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Public-Private Co-Regulation in the making of the capital markets union

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ABSTRACT

This contribution investigates the conditions and dynamics of a public-private regulatory partnership in the making of the Capital Markets Union. According to our argument, structural interdependence and the strategic use of market narratives in a low salient policy domain allowed the EU financial industry to frame their interests as a solution to Europe's missing recovery. Under the pressures of the Eurozone crisis and the EMU constraints, the goals of critical financial industry sectors and EU policy-makers met together, leading to a renewed regulatory cooperation. Such a mechanism is unveiled through a process-tracing case-study analysis on the EU covered bonds framework.

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The Capital Markets Union (CMU) represented a flagship initiative of the Juncker Commission to unlock financial market-based funding to the real economy. The CMU offers an interesting puzzle for the future of European financial integration. As the emerging literature variously highlighted, the plan for a revitalization of capital markets signaled a return to pre-crisis-like – or at least a less distrustful – approach towards financial industry interests. While the post-crisis years saw a wave of stricter financial regulation, the CMU pointed at the revitalization and expansion of financial markets as critical infrastructure to boost economic growth in the EU. Such an effort refocused the regulatory objectives back to increase the competitiveness in the European financial industry players. In line with these arguments, Dorn conceptualized the CMU as an original case of "cohabitation" between public and private actors in financial policy-making (Dorn, 2016a, 2016b). However, the hypothesis of a renewed public-private regulatory cooperation in the CMU has received little empirical scrutiny so far. Moreover, little attention has been devoted to the determinants and conditions of the mutual interactions between public and private actors in the making of the CMU.

By building on the literature on structural and discursive power in the EU financial governance, this contribution aims to enrich the theoretical and empirical debate on the CMU by adding another item to its mosaic: the harmonization of covered bond markets in the EU. Covered bonds represent a critical financial market segment in Europe, whose harmonization has been a major policy initiative and achievement in the CMU agenda. The former is a relevant case study to investigate the dynamics of the CMU. According to

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the argument developed here, the EU financial industry obtained influence by framing its demands as a solution to the policy-makers' pressing problems. On their part, the European policy-makers market-based financing in the context of bank lending shortage and restrained fiscal capacity. Under the structural pressures of the EMU and dominant post-crisis EU economic governance, the goals of critical financial industry sectors and policy-makers met together, leading to a public-private regulatory partnership.

The paper is structured as follows. The first section briefly reviews the existing literature on the CMU by highlighting its merits and limits. Building on the latter, an analytical approach for the analysis of private-public regulatory partnerships is developed. The subsequent sections are dedicated to an in-depth process-tracing analysis of the covered bond reform, from the agenda-setting to the final regulation, in which the analytical framework and its expectations are tested. Lastly, the conclusion briefly recaps the main findings of this research and its possible developments.

Literature review

Much of the literature has depicted the CMU as a turn in the EU policy-makers' stance towards the financial industry. This changed relationship has been scrutinized in its structural and discursive dimensions. Focusing on the former, Braun, Hübner and Gabor showed how the CMU expressed a "governing through the markets" approach by the ECB and the Commission. According to it, financial markets were a crucial governance infrastructure in the management of the crisis, providing viable stabilization tools to the real economy within the EMU and the post-crisis austerity paradigm. A similar systemic interdependence brought to an overlap between the goals of the financial industry and those of the public authorities (Braun, Gabor, and Hübner 2018; Braun and Hübner 2018). The (infra)structural power approach sheds light on the grounding dynamics underlying the CMU. Nevertheless, the former did not account for the whole policy-making process, and the actual influence of the financial industry.

Other authors analyzed the emergence of a pro-market policy narrative by the Commission, providing the policy framing and legitimization of the CMU project. While Howarth and Quaglia highlighted the Commission's strategic use of the pro-market narrative to win the consensus of the industry interests (Quaglia and Howarth 2018), Engelen and Glasmacher analyzed the formulation of the CMU agenda as a case of epistemic and regulatory capture (Engelen and Glasmacher 2018). Other studies addressed the CMU reform of securitization by looking at the financial industry lobbying (Montalbano 2020). What seems underdeveloped in these accounts is an in-depth account of the agentic weight to attach to the private actors vis-á-vis the public policy-makers. Likewise, little theorization is provided on the structural and political factors shaping the public-private relationships in financial regulation.

Moving in this last direction, Dorn depicted the CMU in terms of an "[i]n-principle public-private symbiosis" in which "public and private regulators [...] articulate a co-governance space" (Dorn, 2016a, 85; Dorn 2016b, 30). However, the author did not clearly define and empirically test this concept. By building on the infrastructural power and following Dorn's idea, this work integrates structural and political determinants to explain the relationships between public authorities and private interests in the CMU outcomes.

