The Perils of International Regime Complexity in Shadow Banking: The Case of Securitisation

Lucia Quaglia (University of Bologna)

My talk and this material are based on Chapter 1 & Chapter 7 of my forthcoming book with Oxford University Press

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Chapter 1
Introduction

Shadow banking, which constitutes a huge part of the global financial system, played a crucial role in the building up and amplification of the international financial crisis of 2008 because it turbo charged that sequence of events, and it was where the financial 'weapons of mass destruction' were mostly located (Group of Thirty 2009; De Larosière et al. 2009; Financial Services Authority 2009). Despite the acknowledgement of the risks posed by shadow banking, post-crisis regulatory reforms were feeble and piecemeal. At the international level, the political leaders of the jurisdictions of the Group of Twenty (G20) (2010) tasked financial regulators gathered in the Financial Stability Board (FSB) and other international standard-setting bodies to 'strengthen the oversight and regulation of the shadow banking system' and regulators worked on this matter for several years. Yet, the results were underwhelming and the international governance of shadow banking remained weak. Indeed, in the context of the covid-19 economic crisis, there are growing concerns about this important part of the financial sector.

This book argues that the main reason for this disappointing outcome is the international architecture for shadow banking governance, which is a 'regime complex' characterized by the presence of multiple institutions and elemental regimes governing a set of related issues (Alter and Meunier 2009; Alter and Raustiala 2018; Keohane and Victor 2011; Johnson and Urpelainen 2012; Pratt 2018, 2019). Indeed, shadow banking is a quintessential case for demonstrating the perils of international regime complexity,[1] which compounds problems that arise in 'silos-like' regimes, while splintering solutions. This research goes further than the existing literature in showing the negative effects of international regime complexity, explaining why it is a problem and what could be done about it. The crux of the argument is that regime complexity magnifies problems that are endemic in governing global finance – namely, interstate competition, disagreement between technocratic bodies, and the power of the financial industry - while splintering solutions, due to the fragmentation of regulatory authority. As illustrated in this book, the interplay of states, regulators, and private actors produced a 'game of shadows' concerning the definition, monitoring, and regulation of shadow banking. The playing out of such a game was facilitated by international regime complexity, which produced a multi-dimensional chessboard.

There is not a universally agreed definition of shadow banking and even the term 'shadow banking' is contested and is often accompanied by an explanatory footnote, as discussed in Chapter 3. By and large, shadow banking refers to the system of credit intermediation that involves *entities* and *activities* outside the traditional banking system. It includes entities that raise funding with deposit-like characteristics; perform maturity and/or liquidity transformation; engage in credit risk transfer; and use direct or indirect leverage (FSB 2011a,b). These entities include: money market funds (MMFs);[2] investment funds that provide credit or are leveraged, such as hedge funds[3] and private equity funds;[4]

[1] I borrowed this expression from Drezner (2009).

[2] MMFs are a type of mutual funds that invest in high-quality, short-term debt instruments.

[3] Hedge funds are highly leveraged funds that pool investors' funds and engage in complex portfolio-construction, using high risk - high return strategies.

[4] Private equity funds resemble venture capital firms because they invest directly in companies. Once they acquire or control a company, private equity funds restructure it with the goal of selling the company for a profit.

securitization[5] vehicles, such as special purpose vehicles,[6] structured investment vehicles,[7] and conduits.[8] A member of the Federal Reserve Board, Daniel Tarullo (2016a), noted that the integration of traditional bank lending and capital markets is most clearly in evidence in shadow banking, albeit in different ways.

The shadow banking system grew considerably in the run-up to the international financial crisis of 2008 also due to its competitive advantages over the traditional banking system. In fact, before the crisis, shadow banking was for the most part outside the perimeter of public regulation and oversight, although there was variation across countries (Thiemann 2018, 2014). The shadow banking system was one of the main culprits of the crisis and some commentators considered the international financial crisis as a bank run on shadow banks (Krugman 2009), or a bank run through the back door (Engelen 2018), especially in the repo market (Gorton 2010; Gorton and Metrick 2009, 2010). Thus, from 2009 onwards, there was a concerted effort to monitor and regulate various aspects of shadow banking. At the international level, the reform of financial regulation, including shadow banking, was discussed by the political authorities (i.e. national governments) in the G20 (Viola 2014, 2015). It was followed by 'soft laws' (Brummer 2015; Zaring 2020), that is to say, international standards[9] issued by various transgovernmental fora of domestic financial regulators (Bach and Newman 2010, 2014; Newman and Posner 2018). A vast array of international financial standard-setting bodies as well as non-financial standard setters, such as the International Accounting Standards Board (IASB), were involved in the post-crisis regulation of shadow banking (see Figure 1.1) and several standards were jointly issued by these bodies, as elaborated in the following chapters.

The result was an over-crowded regulatory space and an international regime complex, whereby international standards were issued concerning shadow banking entities, activities as well as traditional banks that interacted with shadow banks (see Figure 1.1). These standards were part of elemental regimes, partly 'nested', partly 'parallel', partly 'interlinked', which are not hierarchically ordered, as elaborated in Chapter 3. Regime complexity, which has become a prominent phenomenon in world politics and the global economy (Henning 2017; Pratt 2018), increased considerably in finance after the crisis of 2008, in particular in areas that previously were not subject to regulation and dealt with several cross-cutting issues, such as shadow banking.

[5] Securitization is the process whereby certain types of assets (such as mortgages, or credit card obligations) are pooled so that they can be repackaged into interest-bearing securities (Jobst 2008; for further details see Chapter 7).

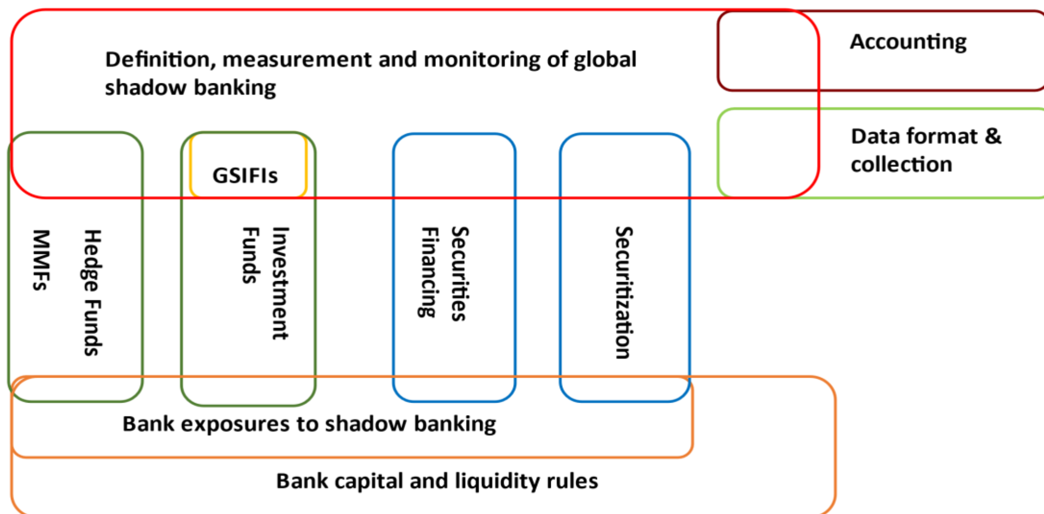
[6] A special purpose vehicle, also referred to as special purpose entity, is a bankruptcy-remote subsidiary of a company that may be used as a holding company for the securitization of debt.

[7] A structured investment vehicle is a pool of investment assets that seeks to profit from credit spreads between short-term debt and long-term structured finance products, such as asset-backed securities.

[8] Conduits involve the use of special purpose vehicles by banks and other financial institutions to raise short-term funding.

[9] According to the FSB (2018a), international standards set out 'principles, practices, or guidelines in a given area'.

