banking, where positive regulatory agency requires the coordination of several actors on complex and sensitive regulatory matters that are of extraordinary complex nature. On one hand, policy networks become more independent from outside influences through the use of common language and skill set as factors facilitating coordination (Peterson, 2003; Seabrooke and Tsingou, 2009). On the other hand, issue complexity as well as politicization are factors identified as hampering coordination. Figure 2 depicts the process of regulatory agency overcoming technical complexity by including the wider regulatory network and facilitating co-habitation which feeds back into the way the rule-makers address the technical complex issues. Decisive for this evolution is the time that private agents have to undertake their ‘educational work’ (Interview 13). Unlike other authors argue (Baker, 2010), private actors’ access to the rule-making agents is not unlimited and highly depends upon the timing and the political viability of the particular topic (Interview 13). In the case of our analysis, the reconstruction of the shadow banking chain implies the need for coordination on different projects to permit the interlocking of different financial instruments into one chain of financing.

The next section shows how the regulatory agency at the EU level was conditioned by the institutional setting and the larger discourses embedding these activities. Under the direct impact of the crisis, actors first sought to constrain shadow banking; however, over time they reframed the matter and favoured economic growth through deep and liquid capital markets. This latter shift reoriented regulatory strategies to reconstruct the shadow banking chain. Yet, complexity and the need for intense coordination were obstacles which were difficult to overcome in a rushed process of negotiations.

The shadow banking chain and its intricacies

To better understand these complexities, we will outline some of the key features of the complexity residing in this interlinkage between MMFs, ABCPs and banks. While MMFs as well as ABCP conduits engage extensively in maturity transformation and hence appear

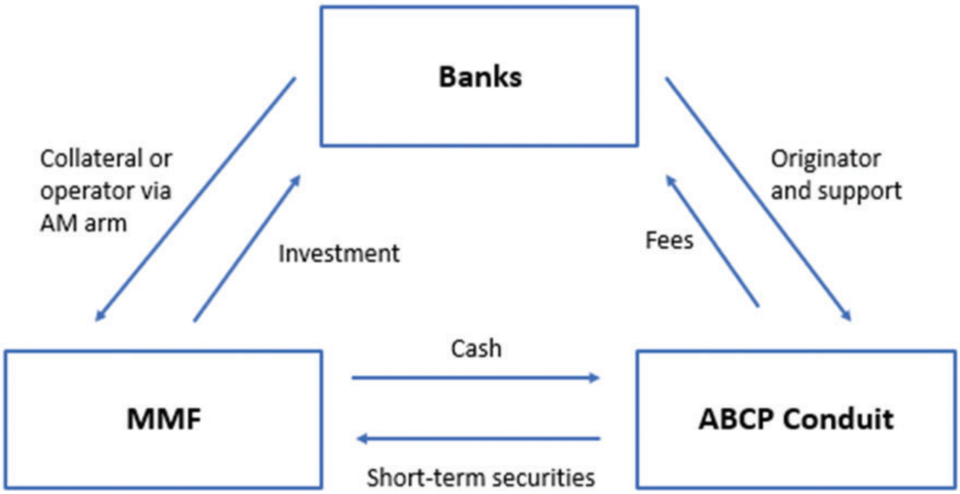

Figure 3. Shadow banking chain pre-crisis. MMF: Money Market Funds; ABCP: Asset-Backed Commercial Paper; AM: Asset Manager (Based upon insights from Gorton and Metrick 2010: 264).

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

Before the crisis, this intricate web of relationships did not emerge solely because of the competitive pressure within the financial sector, but it also required the appropriate regulations and hence regulatory agency to allow banks to engage in this line of business in a profitable manner, excluding them from banks’ balance sheets (for ABCP, see Thiemann, 2012, 2014, 2018). Consequently, and due to differences in regulatory treatment across Europe, we find the ABCP and MMF industries to be concentrated in few European countries, where accounting rules allowed banks to engage in ABCP trading (Thiemann, 2018) or beneficial tax treatment made MMFs an attractive money market instrument (Baklanova and Tanega, 2018), most notably in Ireland, France and Luxemburg. Due to specific tax rules, in Ireland and Luxemburg, the industry is dominated by Constant Net Asset Value (CNAV) MMFs, covering more than half of the European MMF market. The other half is to be found in France which is home to almost the whole European Variable Net Asset Value (VNAV) MMF industry, funds which are not as bank like as CNAVs.[6]