Explanatory framework

The idea of public-private partnerships (PPPs) emerged in the IRs to conceptualize "a hybrid type of governance" involving State and non-State actors (Schäferhoff, Campe, and Kaan 2009, 451). Such a conceptualization was particularly developed within the research programs on transnational private governance(Hall and Biersteker 2002, 204; Mattli and Büthe 2004, 229–30; Graz and Nölke 2007, 14, 18). Similarly, the emergence of the EU financial regulation has been analyzed in terms of public-private hybrid governance (Egan 2001, 264). Along this line, Holman linked the concept of PPPs to the transnational private governance in the EU agenda-setting (Holman 2007, 175–78). Similar Critical IPE approaches also focused on the constitution of "hegemonic projects" led by dominant capital fractions in the European integration process (Macartney 2010).

Taking the cue from this literature, a set of hypotheses can be formulated. First, a public-private regulatory cooperation could be expected to emerge if the patterns of structural interdependence incentivize the involvement of private actors in the provision of public goods (see Holman 2007). Within capitalist economies, public authorities need well-functioning banking sectors and capital markets to ensure funding in the real economy (Gill and Law 1993). Financial liberalization and market-based banking (Hardie and Howarth 2013) strengthened the role of financial markets as a crucial conduit of economic governance (Braun 2018, 6–7). In such cases, corporate actors leverage on infrastructural power to influence the policy process. As the first hypothesis thus:

[H.1] *the higher the dependence on a market segment for the attainment of public policy goals, the higher the influence by market incumbents and the potential for a public-private co-regulation.*

Although necessary, such infrastructural power is not a sufficient condition for a public-private regulatory partnership. Collective action is crucial for corporate actors to ensure the preferred policy outcomes (Macartney 2010). Some intra-sectorial industry coordination is a vital condition for gathering individual preferences into advocacy coalitions, spurring or preventing regulatory changes. The perception by an industry segment of shared competitive pressures, either as common threats to established market positions or potential opportunities to reap, incentivizes business interest groups to become policy entrepreneurs and lobby policy-makers (Kingdon 2014; Montalbano 2020). On this basis, as a second expectation:

[H.2] *the larger the shared competitive pressures from an existing or potential public regulation, the larger the incentives for industry actors to become policy entrepreneurs and enter into regulatory cooperation with public authorities*

Together with a joint lobbying stance, business policy entrepreneurs must also win the policy-makers' consensus. The literature on public-private regulation mostly neglected the relevance of salience and politicization dynamics. For example, it has been shown that a low salience environment allows market incumbents to entertain elite-level privileged relationships with policy-makers (Culpepper 2011, 4–5). On the contrary, an increased salience of issues usually absent from the public debate opens short-term windows of opportunity for the mobilization of weaker social groups to offset against dominant insiders (Woll 2013;). Indeed, a relatively high salience of policy issues fosters public scrutiny, the broadening of stakeholders and consequent responsiveness by elected politicians and regulators. Public authorities thus need inclusive policy framings and strategic narratives to gain support from broad societal constituencies (Quaglia and Howarth 2018). In facing a contested battlefield), corporate interests are thus pushed to frame their preferences as goals serving the general interests, striving to hegemonize the debate (Macartney 2010) m. Therefore, it could be expected that

[H.3] *the higher the public salience of the policy issue at stake, the more the need for inclusive policy framing for industry actors interested in a public-private regulatory partnership*

The patterns of regulatory cooperation will be analyzed across three policy-making stages: 1) the agenda-setting and 2) formulation of the policy proposal by the Commission; 3) the negotiations in the Council and the European Parliament leading to the final legislation. In relation to the policy-making process, it could be expected that the higher the influence capacity at the agenda-setting and policy-formulation stages, the larger will be the chances to shape the very terms, approaches and goals of the reform initiative. By contrast, at the later policy definition stages, stakeholders' influence is directed at either amending specific provisions or watering down the whole reform process. Since the CMU agenda-setting took place in a context of declining salience of financial regulation, its policy initiatives represent a crucial test bench to assess the behavior and lobbying strategies of a corporate community in a changing salience environment.

To assess the above expectations, the process-tracing and preference-attainment methods will be used to infer influence in terms of causal nexus linking industry interests to the policy outcomes (Bennett and Checkel 2015). Disclosed data and written documents are triangulated with six interviews with key representatives of the covered bond industry and the Commission.

Covered bonds' markets in Europe

Covered bonds were born in Germany during the 18th century and spread in Continental Europe to finance private and commercial mortgages, playing a pivotal role in the housing policies (Cross 2008, 296–97). Like securitization, covered bonds ensure new funding for a financial company by selling assets in exchange for cash. Yet, they differ from the former in two fundamental respects. First, they are secured by collateral which is ring-fenced and protected from creditors' claims other than the covered bondholders, in the event of the issuer's bankruptcy. Moreover, the cover pools are "dynamic": deteriorated and weak assets are continuously substituted by good-quality assets throughout the life of the bonds. Second, the investors in covered bonds have a legal right of recourse against the issuer in the event of collateral insufficiency. This "dual recourse" mechanism makes covered bonds a less risky investment than securitization. The latter was based on the originate-to-distribute model, which transfers credit risk from the originator to the investor.