Figure 1.1 Overview of the post-2008 crisis international shadow banking regime complex



Research Questions and Research Design

The magnitude of financial assets in the shadow banking system, its relatively loose regulation and oversight (especially if compared to the 'traditional' banking system), and its interconnectedness with the banking system contribute to systemic risk. Whereas other parts of the financial sector, such as banking and derivatives, were subject to significant international and domestic regulatory reforms after the international financial crisis of 2008, the governance of shadow banking remained feeble, especially at the international level, and became somewhat less stringent as time passed by, as documented in the following chapters. This is rather puzzling, given the vast size of the shadow banking system, its cross-border nature, the danger of regulatory arbitrage, and the risks it poses for financial stability. Such risk can go undetected and unmanaged in shadow banking.

The shadow banking grew dramatically in the run-up to the financial crisis of 2008 - it even briefly overtook the traditional banking system in the United States (US) (Financial Crisis Inquiry Commission 2011) - and began to grow again, especially in Europe and in large emerging economies (first and foremost, China), a few years after the crisis. According to the most recent data, the 'narrow measure' of global shadow banking (for various definitions and measurements of shadow banking, see Chapter 4) is estimated at $51 trillion, around 75% of the gross domestic product of all jurisdictions of the G20, including the euroarea as a whole (FSB 2019a). Furthermore, shadow banking, like derivatives (which also played a major role in the building up of the 2008 crisis), has a strong cross-border dimension, which would have called for robust international governance to safeguard the 'common good' of financial stability as well as the 'levelled playing field' across jurisdictions (Kapstein 1989; Singer 2007). Yet, this was not the case. Why?

Theoretically, this book brings together the literatures on the regulation of finance in international political economy and regime complexity in international relations. From the literature on international standard-setting in finance, this research teases out three sets of actors - states, regulators, and private actors - and several pathways through which they influenced the governance of shadow banking after the 2008 crisis. From the literature on regime complexity, this research takes the perspective of analyzing the making of several international standards concerning various aspects

of shadow banking at the same time, examining how they interact with one another, rather than looking at each of them in isolation, and spelling out the governance challenges in a regime complex (see also Quaglia 2020).

Methodologically, this research is operationalized, first, by distinguishing various elemental regimes concerning different aspects of shadow banking, namely: international standards for defining, measuring, and monitoring global shadow banking; international standards for shadow banking entities, including MMFs, hedge funds, and investment funds; international standards for shadow banking activities, such as securitization, securities lending, and repos; international standards for bank capital exposures to shadow banking. For each elemental regime, this book investigates the international standard-setting processes, teasing out the key issues at stake, the preferences of states, regulators, and private actors as well as the pathways through which they exerted influence. Furthermore, the elemental regimes and their dynamics are compared and contrasted in the penultimate chapter. Overall, the book discusses the making of more than a dozen standards (principles, guidelines, etc.) from the peak of the international financial crisis in late 2008 to the present (see Figure 3.1). To do so, it relies on a variety of sources, including a systematic survey of press coverage, policy documents, responses to consultations, and confidential semi-structured elite interviews.

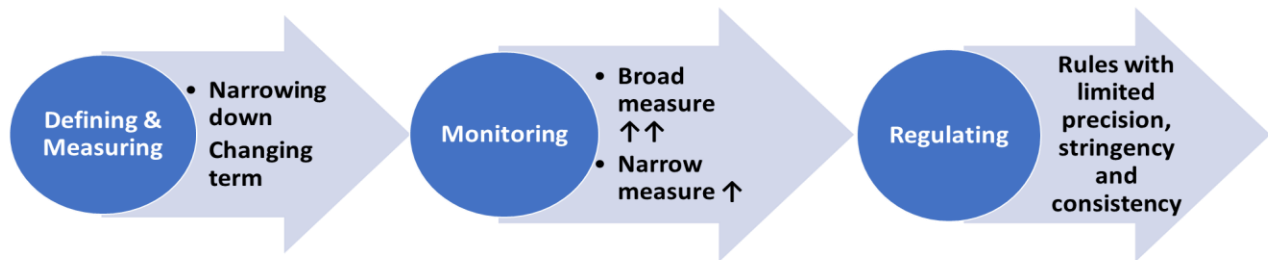
Overall Argument

This book identifies a 'game of shadows', which unfolded in consecutive and recursive steps concerning the definition, monitoring, and regulation of shadow banking internationally (see Figure 1.2). In a real-life game of shadows, the casting of selective light in different directions also moves the shadows in different ways, failing to illuminate the entire picture.[10] Likewise, states, regulators, and private actors tended to cast light away from various parts of the shadow banking system – which was portrayed as 'something else', 'somewhere else' (Palan and Nesvetailova 2014). Thus, shadow banking was (re)fined over time, its measurement was narrowed down, lessening the (perceived) need for regulation.

The first step in the game of shadow concerned the *definition* of shadow banking, which was narrowed down over time, several entities and activities fell outside its scope, and eventually, the very term disappeared and was replaced by non-bank financial intermediation and market-based finance (which had fewer negative connotations). This had implications for the second step in the game of shadow, namely, the *measuring* and *monitoring* of global shadow banking, whereby the broad measure was complemented and, eventually, supplanted by a narrow measure. Whereas the broad measure increased considerably over time in the post-crisis period, the narrow measure did not increase to the same extent, underestimating the potential risks that shadow banking entailed and, thus, the need for regulation. In turn, the definition and monitoring had implications for the third step, the *regulation* of shadow banking, which was selective - international rules did not focus on entities and activities that were considered outside the scope or at the margins of shadow banking; and remained rather 'thin' - international rules were partly hollowed out or watered down over time, whereas important issues remained off the agenda. Overall, the post-crisis international governance of shadow banking was rather feeble because international standards for shadow banking entities and activities had limited precision, stringency, and consistency, even though there was variation across elemental regimes.

[10] In one of her novels, the science-fiction writer Ursula K. Le Guin wrote that 'When you light a candle, you also cast a shadow', a metaphor used by Greene and Broomfield (2013) with reference to shadow banking.

Figure 1.2. International shadow banking governance and the game of shadows



The playing out of the game of shadow by states, regulators, and private actors was facilitated by international regime complexity, which produced a multi-dimensional chessboard. Regime complexity compounded problems that are endemic in regulating global finance: interstate competition (that is, conflicts among jurisdictions); competition between financial regulatory bodies (that is, conflicts among technocrats), and the power of the financial industry, which mobilises across multiple levels and venues. At the same time, it hindered problem-solving and the quest for policy solutions due to the fragmentation of regulatory authority across elemental regimes, meaning that no actor was in the driving seat, several of them worked at cross purposes, whereas a focal coordinating institution was missing in the complex. The analysis of the international governance of shadow banking through the prism of regime complexity has considerable value-added because it allows us to consider the interplay of a variety of actors in an international institutional architecture characterised by the lack of hierarchy, the multiplicity of regulatory venues, combined with gaps, overlaps, and interlinkages across elemental regimes. Moreover, since the key players – states, regulators, private actors – participate in all the elemental regimes of the complex at the same time, their influence can be gauged only by looking at the complex as a whole, as well as its individual components.

Structure and Content of the Book

The structure of the book is as follows. Chapter 2 discusses the state of the art, the research design, and the methodology, outlining the scope of the research, the timeframe, and the empirical coverage. Chapter 3 examines the international shadow banking regime complex, delineating the institutional architecture for the governance of shadow banking and the elemental regimes of the complex. Chapter 4 provides several definitions and measurements of shadow banking and maps the evolution of its global monitoring after the international financial crisis of 2008.

Chapters 5, 6, 7, 8 examine the post-crisis regulation of shadow banking entities and activities, as well as the link between traditional banking and shadow banking. These chapters follow a similar structure, whereby each chapter begins by discussing the key issues at stake in the regulation of a given aspect of shadow banking (e.g. investment funds, securities financing, securitization) and then explains the influence of states, regulators, and private actors in the international standard-setting process and the regulatory outcomes. Specifically, Chapter 5 examines the international standards for shadow banking entities: MMFs, hedge funds, and investment funds. Chapter 6 examines international standards for securities lending and repos. Chapter 7 examines international standards for securitization. Chapter 8 examines international standards for bank exposures to shadow banking. The penultimate chapter engages in a comparative cross-cutting assessment of various elemental

regimes in the shadow banking complex, spelling out the perils of regime complexity and putting forward some policy recommendations. The concluding chapter summarises the main findings, discusses how they contribute to the literature, and teases out some open issues concerning shadow banking.