The financial crisis, described as a ‘a run on various forms of “safe” short-term debt’ (Gorton and Metrick, 2010: 279), showed the dangers of these interlinkages, as MMFs refused to refinance ABCP, forcing the latter to return on banks’ balance sheets (Thiemann, 2012). Further risks to financial stability were illustrated in 2011, when US MMFs refused to refinance European banks and the dependency of the latter on short-term refinancing threatened the entire European banking system (Van Rixtel and Gasperini, 2013). In the immediate aftermath of these crises, regulatory efforts at the European level caused a considerable restructuring of the market. While ABCPs became fully supported by the respective bank (Interview 1, 2), the MMF industry had to consolidate due to cost pressure (DB Research, 2015). Regulatory concerns at that moment bore a strong macro-prudential imprint and action was dominated by transnational and US intervention (Thiemann, 2018). Overall, the crisis related implosion of the chain and multiple regulatory interventions in its aftermath mutually shaped market structures in the immediate post-crisis era.

As our case study shows, European policymakers endowed with new competencies (Falkner, 2016) soon aimed to move beyond transmitting international shadow banking regulation. From 2012 onwards, they sought to use their new competencies to actively create a regulatory infrastructure amenable to credit flows from these institutions into the real economy. However, due to the differences in the respective national industries and the profound data gaps for both products, their regulators were soon restricted to experts’ knowledge. They hence changed their mode of policymaking and considerably altered the policy network, using private actors as a source of knowledge to achieve their objectives despite the technical complexities. In the following, we trace this political process on the level of EU legislation of MMF and ABCP from 2012 to 2017 and show the relation between regulatory agency, technical complexity and co-habitation.

From curtailing shadow banking to making markets reach the real economy

Figure 4 depicts the timeline for the two reforms and shows how they were adjusted over time to better account for the specificities of these markets and their mutual dependencies. This process was driven by the enhanced understanding of rule-makers about the two products and their role in enhancing the flow of real economy debt through capital markets. The analysis will show how the process was subject to political and time pressure, which did not allow for an exhaustive refinement of the new rules that could have ensured a proper interlocking of these two institutions in a shadow banking chain.

Furthermore, the chronological analysis of the regulatory processes unveils the attempts of European regulators to use the new-found power for the purpose of crafting regulation which were soon impeded by the inherently different concepts of a desirable financial system, the high technical complexity of the two subjects and the generally slow pace of European regulatory processes. Besides that, it brings to the fore how sensitive these developments were with respect to their timing and the concomitant political reasoning arising from the mutual constitutive constellation of micro-actor, meso-institutional and macro-discursive factors. Immediately after the crisis, the central problem of MMFs and ABCPs was defined as their linkages to each other and to banks. However, over time, the attention shifted towards their importance for the financing of the real economy. This change then