Nevertheless, covered bonds led to specific risks. Due to the complexity of the cover pools, covered bondholders can be induced to an over reliance on rating agencies and modeling typical of securitization markets (Schwarcz 2011, 581–2). Most critically, covered bonds increase the level of asset encumbrance and systematically shift risks to unsecured creditors and depositors (EBA 2014, 137). The crowding-out of unsecured funding could lead to reduced market discipline, as unsecured investors are those mostly incentivizing in monitoring and correctly pricing risk. Besides, asset encumbrance reduces the levels of potential liquidity buffer of the institution and increases the dependency of the institution's liquidity profile to the market values of collateral, leading to pro-cyclical effects which could endanger financial stability (EBA 2014, 138). While less risky than pre-crisis securitization, covered bonds could potentially lead to severe threats to financial stability, especially if one considers the size of their markets in the EU.

The European market for mortgage-backed covered bonds in 2008 reached a value equivalent to around 40% of European GDP, representing nearly 20€% of total EU private mortgages in the aftermath of the crisis. In 2008, mortgages constituted roughly 60% of the covered bond's collateral in the EU, the remaining being composed of public sector debt (Kemmish, Wilkinson, and Andruszkiewicz 2017, 24). Covered bond markets remained fundamentally centered in Europe, its birthplace, with 98%of the outstanding global volumes in 2003. An EU primacy was retained in the post-crisis years, to the amount of 84% of the international markets' shares in 2015 (Kemmish, Wilkinson, and Andruszkiewicz 2017, 17). Within Europe, however, these markets were highly fragmented. Germany, Denmark, Spain, and France accounted for more than 81% of the total outstanding covered bond issuance in 2007 (see Figure 1). Each Member State developed its definition and legislation on covered bonds, so that they lacked a cross-border regulatory framework at the EU level.

The German covered bonds (*Pfandbriefe*) constituted a historical pillar of the German financial system, representing the primary source of market-based funding for its banking sector (Hardie and Howarth 2013, 115). Up to the outburst of the global financial crisis, the German market was the largest at the worldwide level, with about 50% of all outstanding covered bonds in 2006 (Kemmish, Wilkinson, and Andruszkiewicz 2017, 21). Covered bonds were not spared by the financial crisis. The global covered bond issuance collapsed from about €650 billion in December 2008 to less than €200 billion at the end of June 2009. Their spreads skyrocketed, with the German *Pfandbriefe* increasing from zero to 100 basis points. From 2008 to 2013, six large covered bond issuers have been bailed out to preserve financial stability (EBA 2014, 139).

In those same years, the European covered bond industry and the ECB came to the rescue of each other. The ECB had to face the disruption of a critical market-based source of bank funding and mortgage markets, profoundly affecting the banking industry, and the real estate sector. At the same time, leading covered bond issuers, large universal banks, and investment firms in the top national markets (Germany, Spain, Denmark, France, Sweden, and the UK) advocated the relaunch of covered bonds as a more acceptable form of securitization for the public authorities. The emerging competitive constellation was not thus inter-sectorial, as covered bond and MBS issuers were not

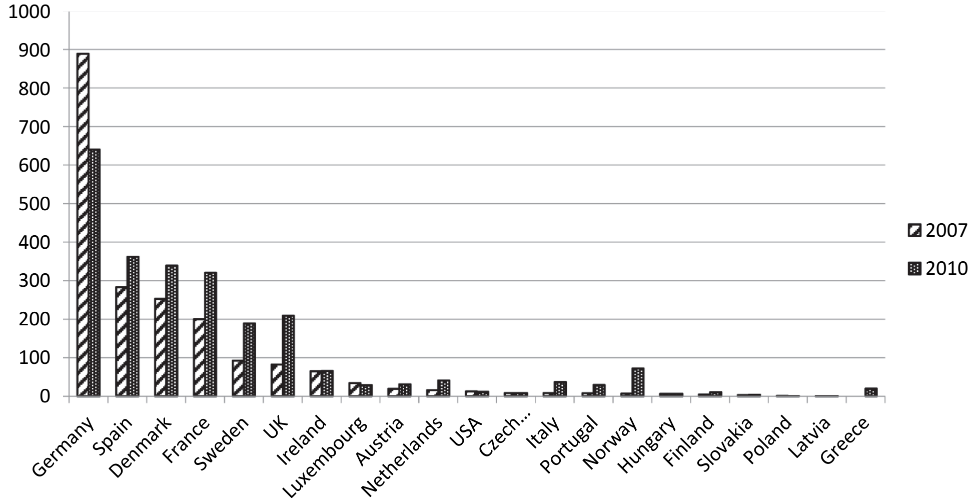

Figure 1. Covered bonds outstanding (EUR bn). Source: ECBC Fact Book, 2011, 152.

independent firms), but along inter-firms and geographical cleavages. Firms entrenched in national covered bond markets pushed to recover and expand their EU activities by preserving their local frameworks. Specialized covered bond issuers soon developed a common interest in revitalizing the disrupted markets for covered bonds. At the same time, other universal banks and financial firms were incentivized to promote them to offset, at least partially, the collapse of securitization. Following H.2, then, shared competitive pressures provided the premises for the policy entrepreneurship of the covered bond industry. On the part of the public regulators, in line with H.1, the ECB looked in those same years at the covered bonds as a primary market-based funding channel to restore the ailing European banks and incentivize lending. In this way, the ECB responded to the increased salience of financial stability as a goal requiring the expansion of its powers and a renewed cooperative approach towards the critical segments of the financial industry.