The empirical chapters offer a complete picture of the post-crisis regime complex on shadow banking, rather than examining only certain parts, which would only provide a piecemeal view of the regulatory reforms undertaken. However, there is a trade-off between the broad scope of the research and the limited amount of detail that can be examined on specific issues. For this reason, although international standards produce domestic changes, feedback effects (Newman and Posner 2018, 2016a,b) and compliance problems (Chey 2006, 2007, 2014; Mosley 2003, 2010; Quaglia 2019; Walter 2008), these are beyond the scope of this research.

Chapter 7
Securitization
A Problem or a Solution?

Besides securities lending and repos, which have been discussed in the previous chapter, another set of international discussions concerning shadow banking activities focused on securitization. Securitized products were major culprits of the 2008 international financial crisis in the US and, to a lesser extent, in the EU, which were the main markets for securitization. In the wake of the crisis, international bank capital requirements for securitized products were increased. These regulatory measures, together with market reactions, led to a steep decline in securitization. From 2015 onwards, however, there were attempts to re-launch 'simple, transparent and standardised securitization' in Europe, as an alternative source of funding for the real economy, in addition to bank lending. This effort was reflected internationally, whereby international criteria for 'simple, transparent and comparable securitization' were jointly issued by the BCBS-IOSCO, while bank capital requirements for this type of securitization were lowered by the BCBS.

The first factor that affected the international governance of securitization was pace-setting by the main jurisdictions, which, however, inverted roles over time. In the aftermath of the 2008 crisis, the US, which worried about the financial stability implications of securitization, sought to curb this financial activity, sponsoring higher capital requirements for banks that engaged in securitization. As time went by, jurisdictions in Europe worried about the opposite problem, that is to say, the relatively low level of securitization, which came to be considered as an alternative source of funding. Hence, the EU and the UK sponsored international criteria for safe[11] securitization and lower capital requirements for banks that engaged in securitization.

Puzzling among financial regulators contributed to the swings of the regulatory pendulum. Initially, regulatory agencies, especially in the US, considered securitization as a problem to be addressed. Hence, they favoured the trading up of rules. Later on, regulators, especially in the EU and the UK, came to regard securitization as a solution to the problem of providing credit to the real economy and reinvigorating capital markets. Furthermore, there was some turf fighting among sectoral regulators because banking and securities market regulators paid attention to different aspects of securitization, which also has implications for the monetary policy of central banks. Yet, compared to other shadow banking elemental regimes (notably, those on investment funds and securities financing), disagreement among domestic regulatory agencies and the international standard-setting bodies they were members of, was limited.

The third factor that affected the international governance of securitization was lobbying by the financial industry, which strategically articulated the self-serving narrative about the (potential) benefits of securitization and sought to forge an alliance with private actors in the real economy, unlike in the case of the elemental regime on shadow banking entities (see Chapter 5). Moreover, financial associations and companies mobilized in several regulatory venues, vertically and horizontally, to pursue their goals. In particular, they reached out to European regulators and elected officials, which were rather sympathetic to the views of the securitization industry because they were eager to develop this market in Europe. The financial industry also used the international debate on securitization as a way to influence international standard-setting on bank capital to make these rules less stringent – it was a notable instance of venue shopping.

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[11] Initially, regulators used the term 'safe' or 'high quality' securitisation. Afterward, they preferred to use the term 'qualifying' (i.e. 'simple', 'standard' and so on) securitisation in order not to attach a 'quality' label to securitised products.

Main Issues in the International Governance of Securitization

Securitization is a process in which certain types of assets are pooled so that they can be repackaged into interest-bearing securities (IOSCO 2012c). The buyers of these securities receive the cash flows from the underlying assets, and can use the securities as collateral in wholesale funding markets (Gabor 2016a). Through securitization, a bank transforms its (usually) illiquid assets, traditionally held until maturity, into marketable securities by pooling these assets and transferring them into a special purpose vehicle, a bankruptcy-remote entity that, in turn, finances the purchase through the issuance of securities backed by the pool (generally referred to as asset-backed securities) (IOSCO 2012c).

In the run-up to the international financial crisis, the size of securitization markets increased considerably, driven both by supply and demand. On the supply side, securitization allowed banks to convert illiquid loans into marketable securities, freeing capital for other investments (Casu, Clare, Sarkysian, Thomas 2011). On the demand side, the growth of securitization was fuelled by the growth of asset management funds and institutional investors, which were keen on investing in highly rated debt instruments. In the US, the outstanding volume of securitization more than tripled from approximately $3 trillion in 1996 to approximately $10 trillion in 2007. In Europe, the annual securitization issuance soared from less than $100 billion in 1999 to $1.2 trillion in 2007, most of which comprised residential mortgage-backed securities (Buchanan 2017).

Securitization changed the role of banks as financial intermediaries. The traditional 'originate-to-hold' model, whereby banks originated loans and then held them on their balance sheet until maturity, became the 'originate-to-distribute' model, where loans were pooled and sold to outside investors. Thus, securitization blurred the boundaries between loans and bonds and fragmented banks' traditional role as intermediaries into several specific functions, increasingly outsourced to specialized non-bank financial entities (Cetorelli, Mandel and Mollineaux 2012). In addition, securitization increased the reliance of banks on capital markets as a source of finance. Banks expanded their funding sources, moving away from retail deposits to include bonds, commercial paper, and repo. Other securitized products that boomed in the pre-crisis period were asset-backed securities and structured investment vehicles.

From the early 2000s onward, the creation of collateralized debt obligations departed from the traditional securitization model because these instruments were backed by heterogeneous assets, including high yield bonds, leveraged loans, and tranches of other securitizations. Before the crisis, policy-makers endorsed securitization as a way of parcelling out risk in the financial system. For instance, the BCBS (2004a: 8) noted that 'securitization is important in helping to provide better risk diversification and to enhance financial stability'. With specific reference to the securitization of mortgage finance, the IMF (2006, Chapter 2) argued that it provided a steady source of funding, reducing the volatility of the provision of housing credit, and contributed to moderating credit cycle dynamics. Nonetheless, the originate-to-distribute model created misaligned incentives between banks and investors because low-quality loans were securitized and since loans could be sold, lenders lacked incentives to screen and monitor borrowers. Securitization weakened lending standards and fuelled the subprime mortgage crisis (Dell'Ariccia, Igan, and Laeven 2012).

In the run-up to the 2008 crisis, securitization became increasingly complex and opaque, with poor quality of underwriting standards, over-reliance on credit ratings, and absence of retention requirements. Bank capital requirements were low and there was a lack of disclosure requirements on banks' exposures to securitization, coupled with accounting rules that allowed many exposures to

be held off-balance sheet (Bank of England and ECB 2014b). During the crisis, financial institutions were unable to assess the value of securitized instruments, and stopped accepting them as collateral. This led Malcom Knight (2008), general manager at the BIS, to ask whether securitization was the proverbial 'dog that was wagged by its own tail',[12] that is to say, whether the realization of 'tail risks' wagged the 'dog' of securitization to the point where it was no longer a useful element of the financial system. Or, whether the weaknesses that emerged during the crisis were due to how securitization was implemented.

After the 2008 crisis, several issues concerning the regulation of securitization needed to be addressed. First, there was the need to reduce complexity, given the riskiness posed by re-securitization. Fewer re-securitizations and shorter securitization chains would reduce complexity and better align incentives. Second, better information and more disclosure were needed, for instance, on the nature and performance of the assets underlying securitized products. The relevant information should be standardized to be easily comparable across assets and jurisdictions, to rely less on credit ratings.[13] The specific questions to decide upon were what needed to be reported, to whom, and how it should be disclosed.