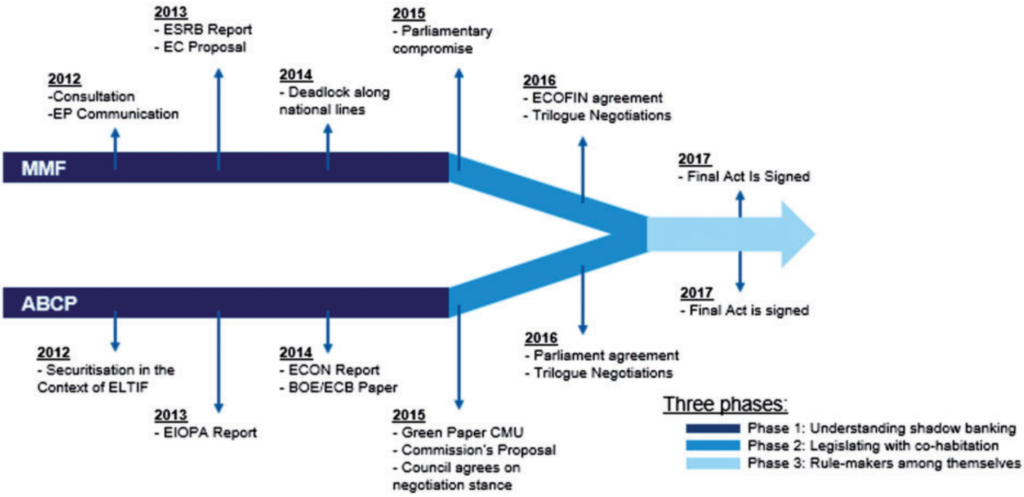
2013
- ESRB Report
- EC Proposal
2015
- Parliamentary compromise
2012
-Consultation
-EP Communication
2014
- Deadlock along national lines
2016
- ECOFIN agreement
- Trilogue Negotiations
MMF
2017
- Final Act Is Signed
ABCP
2017
- Final Act is signed
2012
- Securitisation in the Context of ELTIF
2014
- ECON Report
- BOE/ECB Paper
2016
- Parliament agreement
- Trilogue Negotiations
2013
- EIOPA Report
2015
- Green Paper CMU
- Commission's Proposal
- Council agrees on negotiation stance
Three phases:
Phase 1: Understanding shadow banking
Phase 2: Legislating with co-habitation
Phase 3: Rule-makers among themselves

Figure 4. Key developments in the legislative process. ABCP: Asset-Backed Commercial Paper; BOE: ; CMU: ; EC: European Commission; ECB: ; ECOFIN: ; ECON: ; EIOPA: ; ELTIF: ; EP: European Parliament; ESRB: European Systemic Risk Board; MMF: Money Market Mutual Fund.

defined the perceived trade-off between its benefits as channel for debt and its associated risks (e.g. a run on MMFs).

In their attempt to balance the risks and advantages of shadow banking, the rule-making network opened up to the expertise of private actors and thus increasingly engaged in co-habitation as depicted in Figure 5. The subsequent analysis of the three phases will show how, instead of being captured by the industry, public actors dealt with the technically complex topics by including their expertise and yet ultimately had to prioritize political viability over a market-conform regulation. Notwithstanding the substantial changes undertaken in both legal texts, the outcome is punitive in the case of ABCP or unclear as regarding the exhaustive MMFR.

Trials and tribulations in reframing shadow banking (2012–3/2015)

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

Yet, a more drastic intervention into the MMF market, as suggested by the European Systemic Risk Board (ESRB, 2012) was not incorporated into the regulation. The latter would have involved the forced conversion of CNAV into VNAV, which would have ended

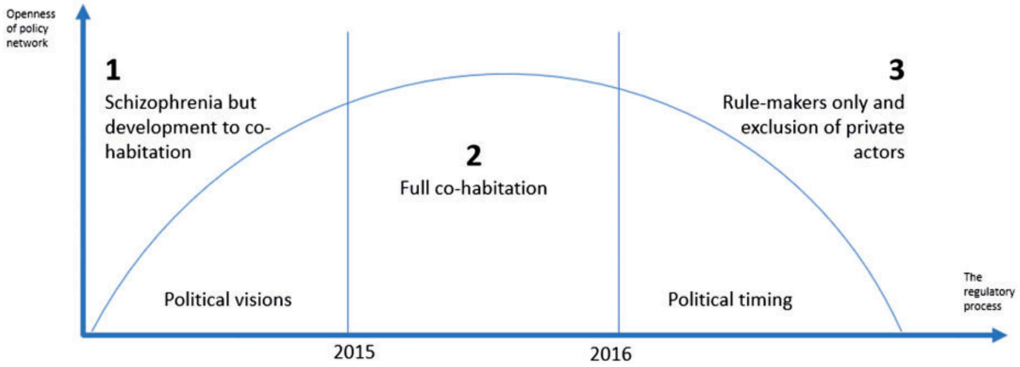
Openness of policy network
1
Schizophrenia but development to co-habitation
2
Full co-habitation
3
Rule-makers only and exclusion of private actors
Political visions
Political timing
The regulatory process
2015
2016