However, the financial industry faced a regulatory agenda that targeted structured financial products among the main culprits of the financial crisis (G20 2008). Building up a narrative on the safeness of covered bonds became an urgency for market incumbents (Interview ECBC, 2018). Looking at the news coverage at the EU level, we can observe that covered bonds remained a rather technical question and a low salience issue (Figure 2). However, we can observe an increase in news coverage from 2013 to 2017, in correspondence with the ECB purchase program and the CMU proposal, mirroring some media attention on covered bonds (particularly in Germany). Thus, following H.3, the covered bond industry was confronted with an emerging regulatory agenda at the international level, together with a generalized investors' fear for structured financial products and increased public attention on the issue.

Based on our three hypotheses, we can formulate the following expectations. The EMU constraints and asymmetric economic recovery dividing creditor and debtor countries in the Euro-zone pushed the Commission and the ECB to recur to capital markets as a macro-economic stabilizer (Braun and Hübner 2018). At the same time, the

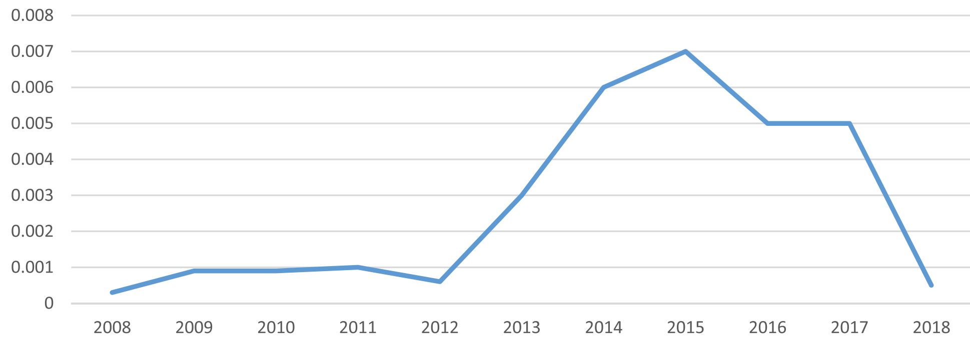

Figure 2. News coverage on covered bonds, percentage of total political/general news. languages: English, German, French, Italian, Spanish, Danish, Sweden. Source: Factiva. Search terms: (covered w/3 bond*) or (obbligaz* w/3 garant*) or (obligat* w/3 garant*) or (obligat* w/3 secur*) or Pfandbrief* or (gedeckt* w/3 Schuldverschreib*) or (gedek* w/3 obligat*) or (bon* w/3 garantiz*) or (täckt w/3 obligat*) or (dækket w/3 obligat*). Political/General News; European Union Countries; All languages.

financial industry was pressured by the post-crisis markets' disruption and the tight regulatory agenda, leading to a minimum shared interest in relaunching capital markets. This was true for covered bonds as well, as they represented a significant source of funding for banks in core EU economies, like Germany. However, under the international and European reform process, the political salience of financial regulatory issues and structured products was still relevant in the soon aftermath of the crisis. Thus, while EU supranational authorities needed financial markets as a critical source to stabilize the system, financial markets players needed public authorities' support to reduce the regulatory burdens and revive their business. In this context, industry entrepreneurs had to adapt to the objectives of the European reform in order to gain influence.

The Covered bond label initiative

The European covered bond industry responded to the global financial meltdown and the collapse of its markets by starting work on market-led standards of transparency and disclosure for covered bonds at the EU level. The initiative was prepared and carried out by the European Covered Bond Council (ECBC), the pan-European organization representing the covered bond market participants and stakeholders. As of August 2009, the ECBC had around 120 members in more than 20 jurisdictions, covering about 95% of covered bond issuers at the EU level (ECBC 2009, 19). The vast majority of its associates were large European banks and financial firms.[1] The ECBC set an "EU Legislation" team dedicated to lobbying EU policy-makers among its working groups. Within this working group, between 2008 and 2009, the ECBC members started to work on a market-led quality label. The label was to be awarded to covered bond issuers committing with a set of criteria regarding the transparency and composition of the cover pools. The initiative aimed to restore the investors' confidence and revitalize the covered bond markets (ECBC 2010, 25). Market fragmentation along domestic lines and the lack of transnational disclosure and regulatory standards were targeted as a primary source of mistrust and concerns for third-country investors. As declared by a prominent representative of the ECBC:

> *Already in 2006, we had clear in mind that it was necessary to improve the transparency in the covered bonds' sector to provide guidance for investors. Then, in 2012, we launched the Covered Bond Label: an initiative in preparation since 2008. As a European organization, we discussed these issues immediately after the crisis, and thus we decided to step on it* (Interview ECBC, 2018).