Third, loan underwriting standards needed to be strengthened. The originate-to-distribute model - whereby assets were originated to be securitized - posed significant risks that were not adequately controlled by the market. There was a wrong incentive structure, whereby financial rewards encouraged participants to lower their underwriting standards on the securitized assets. In fact, if originators did not retain an interest in the asset pool (the originate-to-distribute model), they did not have sufficient incentives to ensure that lending standards, and by extension, the asset pool, were of appropriate quality (IOSCO 2012c; Joint Forum 2011). One way to correct the flaws in the originate-to-distribute model was to revise the incentive structure in the securitization value chain. Credit retention requirements— also known as 'skin in the game' — would better align the incentives of originators and investors (Adrian, Ashcraft, Breuer and Cetorelli 2019). The specific questions to decide upon were the party on which obligations were to be imposed (i.e. direct and/or indirect regime), the forms of risk retention (e.g. vertical, horizontal, etc.), and the exceptions or exemptions from risk retention requirements.

Finally, given the fact that banks were often both arrangers of and investors in securitized instruments, there was the need for adequate capital requirements for securitized products and off-balance-sheet vehicles as well as the revision of the regulation of the banks' trading books. Hence, the regulations of securitization and banking were interlinked. In the wake of the crisis, bank capital requirements on securitized products were increased, given the concern about the potential risks involved in securitization. Once securitization was relaunched five years or so after the 2008 crisis, bank capital requirements on safe securitization were lowered. Here, the issues to decide upon were the calibration of bank capital requirements for safe securitization and the criteria for securitization to qualify as safe for regulatory capital purposes.

Main Actors in the International Governance of Securitization

Pace-setting by the main *jurisdictions*, first and foremost, the US, whose securitization market had been badly hit by the 2008 crisis, accounts for the initial tightening of international standards for bank capital rules on securitization. However, in the wake of the crisis, neither the US nor the EU sponsored

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[12] This expression is used to describe a situation in which a small or unimportant part of something becomes too important and controls the whole thing.

[13] Alternatively, there could be to have a distinctive rating system for structured finance instruments.

international standards for securitization as such, for instance, rules on retention, disclosure, and transparency. Rather, these jurisdictions preferred to issue domestic rules, not least because the main originators of securitization were based in the US and the EU, hence, it was felt that domestic rules in these jurisdictions would suffice to tackle the problem. Moreover, the timing was of the essence and domestic regulatory reforms are generally quicker than setting international standards. In the aftermath of the 2008 crisis, loan underwriting standards were strengthened in both the US and the EU; information disclosure requirements were increased; and the scope of prudential consolidation was expanded, requiring banks that sponsored securitization vehicles to hold regulatory capital against these exposures. Credit retention requirements— also known as skin in the game — were introduced to better align the incentives of originators and investors (Adrian and Ashcraft 2012). However, a few years after the crisis, the EU and the UK were pace-setters in sponsoring international standards for 'safe' securitization as well as less stringent bank capital rules for securitization. Let us elaborate on these points in detail.

In the US, the Dodd-Frank Act (2010) imposed new requirements on asset-backed securities. Specifically, it prohibited conflicts of interests and prescribed rules on risk retention, disclosure, and reporting. In 2011, the SEC adopted rules requiring issuers to provide additional information, conduct reviews of assets underlying securitized products, and disclose those reviews. In 2014, the SEC revised the rules governing the offering process, disclosure, and reporting for asset-backed securities, setting data format standards for issuers to facilitate comparison among asset classes and to disclose asset and loan-level information.[14] In 2014, the SEC, the Office of the Comptroller of the Currency, the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, and the Federal Housing Finance Agency issued joint rules requiring mandatory risk retention. These rules required a flat 5% risk retention for all asset classes, except for securitization involving so-called 'qualified residential mortgages' for which the risk retention level was zero (Morgan Lewis 2018). US banking regulators also increased the risk weight on capital requirements for securitization held in the bank's trading book.

The securitization industry in the US sought to push back against these domestic reforms. For instance, in a public hearing before Congress, the American Securitisation Forum argued that tighter rules for safer securitization in the US threatened to make this business 'unviable' and 'suffer death by 1000 cuts' (*Financial Times,* 19 May 2011).[15] Later on, when US banking regulators increased risk weight on bank capital for securitization, Tim Ryan, Chief Executive of the Securities Industry and Financial Markets Association, noted that the main issue was not the risk weight per se, but rather the difference between countries (*Financial Times*, 30 Jan 2012).[16] Thus, the US, initially, had an incentive to act as a pace-setter concerning international bank capital rules for securitization, to preserve a levelled playing field for the US financial industry and reduce negative externalities ensuing from less stringent rules in other jurisdictions.

The US market was larger and more sophisticated (meaning, with more complex and opaque products) than the market of other jurisdictions, including that of its main counterpart, the EU. After the 2008 crisis, the US securitization market bounced back more quickly than that in the EU for several reasons. The US securitization market was underpinned by Fannie Mae and Freddie Mac, two government-backed mortgage companies, and the Federal Reserve had $1.7 trillion in mortgage-backed securities on its balance sheet as a result of its bond-buying programme. Furthermore, large

[14] https://www.sec.gov/news/press-release/2014-177

[15] Tom Deutsch, Executive Director of the American Securitization Forum, cited in *Financial Times,* 'Bankers warn US securitization reform is 'death by 1,000 cuts'' by van Duyn, A., 19 May 2011.

[16] *Financial Times*, 'New capital framework 'biased against US' by Braithwaite, T., Masters, B., 30 January 2012.

investors, such as insurers and pension funds, were buyers of asset-backed securities in the US. While the kind of subprime mortgage-backed securities that played a prominent role in the build-up to the 2008 financial crisis remained dormant, other types of securitization rebounded thanks to investors' quest for yield (Nassr and Wehinger 2015).

In the EU, there was a backlash against securitization in the wake of the international financial crisis of 2008, even though, during the crisis, securitized products in Europe performed much better than those in the US. Of more than 9000 European asset-backed securities issued before 2008, only 2% defaulted, compared with about a fifth of US asset-backed securities (*Financial Times*, 5 June 2014).[17] In 2009, the EU Capital Requirements Directive III was amended to forbid banks from taking on exposure to a securitized product, unless the original lenders had committed to retaining a material net economic interest (i.e. skin in the game) not less than 5%. In 2013, the Capital Requirements Directive IV included higher capital provisions for securitized products as well as requirements for risk retention and due diligence.

Following market reactions and more stringent public regulation, the level of securitization dropped significantly in the EU, also because banks preferred to tap central bank facilities for funding. At the same time, the collateralized debt obligations that caused considerable damage during the 2008 crisis largely disappeared and synthetic securitization, which used derivatives to replicate credit, remained limited (*Financial Times*, 9 May 2013).[18] As time went by, the problem in Europe, which suffered very low economic growth and had to deal with the sovereign debt crisis, became how to revive securitization in an attempt to boost economic recovery, while safeguarding financial stability (Montalbano 2020).

Thus, the EU and the UK engaged in concerted *pace-setting* to reform the regulation of securitization by increasing the transparency and standardization of securitized products, while reducing bank capital requirements for less risky securitization (Quaglia 2021). In May 2014, the Bank of England and the ECB jointly published a joint paper regarding the impaired securitization market in the EU. At the same time, the EBA (2014) issued a discussion paper on simple and transparent securitization. The ECB, the European Banking Authority, the Bank of England, and the European Commission were keen on assuaging public concerns about securitization, which had a bad reputation as a consequence of the crisis (Braun 2020; Braun, Gabor and Hubner 2018).

Subsequently, securitization became a key component of the project for Capital Markets Union in Europe, proposed by the European Commission (2015) with the support of the member states, first and foremost, the UK, France, and Germany (Quaglia et al. 2016). The Commission was eager to ‘harness financial markets as macro-economic stabilization tools’, while ensuring fiscal discipline at the EU level (Braun and Hübner 2018). Hence, the Commission openly endorsed existing market-based initiatives to develop safe securitization. In 2015, two legislative proposals concerning securitization were put forward by the Commission as part of a broader set of initiatives concerning Capital Markets Union. First, a regulation on securitization set criteria to identify ‘simple, transparent and standardised’ securitization – this was the expression used in the EU. At the same time, the regulation on capital requirements for banks was amended to make the capital treatment of safe securitization more risk-sensitive (i.e. less stringent) for banks and investment firms. These pieces of EU legislation were eventually adopted in 2017.