Figure 5. Developments in the regulatory network.

the deposit-like function of MMFs that was the cause of the macro-prudential concerns by the ESRB. Instead, the Commission suggested to make banks-like MMFs (CNAVs) subject to capital buffers similar to capital requirements for banks (EC, 2013a). Nevertheless, it also focused on 'the role of money market funds in the management of liquidity for investors, their engagement in the securities lending and repo-markets as well as their systemic involvement in the overall financial marketplace' (EC, 2012a). Consequently, the capital buffer was a first concession to align the diverging positions in a long chain of compromises during the MMFRs' drafting process.

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

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

All to the contrary, changes in the regulatory treatment of securitization and ABCP were not publicly discussed at this early stage. Nonetheless, they evolved in order to prevent a further punitive treatment on the international level. Therefore, European industry representatives lobbied for a regulation distinguishing between good and bad securitization (Interview 1). In line with this, a High-Level Expert Group (HLEG) of the Commission invited regulators 'to consider how best to identify high-quality, simple and transparent securitization and how this could subsequently be reflected in regulatory treatment' (HLEG, 2013: VII). Furthermore, the ECONs report on long-term financing of the European economy stressed the important role of securitization as an 'efficient technique to deleverage and free up bank balance sheets' (EP, 2014: 14). However, these initiatives were about securitization as a whole and the particularities of ABCP were not acknowledged (Interview 1, 2, 6). The problem of differentiating ABCP from other, more long-term securitization was already acknowledged earlier by the HLEG (2013) which found that

> the treatment of back-up liquidity lines provided to ABCP vehicles is at best unclear and at worst heavily penalizing transactions that have provided over time and successfully an effective answer to corporate in search of working capital funding solutions (among other objectives) to corporates. (47)

These clashes regarding the future of MMFs as well as the acknowledgement of the specificities ABCPs vis-à-vis other securitization techniques occurred against the backdrop of discourses focusing on stability and the proper regulation of shadow banking. As soon as the first wave of post-crisis regulation was completed, these discourses receded and a second macro-level dimension becomes more dominant: the widely differing visions about the future role of finance in different EU countries. While some countries like Luxembourg and Ireland were clearly in favour of a finance-led growth system, other countries like Germany and France rather wanted to limit the shadow banking system (Interview 7, 11).[7] This interacted with the meso-level where the institutional set-up favoured a bias towards national interests that in the case of the MMFR was exacerbated by the lateness in the legislature period allowing for strong positions of the single rule-making agents in the Parliament and in the Council (Interview 12, 5). However, rule-making agents start to get more knowledgeable and increasingly include private actors in their work for coping with the complex set up of funds and their market (Interview 7). To the contrary, regarding ABCP the closedness of the rule-making network did not allow for the acknowledgement of their specificities at the beginning making the interference of the industry later on much more difficult (Interview 13).

On the micro-level actors' strategies are directed towards the national interests. However, some actors seek a European solution, for example Italy that tried to act as an 'honest broker' and find a compromise (Interview 12). Yet these efforts are restricted by the six months' duration of its Council's presidency and the upcoming European parliamentary elections. Meanwhile a few European players, such as Italian MEPs, Commission officials and Attachés, tried to support the creation of a European regulatory agency, strengthening European rules and supervision. For example, the Commission cautiously supported a differentiation between good and bad securitization (Interview 2, 13), and formulates such a request to EBA (2015). This increasing engagement with the technicalities of the process is concomitant with an expansion of the rule-making network, including private actors closely familiar with the industry. These could explain the dynamics of MMFs and ABCPs, which are technically complex and not well replicated in any kind of public data base (Interview 9, 10, 13). Their involvement would only grow in the next phase.