From the very outset, such a market labeling initiative looked as well at the intervention of the EU public authorities to rescue the covered bonds' markets. The quality label would have paved the way for possible ECB extraordinary interventions, providing at the same time a blueprint for future EU regulatory reforms. Moreover, the covered bond industry would have further remarked the diversity of their products from the Anglo-Saxon-style riskier securitization instruments, which were blamed after the financial crisis. In this way, the ECBC acted as a policy entrepreneur, in line with H.2. and H.3, by promoting an industry self-regulatory effort to anticipate and include the public authorities' demands for safe financial market instruments (Interview European Commission, 2018).

The covered bond label relied on the issuers' voluntary registration and self-certification according to transparency templates. An evaluating committee was charged to assess, monitor and possibly withdraw the certification to participants failing to meet the required standards. Next to the labeling committee – composed of industry associations and investment banks sitting at the ECBC steering group -, an advisory council was set up as a forum to include market participants and representatives from national, EU and international authorities. They included, as permanent observers, officials from the ECB Market Operations' division, the European Banking Authority (EBA), the European Banking for Reconstruction and Development, the European Investment Fund, and on a rotating basis, two observers from international organizations, like the World Bank, and a representative of central banks from crucial jurisdictions. Moreover, the advisory council had three formal members from EU national regulatory authorities nominated on a revolving basis.[2] These EU public authorities were involved from the beginning to advise on the design and realization of the covered bond label. Although not a formal member of this committee, the European Commission was "a very active interlocutor and participant in our discussions" (Interview ECBC, 2018; Interview European Commission, 2018).

The industry entrepreneurship met the ECB support for a revival of covered bonds as a safe asset for investors and critical funding sources for banks. In line with H.1, covered bonds soon emerged as a market-based instrument to support the ECB's extraordinary policy and underpin the distressed banking sector. The creation of a quality label for covered bonds then paved the way for the intervention of the central bank.

> *The ECB came to our rescue, with the aim of reviving covered bonds as a 'lighthouse' in the storm and signaling to the investors that they were a safe asset* (Interview ECBC, 2018).

In May 2009, the ECB Governing Council announced the first covered bond purchase program in the euro area (ECB 2009). As stressed by Trichet, covered bonds would have provided banks with "access to funding of a longer-term nature than the ECB's refinancing operations" to "allow banks to manage the maturity mismatch between their assets and liabilities" (Beirne et al. 2011, 12). From July 2009 up to the end of June 2010, the ECB purchased €60 billion of covered bonds in primary and secondary markets, under conditions of a minimum rating of AA. The ECB intervention spurred the fast recovery of the covered bond markets (Beirne et al. 2011, 24; Kemmish, Wilkinson, and Andruszkiewicz 2017, 19). As its balance sheet thus inflated, the ECB developed an additional interest in ensuring the revitalization of a sound covered bonds market (Braun 2018).

The ECB intervention further incentivized the ECBC to proceed with the creation of its market label. After rescuing the covered bond markets, the industry had to face a first regulatory challenge: the reform of the Basel III agreement and the following EU rules on the capital adequacy requirements for financial institutions. The covered bond industry thus pushed to either prevent or at least minimize the tightening of the risk weightings and related increase in capital amounts to hold against covered bonds. The ECBC and its members were not alone in this battle. The ECB sustained the industry demands, by "commenting on proposed changes in the CRD as well as arguing in favor of covered bonds when compared to MBS" (ECBC 2010, 25).

The first revision of the capital requirements directive (CRD) in 2010 restricted the eligibility of residential and commercial mortgage-backed securities within the pool of cover assets, as they were pointed among the main responsible for the financial crisis (EU 2010, 19; ECBC 2010, 87). These provisions were included in the Commission proposal of July 2011 for a significant overhaul of the capital requirements framework, leading to the CRD IV. The proposal advanced new risk-weightings for covered bonds, which were far lower than similarly rated senior bonds issued by banks, together with the prospected qualification of covered bonds as liquidity buffer investments in the proposed new liquidity risk framework. These measures were welcomed and positively assessed by the ECBC as responding to its main demands (ECBC 2011, 41–42).

A few months later, in October 2011, the ECBC publicly announced its incoming Label initiative. The label was described as a tool to "further enhance the recognition of, and trust in the covered bond asset class", developed "in cooperation with issuers, investors and regulators with the aim of ensuring that the views of all stakeholders are incorporated" (ECBC 2011). Soon after, in November 2011, the ECB launched a second covered bond purchase program as part of a new set of extraordinary interventions after the sovereign debt crisis. However, it fell below expectations, as the Long-term Refinancing Operation at the end of 2011 brought to general spread compression and pushed up the demands for covered bonds so that the purchase program soon lost its importance (ECB 2012, April 4).