[17] *Financial Times*, by Alloway, T., Thompson, C., 5 June 2014.

[18] *Financial Times*, ‘ECB's Draghi in drive to revive slicing and dicing: News analysis’, by Atkins, R., 9 May 2013.

The emphasis on securitization was due to the fact that Europe had a bank-based financial system, whereby securitization could be used by banks to increase lending to the real economy without increasing their capital requirements. However, the relaunch of securitization was also to encourage small and medium enterprises to bypass banks by securitizing their own assets and selling them on corporate debt markets (Quaglia et al. 2016). Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union, repeatedly pointed out that EU initiatives on securitization were part of a broader international effort. In fact, in parallel to the discussions on Capital Markets Union and the re-launch of securitization in the EU, the BCBS-IOSCO consulted on criteria for simple and transparent securitization and the BCBS considered how to incorporate these criteria in its revised Securitization Framework. The reforms concerning the criteria for securitization and bank capital requirements for securitization were interlinked, as elaborated in the following section.

One form of leverage that the EU and the UK deployed in their international pace-setting efforts was the argument that international standards on safe securitization and related bank capital rules were needed to protect the levelled playing field and avoid global market fragmentation resulting from different regulatory approaches (*Financial Times*, 6 January 2016).[19] Initially, the EU's plan to boost its securitization market through regulatory changes envisaged that this securitization had to originate in the EU, raising the question of whether European investors would be discouraged from buying products originated elsewhere, in particular those created in the US. Moreover, while the EU legislative proposal would reduce capital requirements for European investors, similar requirements for US-based investors would not be reduced because those standards were set by the US (*Financial Times*, 6 January 2016).[20] Given these premises, the US had then an incentive to support international standards on these matters.

Puzzling and *turf fighting* involved central bankers, banking regulators, and securities markets *regulators,* who sought to understand the risks that securitization entailed as well as how to tackle those risks. In turn, problem-definition and problem-solving concerning securitization depended on the regulatory outlooks, mandates and competences of sectoral regulators. Thus, macroprudential regulators (generally, central bankers) led the discussion on the financial stability risks related to securitization. Banking regulators dealt with bank capital rules for securitization. Securities markets regulators discussed disclosure and retention requirements. Central bankers also paid attention to the implications of securitization for their monetary policy.

In the wake of the crisis, central bankers and banking regulators called for 'new standards applicable to securitization activities that would better align the incentives faced by market participants involved in the various stages of the securitization process' (Bernanke 2010) – these rules, however, were to be set by securities market regulators. As Paul Tucker (2010) at the Bank of England noted, 'when the music stopped … investors and savers could not tell sound asset-backed securities from unsound ones. So, one lesson must surely be that securities regulators and exchanges, which admit asset-backed securities to the listing, should set more exacting but also simpler standards for transparency'. The ECB advocated greater transparency and disclosure in securitization markets, noting that investors needed to get access to relevant information to be able to exercise the required due diligence. Banking regulators worried about the risk that securitization involved for banks, but also considered securitization as a potential way for banks to diversify risks. Thus, they were aware of the trade-off

[19] *Financial Times,* 'EU and US split over securitisation: Capital markets' by Brunsden, J., Hale, T.,, 6 January 2016.
[20] *Financial Times,* 'EU and US split over securitisation: Capital markets' by Brunsden, J., Hale, T.,, 6 January 2016.

between the risk posed by securitization and its function as an important tool for bank funding and liquidity (*Financial Times*, 19 December 2012).[21]

Securities market regulators called for more transparency, disclosure, and better underwriting standards in securitization. In the wake of the crisis, the SEC noted that US securities laws were outdated and new legislation was needed on securitization (*Financial Times*, 27 October 2009).[22] Mary Schapiro (2010), the Chair of the SEC, pointed out that two things had to change after the crisis: investors needed better information about the pooled assets that backed securities; and the interests of organizations that issued and sponsored these securities had to be better aligned with the interests of investors. In a later speech, she noted that 'many originators were not accountable for the loans they made, loosening underwriting standards and passing off the entire credit risk to investors through securitization' (Schapiro 2011).

Among US regulatory agencies, there were some disagreements on retention requirements. Thus, the Federal Deposit Insurance Corporation supported the 5% risk retention requirement and Michael Krimminger, the Deputy to the Chairman for Policy at the Federal Deposit Insurance Corporation, argued that retaining some of the risks of the loan on the balance sheet would realign incentives. By contrast, John Dugan, a senior official at the Office for the Comptroller of the Currency, suggested that a better approach would be for regulators to set minimum loan standards (*Wall Street Journal,* 29 Mar 2010).[23] Whereas the SEC, as a whole, supported the introduction of retention requirements, some SEC commissioners disagreed with this choice, which was portrayed as a tool favoured by prudential banking regulators. For instance, Commissioner Piwowar (2016a) noted that

> Rather than carefully examining the attributes of specific types of securitization to determine an optimal credit risk retention rate for each asset class, prudential regulators simply set it at the maximum statutory rate. Perhaps the prudential bureaucrats had their own conflict of interest in setting these requirements because prudential bureaucrats have a strong interest in self-preservation. Will a prudential bureaucrat get credit if optimally tailored risk retention rates increase economic growth and provide additional opportunities to families and businesses? No. Will a prudential bureaucrat take the blame if the next financial crisis – and there will be one eventually – relates at all to securitizations? Probably. Hence, what better way to side step responsibility than to refrain from using reasoned judgment and rely solely on the most risk-averse interpretation of statute instead?'

The epistemic debate on securitization evolved over time, and had different nuances across jurisdictions. Initially, securitization was framed as a problem that required more precise and stringent rules. Five years or so after the 2008 crisis, securitization came to be framed by regulators in the EU and the UK (as well as by the financial industry) as a potential solution to economic problems (Engelen 2018). The European Commission, the EBA, the ECB, the Bank of England noted that during the crisis defaults and losses associated with securitization varied substantially across asset classes and regions. Hence, the 'trick' was to get the 'right type' of securitization.

Central bankers in Europe were also keen to revive securitization because they partly relied on it for the conduct of their monetary policy (Braun, Gabor, and Hübner 2018; Braun 2020; Braun and Hübner 2018; Braun and Gabor 2020). The ECB was particularly interested in the asset-backed securities market, which acted as one of the transmission channels of the monetary policy of the ECB.[24] Thus, the ECB's support for favourable capital treatment for safe securitization was seen as necessary to restore the liquidity of this market. The ECB was also keen on relaunching securitization

[21] *Financial Times,* 'Banks face stricter capital rules for securitisations' by Masters, B., 19 December 2012

[22] *Financial Times*, 'The SEC head urges fresh securities laws' by Scholtes, S., van Duyn, A., 27 October 2009.

[23] *Wall Street Journal*, 'Securities Debate Is All About Trust' by Simon, R., Scannell, K., 29 March 2010.

[24] Asset-backed securities were an important component of the collateral framework of the Eurosystem.

to transfer risk away from the banking sector, freeing up bank capita to extend new credit to the real economy. As early as 2010, José Manuel González-Páramo (2010), a member of the Executive Board of the ECB, gave a speech entitled ‘Re-starting securitization’, calling for the development of transparent, comparable, and simple securitization structures, based on high-quality standards of underlying assets.

Like the ECB, a few years after the crisis, the Bank of England sponsored the relaunch of securitization on the ground that banks could use securitization to diversify their funding and transfer risk on underlying loans and non-banks could also finance lending through securitization (Rule 2015). A senior official at the Bank of England and co-chair of the BCBS-IOSCO Task Force on Securitization, David Rule (2015) noted that banks and non-banks could use securitization to help match the maturity of their liabilities to their assets. However, this market needed to be ‘based on genuine risk transfer, not regulatory arbitrage, such as synthetic sales of thin mezzanine tranches intended to maximize the reduction in regulatory capital at minimum cost’.