Coping with technical complexity through co-habitation (3/2015–7/2016)

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

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

Meanwhile, the securitization initiative was embedded in the CMU project and openly promoted by the Commission (EC, 2015a). They relied on work undertaken by the EBA, but also publicly consulted on a possible framework. However, these proposals did 'not cover short-term securitization instruments, especially asset-backed commercial paper' (EC, 2015b: 7–8). Rather it was the industry that undertook a lot of 'educational work' (Interview 13), as for example during the hearings at EBA in 2014, to include specific requirements acknowledging the particularities of ABCP (Interview 2). For example, the fact that the maturity transformation and maturity of liabilities of an ABCP conduit differ strongly from other forms of securitization (Interview 1). Thus, EBA's (2015) final advice acknowledged that 'the current market is almost exclusively focused on real-economy-related exposures mostly financed by multi-seller conduits' (16). Thereupon the Commission published its proposal with particular criteria for ABCP (see EC, 2015b). The Council agreed in record speed (EU Observer, 2016), with only few adjustments, such as the enlargement of maturity limits for assets ABCP conduits could buy. This would have enlarged the capacity of the shadow banking chain to finance long-term credit. However, the Parliament was highly sceptical of such an approach (Interview 13).

Even though the ECON rapporteur gave industry representatives the possibility to come up with an own proposal, many MEPs were critical regarding securitization in general. This made the people by whom they were briefed key to further regulatory developments (Interview 12, 13). At this moment, this new form of co-habitation between the regulatory network and other agents involved reaches its peak. This allowed the industries' concerns about the vital investor relation of MMFs for ABCPs to be heard. Already in 2013, the industry had outlined that 'MMFs represent approximately 50% of all investments in Asset Backed Commercial Paper (ABCP) in Europe' (IMMFA, 2013: i). In addition to that, the direct link between these two reforms was underlined: 'MMFR will reduce funding of banks by MMF and impact ABCP, a key and growing source of market funding for European companies' (IMMFA, 2013: iii). These efforts, undertaken jointly by the MMF industry association and lobby groups for the ABCP market (including banks and leasing entities), lead to important lobbying successes. Thus, the final MMFR is the only regulation on European level acknowledging ABCPs as liquid assets and hence incentivizing the investment of MMFs into this asset class, turning it into an important win for the industry (Interview 13; Leaseeurope, 2018).

While the MMFR is substantially modified according to MMF industry proposals, the regulatory process to design STS securitization is opened up to appreciate the particularities of ABCPs in contrast to longer-term securitization. Apart from that, rule-makers also started to acknowledge the importance of their deeply intertwined relations for these institutions' role as channel for real economy debt. In other words, they got 'more knowledgeable' about the interlinkages within the financial system (Interview 7) and they attempted to gain 'a clearer understanding of the interaction of the individual rules and cumulative impact of the legislation as a whole including potential overlaps, inconsistencies and gaps'[8] (EC, 2015b: 4). This also happened against the backdrop of the rising discourse about the need for alternative funding models and 'overbankedness' in Europe (e.g. Langfield and Pagano, 2016; Pagano M et al, 2014).

Although the important changes in the first phase were to be found on the macro-level, in this second phase the support for a resilient market-based finance system grew. This culminated in the rediscovery of the importance of money market instruments' liquidity voiced throughout the discussion on alternative funding channel next to banks (Interview 8). Here the micro-level interaction between key actors is important: the newly elected Parliament had a new rapporteur for the MMFR favouring market driven solutions. She listened to the industry, thus aiming to 'keep the best of both worlds' (Interview 11), while several rule-making agents opened up and strongly interacted with private agents in the policy network. Consequently, the stalemate in the MMF is resolved through the LVNAV, which was altered in the rule-making network in such a way that it became politically viable (Interview 12).

However, on the institutional side, actors faced time constraints, which did not allow for a full reworking and coordination of the different negotiation stances. The European schedule of elections and EU Council presidencies also was the reason why the MMFR finally entered the trilogue negotiations at this point in time. The negotiating parties were aware that the next two Presidencies after the Luxembourgian would not prioritize the MMFR. The threatening standstill and the already long negotiation process put the Council under pressure to resolve the stalemate (iTreasurer, 2016). But while rule-makers were willing to adjust the regulation towards the market structure for an orderly flow of debt, their openness towards private agents' advice decreased at this point in time, as they were seeking to close the deal (Interview 13). Thus, it is no surprise that rule-makers and private actors could in principle align their strategies regarding ABCPs and MMF and that the fine-tuning of regulation was inhibited by the time constraint.