Within such improved market conditions, London's ECBC 2012 plenary meeting officially launched the Covered Bond Label, which received praise from the ECB representatives and soon gathered the support of a group of leading investment banks (Euractiv 2012). In that same year, the Roundtable of Financial Services and AFME presented their *Prime Collateralized Securities* label (Montalbano 2020, 95–97): a parallel industry initiative to promote high-quality securitization and secure targeted capital requirements, which further strengthened the ECBC battle.

This section has shown how the initiatives for a revitalization of covered bond markets emerged in parallel with the formation of regulatory cooperation between financial industry organization and the ECB. In line with our expectations, the structural pressures unleashed from the global financial crisis and the institutional mandate of the ECB to rescue the bank funding markets favored a convergence in the interests of the leading association of the covered bond industry, the ECBC, and the ECB. From the very beginning, the ECBC managed to involve both its members and public regulators – mainly from the European financial authorities – in order to devise a shared market-based initiative to relaunch covered bonds and foster their integration throughout the Continent. The quality label pointed at highlighting the safeness of covered bonds: a narrative responding to the authorities' concerns in a time of high salience of financial regulation. The ECBC policy entrepreneurship was thus crucial for the constitution of such a regulatory partnership.

The CMU agenda and the covered bond framework

In March 2013, the Commission issued a Green Paper on the "Long-Term Financing of the real economy" on possible initiatives to unlock "safe" market-based funding channels in the wake of the enduring economic crisis in Europe. In line with the ECB approach, the document highlighted the relevance of covered bond markets for the European banks and their untapped potential due to the fragmentation along national lines. The Commission committed to assess "whether and to what extent greater harmonization could spur the use of covered bonds, in line with recent market-led initiatives", like the ECBC label (Commission 2013, 12). The covered bond potentials to support the European banks' funding (H.1) and the narrative about their "safeness" (H.3) brought the Commission to consider a possible regulatory initiative.

Half of the answers to the Commission consultation supported the idea of a principle-based harmonized framework for covered bond markets in the EU. Most of them, coming from the covered bond industry, took the ECBC label as a starting point (Commission, 2014a 12–13). The ECBC called on the "need to ring-fence the core concept of covered bonds and enhance harmonization in key areas", while "maintaining a certain degree of heterogeneity" (ECBC 2013, June 24, 11). The respondents to the covered bond questions thus showed a high level of overlap to the ECBC positions (Commission 2013, 12–13),[3] mirroring the cohesiveness of the related industry niche (H.2)

In the final Communication, the outgoing Commission Barroso thus committed to "review the covered bonds treatment in the CRR by the end of 2014" and evaluating "the merits of introducing an EU framework for covered bonds" (Commission, 2014b, 10). Accordingly, at the end of 2013, the Commission asked for the EBA advice on the covered bond harmonization in the EU. According to the EBA's verdict, "further convergence of the EU market" of covered bonds would have been "beneficial to the development of a more European investor base" (EBA 2014, 9). However, the report warned about the risks of asset encumbrance, leading to "a threat to the regulatory objectives of financial stability, depositor protection, resolution and bail-in framework and reduction of systemic risk" (EBA 2014, 138). The EBA thus recommended regular reporting and the definition of disclosure standards to allow monitoring of asset encumbrance by supervisors and investors. Moreover, the EBA endorsed the ECBC national transparency templates promoted as a "valuable starting point for the harmonization of covered bond disclosure standards" (EBA 2014, 97).

As the newly elected President of the Commission, Juncker, pledged in July 2014 to work on a "Capital Markets Union" (, he followed the plans left by his predecessor. The Green paper on the CMU agenda thus included "the development of a more integrated European covered bond market" (Commission 2015a, 15). The final CMU action plan launched a dedicated consultation on a pan-European framework for covered bonds, based "on high-quality standards and best market practices" (Commission 2015b 22). The narrative on "high quality" securitized instruments was thus definitely assumed in the definition of the Commission plan, responding to the policy-makers' demands for low-risk market-based instruments to revive the EU banks and real economy (in line with H1 and H3).

The stakeholder consultation prospected either an integration by "voluntary convergence" of national frameworks based on non-binding recommendations or a top-down harmonization . The Covered bond label was then mentioned as an example of a "very valuable initiative" to take as a model for regulatory intervention because there were "limitations to how far they can get without meaningful legislative reform backing them" (Commission 2015c 16).

The consultation received 61 responses, about half of which by industry associations, including the ECBC and nine of its members. An analysis of the stakeholders' responses shows majority support for the project of a more integrated covered bond framework and the need for a policy initiative by the Commission.[4] However, just nine responses explicitly supported the direct "product regulation", while 12 opted for "subsidiarity and indirect harmonization" including most ECBC members. Yet, the ECBC was "also supportive of combining option I with option II" for an EU product regulation, "to create further convergence in the covered bond space via a principle-based approach" (ECBC 2016, 14). Indeed, the most significant jurisdictions for covered bonds' issuance had an interest in preserving their national competitive advantages, while enlarging their investors' base. As well summarized by the DG FISMA officials, the vast majority of stakeholders expressed the view that "further integration should be pursued only based on a high-level principles approach and Member States should retain the power to set detailed or more stringent requirements" (Commission 2016, 7). Such majority views, together with the absence of contrariety to an EU harmonization initiative, revealed the substantive industry cohesiveness in the policy-definition stage, strengthening the ECBC entrepreneurship (H.2).