An early intuition of the Bank of England and the ECB was that lack of transparency acted as an obstacle to the revitalization of the securitization market (Mersch 2017). In a nutshell, the Bank of England and the ECB (2014a)[25] argued that the potential benefits of securitization depend on its purposes: it could be used to fund assets, to transfer risk, or both. Hence, this market had advantages, but also posed potential risks to financial stability. For these reasons, the involvement of regulators was ‘desirable’ to ‘support its revitalization in a more robust form’. Both the Bank of England and the ECB argued in favour of lowering capital requirements for safe securitization on the grounds of its lower risk (see, for instance, Rule 2015). Yves Mersch, a member of the ECB's Executive Board, was critical of the high capital requirements for securitization set in the wake of the 2008 crisis, which was calibrated on the worst-performing securitized products. He likened this move to ‘calibrating the price of flood insurance on the experience of New Orleans for a city like Madrid’ (*Financial Times*, 1 Oct 2014).[26]

Braun (2020) points out that the infrastructural entanglement between the ECB and the securitization market was due to the ECB’s decision to integrate asset-backed securities into its collateral-eligibility framework in 2000. Afterward, in the wake of the failure of Lehman Brothers, the ECB assumed the role of ‘dealer of last resort’ for asset-backed securities. By taking illiquid asset-backed securities onto its balance sheet, the ECB gained leverage over the securitization market, but became more dependent on it (Braun 2020). Yet, while the ECB and the Bank of England sought to revive the securitization market, other central bankers, notably, those in the US, where the post-crisis securitization market was buoyant, warned that the industry had not yet learnt the lessons of the crisis. For instance, Adam Ashcraft, head of credit risk management at the Federal Reserve Bank of New York, cautioned that ‘We haven't done anything meaningful to prevent the securitization market from doing what it just did’ (*Financial Times,* 5 June 2014).[27]

Internationally, banking regulators took the lead in setting bank capital rules for securitization. In doing so, they were facilitated by the fact that capital rules had been set internationally since 1989 and were within the remit of the BCBS, which was the most well-established standard setter in finance. Securities markets regulators agreed on the need for better information disclosure and market transparency, but the international standard-setting on these matters remained very thin initially. Instead, rules were set at the domestic level with minimal international coordination. This was

[25] https://www.ecb.europa.eu/pub/pdf/other/ecb-boe_case_better_functioning_securitisation_marketen.pdf
[26] *Financial Times*, ‘Back from disgrace: Asset-backed securities’ by Jones, C., Thompson, C., 1 October 2014.
[27] *Financial Times,* ‘Sliced and diced debt deals make a comeback’, Alloway, T., Thompson, C., 5 June 2014.

because the IOSCO was a less well-established standard-setter as compared to the BCBS and no previous international standards on securitization existed. Only subsequently, criteria for safe securitization were jointly issued by the BCBS-IOSCO, given the fact that the expertise of both banking and securities regulators was needed (Quaglia 2021).

The third factor that influenced the international governance of securitization was *lobbying cum venue shoppin*g - across jurisdictions and international standard-setters - by the financial industry. In the wake of the 2008 crisis, private financial actors were on their back foot and even though they mobilized extensively against higher bank capital rules on securitized products and retention rules for issuers, they were only partly successful in limiting the regulatory backlash. A few years after the crisis, the financial industry worldwide, but especially in the EU, contributed to the relaunch of securitization, by articulating a persuasive narrative about the benefits of securitization, arguing that the pre-crisis problems caused by securitization were due to how it was used, not to securitization per se (Dorn 2016; Engelen and Glasmacher 2018; Montalbano 2020).

Private actors skilfully engaged in vertical venue shopping, seeking to revive securitization in the EU to revive this market globally by setting international standards that would brand most securitized products as safe, and then lowering bank capital requirements for these products. The 'political entrepreneurship' of the cross-border securitization industry was crucial in explaining the emergence of the Capital Markets Union agenda on the reform of securitization regulation in the EU (Montalbano 2020; Endrejat and Thieman 2020; see also Ringe 2015; Dorn 2016; Engelen and Glasmacher 2018). Like in the case of the governance of the repo markets (see Chapter 6), private financial actors were able to forge an alliance with firms in the real economy (Montalbano 2020) as well as with central bankers, because repo and securitization provided the infrastructure through which central banks, in particular, the ECB, but also the Bank of England, implemented their monetary policy. 'This entanglement makes central bankers, who seek to maximize their economic steering capacity, dependent on bankers, giving the latter *infrastructural power*…. which constitutes a distinct source of financial-sector power' (Braun 2020, emphasis added).

Table 7.1 International governance of securitization: actors, pathways and outcomes

States	**Regulators**	**Industry**	**Outcome**
Initially, *no pace-setters* for securitization standards, but US-led trading up of bank capital rules for securitization Belated *pace-setting* by EU & UK on safe securitization and lower capital rules	*Puzzling* among regulators, some disagreement along jurisdictional lines	*Infrastructural power* and *lobbying* by financial industry, forging coalition with (EU) central bankers & non-financial groups	Not very precise, stringent and consistent rules by IOSCO and BCBS

International Standards for Securitization

In the wake of the crisis, the G20 Leaders (2008) called for a review of the scope of financial regulation with special emphasis on institutions, instruments, and markets that were unregulated. At around the same time, at a US conference on securitization, representatives of the SEC, the Federal

Reserve, and the British Financial Services Authority all identified securitization as an area of concern *Financial Times*, 6 February 2008).[28] At the Pittsburgh summit in 2009, following *pace-setting* first and foremost by the US, the G20 agreed that 'securitization sponsors or originators should retain a part of the risk of the underlying assets, thus encouraging them to act prudently'.

The IOSCO set up the Task Force on Unregulated Financial Markets and Products, co-chaired by the Autorité des Marchés Financiers of France and the Securities and Investments Commission of Australia. In 2009, the IOSCO's Task Force issued a report that chose securitization and credit default swaps as examples of unregulated markets and products (IOSCO 2009b). Concerning securitization, three key recommendations were put forwards. The first concerned the requirement that originators and/or sponsors should retain long-term economic exposure to securitized products. The second recommendation required transparency through disclosure by issuers to investors. The third recommendation required the independence of service providers engaged by issuers (notably, credit rating agencies), if opinions or services provided by service providers could influence investors' decision to acquire a securitized product. At about the same time, the BCBS (2009a) revised its Securitization Framework by issuing the so-called Basel 2.5 accord, increasing bank capital requirements for 're-securitization' (that is to say, collateralized debt obligations comprised of asset-backed securities), which were more highly correlated with risk than traditional securitization. In December 2012, the BCBS proposed a revised ratings-based approach and a modified supervisory formula approach, both of which were intended to create a 'more risk-sensitive' and 'prudent' calibration.

The responses from the financial industry were very critical. The International Banking Federation (2013b) worried about the 'unintended negative consequences' of the proposed rules, noting that the calibration of the proposed approaches failed to produce capital requirements that were commensurate with the 'true riskiness of the securitization exposures'. In particular, the proposed capital floor level (i.e. 20% risk-weight) was 'excessively high' and would eliminate the capital savings from securitization. The Institute of International Finance (2013) noted that the calibration of the proposed approaches did not reflect the quality and performance of the underlying assets. It required significantly more capital to hold securitized assets compared to holding the same underlying assets directly, which eliminated banks' economic incentive to use securitization. The Global Financial Markets Association (2013) submitted a response letter of more than 120 pages, arguing, inter alia, that the proposed rules would result in much higher capital requirements for most securitization, including high-quality senior tranches, while reducing capital requirements for some lower quality securitization. The proposals did not increase risk sensitivity, rather decreased it, by increasing the risk weight floor and increasing risk weights overall.

In December 2013, the BCBS (2013c) issued a revised consultation paper. In comparison to the first consultation paper, the BCBS significantly reduced capital requirements, although they remained more stringent than under the existing framework. The draft framework included a minimum risk weighting of 15% - less than the 20% that had been previously proposed by the BCBS, but more than bank lobbyists were bidding for - and a simpler method of determining capital requirements than previously proposed. The Basel Committee stated that the new draft standards would lead to 'meaningful' reductions in capital requirements compared with initial proposals.