Final modifications and trilogue negotiations (7/2016–1/2017)

In the final phase, the trilogue negotiation took place in an environment, where the openness of the rule-making agents towards the advices of private actor's declined rapidly. Figure 5 depicts the full evolvement of the two reform processes. It illustrates how the three different phases were characterized by the way regulators tried to overcome the technical complexity by opening up to the private agents' expertise and how the openness slowly declined until in this final phase rule-makers interacted predominantly among themselves. Ultimately, timing constraints inhibited a full embrace of the market structures, letting private agents to conclude that they managed to deal with 80% of the problematic parts of the initial proposal (Interview 13).

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

For the MMFR regulation, an industry lobbyist stated, that in trying to keep up with the reality of markets, regulators worked out quite well the advantages of MMF, while in the details they did not do such a good job (Interview 7). Once it became overly politicized, it culminated in plenty details of which some might give rather 'adverse results' (Interview 7, 12) which relates inter alia to the sheer scale of the regulation (BNP Paribas, 2019). Regarding ABCPs, the regulatory refinement of regulation also was insufficient implying adverse results for the industry (Interview 1, 2, 4).[9] In general, the triloge negotiations for the STS proposal resembled a 'fish market', being not so much focused on drafting a workable regulation, but instead to find a politically viable solution. The Commission wanted a 5% risk retention instead of the Parliament's proposed 20% and the Parliament a trade repository while the Council argued for a reversal in the hierarchy of approaches for calculating capital. Notwithstanding the extreme sensitivity of the technicalities discussed for the market dynamics, the time pressure did not allow for the ultimate refinement of the different positions. It also led to actors adopting new strategies, introducing significant changes to the draft in the last minute. One prime example is the reversal in the hierarchy of accounting approaches for ABCP, which was only introduced during the trilogues (Interview 6).

Similarly, under 'a lot of political pressure to close the file' (Pension and Investments, 2016), the MMFR trilogue negotiations came to an end in mid-2017, bringing together 'elements of oversight which have previously been afforded not just by the previous regulations, but also by industry codes of praxis, rating agency requirements and prudent practices' (Treasury Today, 2017). Just like an industry representative forecasted in 2016, the few requirements that were unworkable in the initial draft had been largely removed in the process (Pension and Investments, 2016). With the design of the LVNAV funds, regulators had picked up the current market sentiments, guaranteeing that 'those going down the LVNAV route should continue to operate in a similar manner as they currently do, as they used to do, which means there will hopefully not be too much disruption to the industry'

(Treasury Today, 2017). On the downside, more complex requirements, stricter diversification rules and higher regulatory costs are likely to lead to a further concentration within the MMF market (BNP Paribas, 2019).

Taken together, the influence of the MMFR on market structures is unclear, with more critical voices describing the final text as a good starting point, however, with disappointing details. The STS is finally 'a most of, not best of' text so strict that probably no ABCP program will attain the preferential status of STS, thwarting initial intentions of rule-makers. This shows how in the final phase, everything important has been negotiated in the realm of the political, where there has been no space for co-habitation and technical reasoning but considerations such as changes in the presidency or showing the capability to act become central in shaping the negotiations. Even more, during the informal negotiation processes at the end when new policies and strategies were debated, the process was not only highly restricted to rule-making agents, excluding private agents, but it was also very fragmented between the different regulators and policymakers (Interview 3, 13).

Discussion and conclusion: Politics, time pressure and the complexity of shadow banking

The European regulation of MMF and ABCP are prime examples of the dynamics at work when the institutional and political convolutedness of Brussels meets the technicalities of finance. Even more, it shows how such processes are shaped by their timing and the prevailing political discourses. When European regulators attempted to use their newly crafted regulatory power to draft a truly European shadow banking regulation, it unveiled the diverging national visions of the future role of the financial system and their defence of home-country markets. As key member states could not agree on the future direction of the European financial system, a technical compromise was rendered impossible and led to exhaustive negotiations on the political level. In the end, the central role of the financial system to the economies (through credit creation and allocation) made questions surrounding MMFs and ABCPs a matter of national interest and its regulation was against all conventions negotiated along national lines.