The consultation process ended with a public hearing in February 2016, gathering the EU regulators and representatives of the covered bond issuers and investors, including the ECBC.[5] The covered bond industry and its leading European representative organization thus managed to build up a broad corporate coalition advocating the principle-based harmonization, taking the covered bond label as a reference point.

In an updated report of December 2016, the EBA proposed minimum quality standards to harmonize covered bonds at the EU level, providing a "single and consistent point of reference for prudential regulation purposes" so as to ensure their preferential risk weight treatment (EBA, 2016, 9–10).

Three months later, the ECON Committee of the European Parliament (EP) gave its support to "a principle-based approach" and recommended taking into account "strong market-led initiatives", like "the Covered Bond Label" (EP 2017, 4–5, 10). The success of the Cover Bond Label and its narrative on the safeness of covered bonds soon gained a broad consensus across the main parliamentary groups. At the same time, our process-tracing analysis found no evidence of substantive lobbying efforts and opposition by consumer and civil society groups (thus easing the pressures on the EU policy-makers, avoiding conflicts with non-corporate actors, in line with H.3). The ECON Committee adopted the motion with 43 votes in favor (members of EPP, S&D, Greens/ALE, ALDE, and ECR groups), six against (GUE/NGL, EFDD, and one independent), and the abstention of the ENF. A clear majority secured the final approval of the Parliamentary Resolution in Strasbourg the following July 2017.

Even the majority of Member States aligned with the European covered bond industry in asking for a "harmonization based on high-level principles" in the meetings of the Commission Expert Group on Banking, Payments and Insurance in June and September 2017, reiterating it at the Council's Financial Services Committee in July (EGBPI 2017a, 2, 2017b).

As we showed in this section, thus, the ECBC policy entrepreneurship and framing strategy (H.2) paved the way for a cooperative regulatory approach with the EU institutions and the majority of Member States. However, as we will see in the next section, from the agenda-setting to the policy-definition stages, the covered bond industry faced the risks of a harsh and too intrusive intervention from the EU legislators.

The trilogue negotiations and the legislative outcomes

In March 2018, the Commission published its proposals for a Directive and a related Regulation amending the capital adequacy legislation. Following the EBA's blueprint, the proposed Directive formulated an EU single definition of covered bonds, laying down their structural features (like the dual recourse mechanism), and the principles for a harmonized supervisory framework (Commission 2018a, 9–10).

In May 2018, the ECBC published a paper to raise the concerns of the covered bond community. The main issues concerned the requirement of a "sufficient level of homogeneity" of the cover pool and the "imprecise definition of eligible assets". Similarly, the limitation in the use of derivatives contracts and the requirement of adjunctive liquidity buffers appeared as key critical points (ECBC 2018b, 3). The increased relevance of covered bonds for the EU policy-makers (see Figure 2) thus led to "harder" regulatory provisions than those expected by the industry (as in H.3).

However, the lobbying efforts of the national industry associations and banks vis-à-vis the respective governments proved successful in watering down the contested provisions in the Commission proposal. It is noteworthy that the main issues raised by the largest Member States' officials within the expert groups mainly mirrored those of the covered bond industry, particularly regarding the risks of a narrow definition of eligible assets and the extra liquidity buffer (EGBPI 2017b, 1–2). Thus, a substantive alignment emerged between the national industry associations and the respective governments, resulting in a majority pro-market orientation within the Council. According to our hypotheses, the cohesiveness of the covered bond industry (H.2)and their economic relevance for core European countries (H.1) appear to have counteracted the Commission's stiffer stance.

In November 2018, the Council advanced a compromise proposal to the EP, containing most of the substantive amendments later included in the final agreement. The covered bond industry was able to secure the consent of the ECON, in a context of decreasing salience of covered bonds (Figure 2) and concerted industry lobbying (along with H.3 and H.2). In the EP's amendments, the assets eligible for the cover pools expanded to include assets securing the enforceability of claims for payment, together with loans to, or guaranteed by, public undertakings (EP 2019, 41–43). Moreover, the parliament compromise left the definition of "rules ensuring risk diversification in the cover pool" to the Member States (EP 2019, 46). Responding to the concerns shared by both covered bonds and the Member States, the requirement of assets' "homogeneity" in the cover pool was relaxed, ensuring more discretion for the national authorities (Council 2018, 33; EP 2019, 51). Moreover, both the Council and the EP allowed the unlimited use of derivatives contracts for hedging purposes, as demanded by the financial industry (Council 2018, 34; EP 2019, 52). In February 2019, the Council and the EP reached a political agreement and the final text was approved in Strasbourg the following April. The ECBC welcomed the legislative package, defining it as a "milestone" for the covered bond industry (ECBC 2019). The European covered bond industry saw its main demands accepted, having obtained both preferential regulatory treatment for covered bonds and a principle-based harmonization ensuring substantive national leeway for the composition and supervision of the cover pools.