Moreover, Stefan Ingves, the Swedish central banker who was the Chair of the BCBS, argued that the stringent capital rules on securitization, which had been introduced in 2009, could be softened. He noted that 'securitizations need not in any sense be bad…Risk weights are not forever. We need

[28] Regulators pledge greater scrutiny of debt products', I.shmaell Stacy-Marie, *Financial Times*, 6 February 2008

to review them. We need to look at the appropriateness of various structures and pass judgment on them' (*Financial Times*, 30 September 2013).[29] Thus, in an attempt to revive the securitization market, under the pace-setting efforts of the EU and the UK, the BCBS undertook further work on securitization. The instruments had been blamed for passing US subprime mortgage losses around the world and their perceived risks had prompted regulators to impose sharp increases in risk weightings, pushing up capital requirements as part of Basel 2.5 reforms in 2009 (BCBS 2009a). Yet, five years or so after the 2008 crisis, a reappraisal was necessary.

As early as 2013, Mario Draghi, the President of the ECB, noted that the 'asset-backed securities market is dead and has been dead for a long time' and launched an initiative to revive this market as a way to finance an economic recovery (*Financial Times*, 9 May 2013).[30] Given limited bank lending in Europe, asset-backed securities were no longer seen as dangerous instruments, but rather an alternative source of finance for small companies, particularly in southern Europe, where credit conditions were very tight. At the Bank of England, Andy Haldane remarked that securitization was potentially the 'financing vehicle for all seasons' and that it should no longer be treated as a 'bogeyman'. The shift in the international regulatory discourse in favour of revamping securitization, rather than trading up its regulation, as it had been done in the aftermath of the crisis, reflected the *pace-setting* efforts of the EU and the UK.

In 2014, the ECB and the Bank of England released two documents on securitization. The first document (Bank of England - ECB 2014a) was prepared for the G20 meeting in March 2014. It noted that securitization, if appropriately structured and regulated, could complement other funding sources for the real economy, including for small and medium-sized enterprises. Furthermore, it could provide a diversified funding source for banks and, potentially, transfer credit risk to non-bank financial institutions, thereby providing capital relief that could be used by banks to lend to the real economy. A particular focus was on the promotion of simple structures and transparent underlying asset pools with predictable performance (so-called 'high-quality' securitization), while preventing the resurgence of the complex and opaque structures that contributed to the financial crisis. In May 20914, the Bank of England and the ECB (2014b) issued a longer document, *The Case for a Better Functioning Securitization Market in the European Union,* which was subject to public consultation.

Similarly, the EBA (2014), which issued a *Discussion Paper on Simple Standard and Transparent Securitizations,* argued that a 'well-functioning and prudentially sound' securitization market would provide an 'alternative funding channel to the real economy and enhanced risk-sharing'. The European Banking Authority acknowledged that a one-size-fits-all regulatory approach to securitization was no longer appropriate, as it could result in a lenient treatment of risky securitization and conservative treatment of less risky, simple, and transparent transactions. Consequently, the regulatory approach to securitization should incorporate a distinction between high-quality (i.e. 'qualifying') securitization and other securitization. The regulatory definition of qualifying securitization should follow a two-stage approach, whereby to qualify for a different treatment, a securitization transaction should first meet a list of criteria ensuring simplicity, standardization, and transparency and, as a second step, the transaction should meet the criteria of the minimum credit quality of the underlying exposure (EBA 2014).

Internationally, the BCBS and the IOSCO established a joint Task Force on Securitization, which was asked by the FSB to identify the factors that hindered the development of securitization, and develop criteria for simple and transparent securitization. The Task Force was co-chaired by David

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[29] *Financial Times*, 'Watchdog to retreat from strict capital rules', Jenkins, P., 30 September 2013.

[30] *Financial Times*, 'ECB's Draghi in drive to revive slicing and dicing', Atkins, R., 9 May 2013.

Rule, a senior official at the Bank of England, and Greg Medcraft, the Chair of the IOSCO. The aims of the criteria proposed by the Task Force were threefold. First, to assist investors, according to the 'what you see is what you get' principle. Second, to assist issuers by making risk transfer more robust. Third, to assist regulators to set risk-sensitive capital requirements for securitization on the basis of a differentiation based on criteria to identify safe securitization (Rule 2014). In December 2014, the BCBS and the IOSCO published for consultation 14 criteria to identify simple, transparent, and comparable securitization. The content of this document was very similar to those of the joint documents produced by the Bank of England and the ECB (2014a,b) and the one issued by the EBA (2014). Hence, it had a marked 'European flavour' (Quaglia 2021).

While the BCB-IOSCO worked on criteria for safe securitization, the BCBS, under the pace-setting efforts of the EU and the UK, began work to lower bank capital requirements for safe securitization. The ECB had pushed for reform for more than a year, but the BCBS did not discuss the issue until when, in mid-2014, the ECB and the Bank of England joined forces to push for the relaxation of capital rules on securitization. At a meeting of the International Monetary Fund in Washington, the ECB and the Bank of England jointly intervened to make their case. Yves Mersch explained that these central banks had a 'common analysis and a common suggestion… We have agreement on the main thrust of a policy line to propose…. We call on those who do those rules to reassess their past position, and to take [our views] into account'. If new rules failed to gain traction at the level of bodies, such as the Basel Committee, an EU-specific approach would be needed. 'Either we do it at the global level, [or] if that has no prospect of going through any time quickly, we should take into account the needs of the EU and the differences we have in the EU and adjust our regulation to the environment of the EU' (cited in *Financial Times*, 7 April 2014).[31] Finally, Mersch argued that international proposals did not take account of the fact that European securitization performed better than US equivalents during the international financial crisis. Thus, the ECB felt that EU asset-backed securities were treated inappropriately by existing regulation.

The *financial industry* adopted a two-pronged *lobbying* strategy on securitization. It supported the revival of securitization, seeking to make the criteria for simple, transparent and comparable safe securitization as 'light-touch' as possible. It lobbied the BCBS-IOSCO to this end. At the same time, the industry called for a reduction of bank capital requirements for safe securitization, lobbying the BCBS on this matter, and sought to avoid additional (Basel only) criteria for safe securitization for regulatory capital purposes. To begin with, the industry spearheaded the relaunch of securitization,[32] but wanted to avoid criteria for safe securitization that were too prescriptive and granular. For instance, the trade associations that represented the financial actors most involved in securitization, namely, Global Financial Markets Association, the International Swaps, and Derivatives Association, the Institute of International Finance and the International Capital Markets Association (2015) submitted a joint response to the BCBS-IOSCO, calling for 'sensibly calibrated' criteria for simple, transparent and comparable securitization, avoiding the 'harsh and inappropriate' 'one-size-fits-all regulatory approach of the past'. They also called for favourable bank capital requirements for safe securitization, and the inclusion of synthetic securitization within the scope of the new rules (see also European Banking Federation 2015a).

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[31] *Financial Times*, 'Europe's top two central banks seek to revive 'toxic' assets, 7 April 2014.

[32] The *Financial Times* noted that 'For years, bankers sought to persuade regulators and politicians that mortgage-backed securities had a minimal cumulative default rate. Most of this campaigning took place behind closed doors in Brussels and Washington, making it difficult to ascertain the extent to which the decision of the BCBS was a victory for banks' (**'**Bank lobbying takes the bite out of Basel watchdog's rules0 by Alloway, T., 12 January 2013).

With reference to bank capital requirements for securitization, which were the remit of the BCBS, in a 'jumbo' joint response of the main trade associations, namely, the Commercial Real Estate Finance Council, the Commercial Real Estate Finance Council Europe, the Global Financial Markets Association,[33] the Institute of International Finance, the International Association of Credit Portfolio Managers, the International Swaps and Derivatives Association, the Securitisation Forum of Japan and the Structured Finance Industry Group (2014) argued that the BCBS's proposed capital requirements for securitization exposures, especially for high-quality exposures, remained much higher than justified by historical losses or in relation to the capital requirements of the underlying asset pools.