It is at this point that the importance of timing and political reasoning becomes most evident. At first, there was a cautious investigation into the revival of securitization and strong support for finding a compromise for the MMFR. Yet, the latter proposal was handed over to the Council and the Parliament in a time of transition at the end of the electoral cycle with the Parliament elections forthcoming. Its partial restructuring thereafter, as well as the new president of the Commission's prioritization of growth, allowed for substantial modifications of both legislative proposals rather than the typical watering down. The learning and negotiation process that the rule-making network underwent is mirrored in the creation of the LVNAV as well as in the special treatment of ABCPs in the securitization regulations. In the wider policy network, European rule-makers more and more consulted industry representatives to design regulation that would 'sustain the orderly flow of debt' (for a similar argument, see Fernandez and Wigger, 2016). They aimed for a regulatory infrastructure that allows MMF to contribute to the 'smooth operation of the short-term financing market' (European Council (Council), 2017) and ABCPs to persist as an 'important refinancing tool for non-financial companies' (EC, 2015c: 8). However, to offset their lack of insight into the operations of both, they engaged in a public–private regulatory co-habitation (Dorn, 2016) and drew on the insights of private actors, e.g. by inviting them to workshops or consulting them directly (Interview 2, 6).

Considering the changes in the regulations, the underlying dynamics could be understood as the capture of policy actors by the industry's interests. However, this does not do justice to the agency of European rule-making agents, who in this case deliberately chose to learn from private actors about the technicalities of the markets they were seeking to regulate. Furthermore, the final results of regulations speak against the hypothesis of regulatory capture, because they were not shaped by direct industry input, but instead by the attempts of rule-makers to shape these markets. As the legislature period and the duration of the negotiations advanced, the political willingness to understand the intricacies of finance and to translate these into negotiating positions faded constantly. Whereas in the beginning of the negotiations the topics were highly politicized and led to substantial debates about the appropriate re-design of the shadow banking chain, its protracted negotiations increasingly put pressure on the rule-making network to close the deal and demonstrate its capacity to act. Thus, while the co-habitative mode between rule-making agents and private actors within the policy network enabled the modification in the first place, over time private actors became less capable of finding a sympathetic ear. This culminated in two regulations that are described as 'most of, not best of' (Interview 2), or as good starting point, however, with disappointing details (Interview 7).

While their final versions seem at first sight to be a concession to the industries and thus as a case of capturing regulatory action, they both are likely to have considerable adverse effects on the respective markets. The MMFR might not entail a bank-like regulation but a new class of funds similar to the existing market structures. However, the scope of the regulation will still place considerable burden on funds, in particular the amount of details affecting the regulatory costs for funds (BNP Paribas, 2019).[10] The STS rules at first did not even consider ABCP as a specific kind of securitization, for which reason a separate set of requirements had to be added. These then over time changed substantially, yet not necessarily to the favour of ABCPs. A first prognosis does not expect STS compliance at the program level and only half of the actual transactions (Interview 6, Interview 13).[11] These outcomes reflect how public agents' willingness to get them right were cut short by the particular time dimension of the European legislative process. While they embraced co-habitation as a way of dealing with the technical complexity, the trilogue negotiations took place solely among rule-makers under considerable pressure to demonstrate their capacity to act. Therefore, these developments cannot be explained by regulatory capture or national interests alone, but only by the prioritization of growth, as well as the political and time pressure which let rule-making agents focus on finding a viable compromise rather than the fine-tuning of regulatory rules. Taken together, we argue that the evolution of the MMF and ABCP regulation is a consequence of the mutual constitution of the micro-level strategies of actors, mediated by the institutional set-up on the meso-level and macro-discursive factors shaping the process of regulation.