Conclusions

This article showed how a public-private regulatory partnership emerged between the ECB, the Commission and the EU representative association of the covered bond industry, shaping the CMU agenda on the harmonization of the covered bond frameworks in the EU. An industry standard-setting on covered bonds' quality laid down the premise of the ECB intervention and the subsequent regulatory initiative by the Commission.

In line with the initial expectations, structural pressures brought the EU authorities to revitalize European financial markets, as a stabilizing tool available within the institutional constraints of the EMU and the post-crisis austerity-led policies. At the same time, competitive threats push the covered bond industry to improve its transparency and quality standards to regain the investors' trust and maintain its market position. The twin problem faced by the European authorities and the industry constituted the very basis for a convergence of their different goals.

The two different issues found a shared response thanks to the policy entrepreneurship of the ECBC. The latter represented a pragmatic solution to counter the storm of the financial crisis while laying the premises for the ECB covered bond purchase programs and the Commission plans for unlocking "safe" capital market products to finance growth. By anticipating the EU demands for a substantive turn from the pre-crisis finance, the ECBC designed a policy tool based on a narrative around the high-quality and low risk of covered bonds. In this way, the financial industry prepared for the ECB purchase programs and paved the way for the Commission initiative. The covered bond label served both as a self-regulatory and lobbying instrument, capable of setting the path of the future CMU agenda. The size and importance of covered bond markets for the European Continental finance pushed the public authorities to build on the market-led initiatives to advance a full-fledged regulatory framework, in what emerged as a public-private partnership. However, the regulatory partnership proved to be stronger at the agenda-setting stage, while the policy formulation and trilogue negotiations required intensified lobbying efforts on the part of the industry. Partly against our expectations, it was the Commission, rather than the Council and the EP, to put under strain the regulatory partnership with its more stringent proposals. Nevertheless, the ECBC and national covered bond issuers were able to prevent top-down maximum harmonization options, building up consensus around a softer principle-based harmonization. In the end, the legislative outcome has been welcomed by the industry, as responding to its main preferences.

The harmonization of covered bonds in the EU thus represented the second pillar of the plan for "good" securitization, together with the legislative framework for "high-quality" asset-backed securities (Engelen and Glasmacher 2018; Montalbano 2020), as a core dimension of the CMU. While not being generalizable as such, this single-case study offers an explanatory dynamic on the emergence of public-private regulatory partnerships that could be potentially tested in other areas of the CMU. Although its evident limitations, this study gives more theoretical and empirical substance to Dorn's concept of public-private cohabitation in the CMU. Moreover, it contributes to the debate about the changing relationships between EU authorities and the financial industry in the post-crisis era, shedding some light on the impact of public salience in financial regulation. Rather than a simplistic return to "business as usual", this case reveals how the revitalization of structured finance has been conditional upon a new compromise between the financial industry and regulators. The framing of a "high-quality" narrative successfully responded to the crucial policy-makers' concerns for financial stability. At the same time, the low public salience of covered bonds contributed to cordoning off the decision-making process from other diverse and conflicting demands, ensuring a niche policy debate. In this way, this study offers a more in-depth view of the interplay between structural, ideational, and political factors at stake in shaping the "governing-through-the-markets" mode of governance. Further research is needed, however, to assess if and to what extent the explanatory mechanism here presented would hold for the different CMU policy outcomes, particularly in more sensitive and contested areas like those affecting fiscal and supervisory national prerogatives (Moloney 2021). The post-Brexit CMU thus represents a crucial test bench for the public-private partnership approach, as the former put new competitive pressures and concerns for the (remaining) EU financial powers

Notes

1. Specifically, 83 out of 122 members, as of 2018.
2. https://www.coveredbondlabel.com/governance-advisory-council/: last accessed 25 May 2019

3. https://ec.europa.eu/finance/consultations/2013/long-term-financing/docs/summary-of-responses_en.pdf
4. See: http://ec.europa.eu/finance/consultations/2015/covered-bonds/index_en.htm (last accessed 10 June 2019).
5. See: https://ec.europa.eu/info/node/9525/

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Interviews

- ECBC, European Covered Bond Council, Representative. Realized on 12/05/2018.
- PCS Secretariat, Director. Realized on 12/02/2018.
- European Commission, Head of Unit FISMA E3. Realized on 15/03/2018.
- FBF, French Banking Federation, Head of institutional relations. Realized on 10/02/2018.
- FESE, Federation of European Securities Exchange, Head of Public and Regulatory Affairs. Realized on 10/03/2018.
- BDB, German Association of Private Banks, Head of Public Affairs. Realized on 04/05, 2018

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