Since the BCBS was also in the process of adopting additional criteria to label certain securitization as safe and, therefore, subject to lower capital rules, the financial industry lobbied against precise and stringent criteria. For instance, the Global Financial Markets Association, , International Swaps and Derivatives Association, Institute of International Finance, International Capital Market Association (2015) noted that some criteria proposed by the BCBS were specific to particular jurisdictions, or asset classes, making it hard to apply those criteria across the board, and undermining the purpose of having international criteria. According to the above named financial associations, the criteria should be articulated in a principle-based manner and synthetic securitization should be included. In general, private financial actors believed that the additional criteria proposed by the BCBS were too burdensome, whereas the (less stringent) BCBS-IOSCO *Simple, Transparent and Comparable Securitization Criteria* 'were sufficiently rigorous to differentiate between low-risk and high-risk securitization'.

The financial industry mobilized at the international and EU levels, engaging in a distinctive form of vertical and horizontal *venue shopping*, seeking to connect and influence regulatory processes at both levels. For instance, in its response to the consultation of the Bank of England and the ECB on the relaunch of securitization in Europe, the Association for Financial Markets in Europe (2014a,b) noted the consultation of the BCBS-IOSCO on broadly similar themes, albeit at a more general level. While the joint initiative of the Bank of England and the ECB was more 'likely to produce concrete results in Europe in the near to medium term', the BCBS-IOSCO initiative was 'likely to influence the long-term direction of regulation at a global level'. The Association for Financial Markets in Europe remarked that the work undertaken by the Bank of England and the ECB should be coordinated with other workstreams dealing with securitization in the EU and internationally, including the European Banking Authority's work on defining 'qualifying securitization', the BCBS's revisions to the Securitisation Framework, the BCBS's work on liquidity rules (especially, the eligibility of securitization for the Liquidity Coverage Ratio), and the FSB's work on shadow banking (particularly, its securitization workstream). The European Banking Federation (2014) argued that 'Europe should take the lead' internationally in the definition of safe securitization and the review of related bank regulation, playing an influential role in the design of policies at the global level, including those in the domain of the BCBS and the IOSCO.

The British Bankers Association (2014) argued that a globally harmonized approach was paramount and therefore it urged the Bank of England and the ECB to pursue this goal 'robustly' in the BCBS, which was in the process of revising its Securitization Framework. If, however, international harmonization was not feasible in the near future, then a 'Europe only' approach' should be pursued. This association was also concerned by the high-risk weights for securitization proposed by the BCBS. Similarly, the Deutsche Bank (2014) argued that since securitization markets were global, the

[33] This transnational association included the Association for Financial Markets in Europe, the Asia Securities Industry & Financial Markets Association and the Securities Industry & Financial Markets Association.

Bank of England and the ECB should seek to promote criteria for safe securitization in international fora, such as the BCBS and IOSCO. It also noted that

> The capital charges for securitisation held in the trading book, need to be calibrated in a way that does not discourage trading of securitisation. Unfortunately, the recent BCBS Review of the Trading Book discussion paper proposed significant increases in risk weights for securitisation positions as well as inconsistent treatment and would result in materially higher capital compared to the latest proposals for the regulatory banking book. We hope that the Bank of England and ECB will ensure that the BCBS works to the same guiding principles at the international level that are being used at the EU level. Calibration of both, banking book and trading book capital requirements for securitisation is due to be finalised in the coming months and will be of crucial importance to viability of securitisation markets, not just in Europe, but globally.

In 2015, the BCBS-IOSCO issued the *Criteria for Identifying Simple, Transparent and Comparable Securitizations*, however, noting that additional criteria, such as those related to the credit risks of the underlying securitized assets, were necessary for regulatory capital purposes. The BCBS proposed to supplement the criteria issued by the BCBS-IOSCO with additional criteria to differentiate the capital treatment of simple, transparent, and comparable from that of other securitized transactions. The financial industry opposed the additional (more precise and stringent) criteria proposed by the BCBS, arguing that the criteria issued by the BCBS-IOSCO would suffice. Hence, there was a veiled attempt to pit the BCBS against the IOSCO. At the same time, the BCBS proposed to reduce minimum capital requirements for simple, transparent, and comparable securitization by reducing the risk weight floor for senior exposures, and by rescaling risk weights for other exposures. Eventually, the BCBS revised capital requirements for securitization exposures in 2016, including the regulatory capital treatment for simple, transparent and comparable securitization, and set additional criteria for differentiating the capital treatment of simple, transparent, and comparable securitization from other forms of securitization.

The same process just described was then repeated, under the impulse of EU and UK regulators, with reference to short-term securitization. Therefore, the BCBS-IOSCO (2018) issued *Criteria for Identifying Simple, Transparent and Comparable Short-Term Securitisations,* and then the BCBS opened consultations on the revision of the Securitization Framework for short-term securitization.[34] The Australian Securitisation Forum, the Global Financial Markets Association, the International Capital Market Association, and the Institute of International Finance (2017) submitted a joint response, which was suggestive of the positions of the financial industry. These associations encouraged 'regulators to strive to build a viable consensus among their constituent members regarding the simple, transparent, and comparable securitization criteria to apply to short-term securitizations'. In 2018, the BCBS set additional requirements for the application of lower capital requirements to banks engaged in simple, transparent, and comparable short-term securitization. Eventually, simple, transparent, and comparable short-term securitization received the same reduction in capital requirements as simple, transparent, and comparable securitization.

Table 7.2 International standards for securitization

BCBS	2014	Basel III: Revision to the securitisation framework
BCBS-IOSCO	2015	Criteria for identifying simple, transparent and comparable securitisation

[34] See https://www.bis.org/bcbs/publ/comments/d413/overview.htm

BCBS	2016	Revised securitisation framework (including Capital Treatment for Simple, Transparent and Comparable Securitisation)
BCBS-IOSCO	2018	Criteria for identifying simple, transparent and comparable short-term securitisation
BCBS	2018	Capital Treatment for Simple, Transparent and Comparable Short-Term Securitisation

Conclusion

In the aftermath of the 2008 international financial crisis, new rules on securitization were issued in the main jurisdictions, whereas the international standards issued by the IOSCO remained very thin. By contrast, international bank capital rules for securitization exposures issued by the BCBS were traded up. Less than a decade after the crisis, the regulatory pendulum swung back: criteria for safe (or high quality) securitization were introduced at the international and domestic levels (notably, in the EU), while bank capital rules for securitization became less stringent internationally and domestically.

The relaunch of securitization was mainly promoted by the EU (including the UK), which wanted to make the financial system in Europe less bank-based and considered the US as a potential model to follow. Thus, securitization became the first step in the establishment of Capital Markets Union. By contrast, the US, where capital markets were quite well developed, were somewhat less interested in relaunching securitization, as suggested by the lack of policy initiatives in this area. Whereas the US did not oppose the EU's and UK's efforts, the relaunch of securitization is one of the few instances of international standards that came to light and were sponsored by the Europeans and not the US.

The regulatory community was ambivalent about securitization, but it was mainly divided along jurisdictional lines, whereby regulators in Europe were more well disposed towards securitization than regulators in the US, as illustrated above. Although sectoral regulators had different priorities concerning securitization, this did not result in open epistemic and bureaucratic disagreements because the division of competences was rather clear and the priorities of regulators were compatible. Securities market regulators were responsible for setting rules on securitization, often in collaboration with bank regulators, given that banks were the main originators and traders of securitized products. Banking regulators worried about the risk that securitization involved for banks, but also considered securitization as a potential way for banks to diversify risks. Central bankers, who were generally responsible for financial stability, worried about the risks that securitization entailed. Yet, they also relied on the functioning of this market for the conduct of their monetary policy.

The financial industry resisted more precise and stringent rules on securitization and bank capital requirements for securitised products. Initially, the industry, which was on its back foot in the wake of the crisis, met with limited success. However, over time, private financial actors were instrumental in promoting the narrative of safe securitization to foster economic growth by unlocking alternative sources of funding for the real economy, in addition to traditional bank lending. Furthermore, the transnational financial industry, as well as financial companies based in the US, rallied behind the European efforts to revamp securitization by setting (not very stringent) international criteria for safe securitization and by lowering bank capital rules on securitized products. Only a few (non-financial) groups, such as Finance Watch (2015), and academics (e.g. Gabor and Vestergaard 2015) expressed their concerns about the risks of reinvigorating securitization.

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