Thus, we find that under Commissioner Barnier in the beginning of the process, shadow banking was treated with a certain regulatory rigor. Diverging national visions on the role of finance were intermediated by the institutionally built-in bias towards national interests in the European institutions and let agents align with national positions, leading to a policy stalemate. Over time, the shift in the macro discourse towards growth and the emphasized positive role of finance for growth led to the common European goal of creating resilient market-based finance. This shift was strongly supported by the new European Commission, which was seeking a compromise that provided for an orderly flow of debt through

European capital markets. Yet the final regulations did not allow for a successful reconstruction of the shadow banking chain. In the end, the material was too complex and full of unwieldy details, which the European policy network could not deal with in the context of a charged European legislative calendar. In this sense, our study shows how time pressure and the complexity of the material impeded the coordination necessary to reconstruct the chain. There is a certain irony to these developments: whereas European regulatory agency focusing on financial stability of capital markets is too slow, convoluted and hemmed in by contradictory visions, it is in the end in too much of a hurry for the fine-tuning of the different interlocking components of the shadow banking chain.

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Notes

1. When markets came under distress, IKB's large portfolio of securitized products that the bank had placed off balance sheet into ABCP conduits returned on the balance sheet, de facto bankrupting IKB. This return on the balance sheet was caused by the refusal to refinance them by MMFs, which were the major investors and themselves highly prone to runs (Thiemann, 2018; for an analysis of European MMFs during crisis, see Bengtsson, 2013).
2. By regulatory infrastructure we mean the legislative context consisting of single regulations and directives and their interlocking effects that allows for certain transactions to be profitable.
3. We use the term 'orderly flow of debt' in order to depict the way rule-makers increasingly understood both instruments to contribute to the financing of the real economy. However, this by no means represents the authors' personal views.
4. Unfortunately, not all of our interviewees allowed their interview to be recorded, for which reason we based our work on seven main interviews while the remainder served as sources for background information. A list of interviewees is provided in the Appendix 1.
5. Dorn illustrates these claims by giving the example of a meeting where industry representatives openly supported the idea of giving the European securities regulator more power while only five years earlier the same actors strongly opposed any new regulation (Dorn, 2016: 85).
6. While CNAV MMFs promise to always pay 1$ and thus constitute a similar like bank deposits, VNAVs have a floating value.

7. Remarkably, Luxembourg's resistance remained until the final MMFR, passed by the Council and the Parliament.
8. This for example let the Commission to publish a Call for evidence on the EU regulatory framework for financial services that aimed at analysing 'rules affecting the ability of the economy to finance itself and grow', 'Unnecessary regulatory burdens', 'interactions, inconsistencies and gaps' and 'rules giving rise to unintended consequences' (EC, 2015b: 3–4).
9. It is estimated that less than half of ABCP conduits will gain the STS label and even less of the transactions (Interview 6).
10. Throughout the first phase the bank-like capital buffers for CNAVs have been abolished, then the requirements for VNAVs were altered considerably. In the second phase, the LVNAV became a permanent fund through the abolishment of the initial sunset clause, while the eligible assets have been expanded considerably (in particular for ABCPs).
11. While the initial suggestions for STS criteria did not include specific requirements for ABCPs, they were added in the Commission's proposal and subsequently expanded throughout the trilogue negotiations in particular regarding re-securitization, risk retention and maturity limits.

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Appendix 1

1.	20 July 2016	ABCP Lobbyist, Conduit Manager	Phone interview, Germany
2.	19 October 2017	ABCP Lobbyist	Phone interview, Germany
3.	09 November 2017	European Commission	Phone Interview, Brussels
4.	13 November 2017	Credit Rating Agency	Phone interview, Germany
5.	19 January 2018	Policy Analyst	Phone interview, Brussels
6.	26 January 2018	ABCP Lobbyist, Conduit Manager	Phone interview, Germany
7.	13 February 2018	MMF Lobbyist	Phone interview, London
8.	15 February 2018	MMF Head of Research	Phone interview, London
9.	22 June 2018	MMF Specialist	Phone interview
10.	24 July 2018	Data analyst	Phone interview, London
11.	10 September 2018	MMF Lobbyist	Phone interview, Brussels
12.	03 October 2018	MEP Assistant	Phone Interview Brussels
13.	25 October 2018	ABCP/Securitization Lobbyist	Phone interview, Brussels