Articles

The Law of the Economic and Monetary Union: Complementing, Adapting or Transforming the EU Legal Order?

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The EMU Rationale for Capital Markets Union

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Abstract: Capital Markets Union (CMU) is a plan towards a single market for capital in the EU. While the plan is not limited to the euro area, some of its stated objectives are aimed at supporting EMU, especially by financial stability through private risk-sharing. The present *Article* seeks to specify and clarify these EMU objectives. It points out their expressions in official documents, discusses their role in creating legislative momentum for CMU and its individual initiatives, and observes them in the legislative process and content of selected initiatives. The research results include an explanation of the significance of EMU objectives as arguments in debates and decision-making concerning CMU as well as an assessment of their justificatory force.

Keywords: Capital Markets Union – Economic and Monetary Union – internal market – financial markets – financial stability – private risk-sharing.

I. Introduction

Capital Markets Union (CMU) is a multi-initiative plan, currently in progress, to integrate capital markets in the EU into a single market for capital.[1] Having first been outlined in the Juncker Commission's Investment Plan in 2014,[2] CMU was opened for consultation

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[1] See European Commission, *What Is the Capital Markets Union? General Information on the Objectives of the Capital Markets Union* ec.europa.eu.

[2] Communication COM(2014) 903 final from the Commission of 26 November 2014 on an Investment Plan for Europe, 14-15.

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with a Green Paper and launched with a comprehensive Action Plan in 2015.[3] According to the 2015 Action Plan, CMU aims at unlocking investment from the EU and elsewhere in the world and better channelling it to projects across the EU. In other words, CMU is about mobilisation and allocation of financial resources. CMU also aims at improving financial stability, deepening financial integration, and increasing competition. With its focus on market-based financing, CMU is expected to diversify funding sources for businesses, complementing the European bank-oriented tradition, and to provide new opportunities for savers and investors.[4]

The 2015 Action Plan includes altogether 33 individual legislative or non-legislative (assessments, reviews, reports, consultations etc.) initiatives. Some initiatives cater for start-ups and non-listed companies, others for companies entering and raising capital in public markets. Some initiatives focus on long-term, infrastructure and sustainable investment, others on retail and institutional investment. Finally, some initiatives promise to support the wider economy by leveraging banking capacity, while others seek to facilitate cross-border investment.[5] In a Mid-Term Review published in 2017, the Commission noted having "delivered more than half the measures" of the 2015 Action Plan.[6] At the same time, the list of initiatives was updated and broadened, taking into account, among other things, the looming Brexit, the proliferation of financial technology (FinTech), and sustainability challenges.[7]

CMU builds on the concept of mutual recognition, but its legislative initiatives go beyond that. The legal basis is typically found in art. 114 TFEU, which establishes competence for "measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market".[8]

Opinions vary on the results of CMU so far. On the one hand, initiatives have resulted in major pieces of new EU legislation. Examples include the Prospectus Regulation,[9]

[3] Green Paper COM(2015) 63 final from the Commission of 18 February 2015 on Building a Capital Markets Union; Communication COM(2015) 468 final from the Commission of 30 September 2015 on the Action Plan on Building a Capital Markets Union.

[4] Communication COM(2015) 468 final cit. 3.

[5] *Ibid.* 29-30.

[6] Communication COM(2017) 292 final from the Commission of 8 June 2017 on the Mid-Term Review of the Capital Markets Union Action Plan, 4 (emphasis omitted).

[7] *Ibid*. 8-9, 19-22.

[8] See D Valiante, 'CMU and the Deepening of Financial Integration' in D Busch, E Avgouleas and G Ferrarini (eds), *Capital Markets Union in Europe* (Oxford University Press 2018) 12-13.

[9] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC. According to recital 7, the Regulation combines the aims of ensuring investor protection and market efficiency and enhancing the internal market for capital.

which replaced the earlier Prospectus Directive,[10] and the Securitisation Regulation,[11] accompanied by related amendments to prudential requirements for credit institutions and investment firms.[12] On the other hand, CMU has even been called "failed" because part of the legal reforms planned have not been completed and because reliance on bank lending seems to have increased in the EU recently, which implies that expectations of diversified funding sources have not been met.[13] Indeed, the completion of CMU is delayed from the initially planned 2019, while its capability to transform European finance may have been somewhat exaggerated from the start.[14]

Then again, CMU appears to have become an open-ended plan, so that it can be revised with new objectives and initiatives from time to time. Revisions were recently proposed by the Next CMU High-Level Expert Group,[15] at the request of the German, French and Dutch finance ministers, and the High-Level Forum on the Capital Markets Union,[16] at the request of the Commission. Influenced by the latter's final report and stakeholder views on it, the Commission adopted a new CMU Action Plan in 2020.[17] The 2020 Action Plan introduces 16 new initiatives, grouped under three broader objectives. One objective proposes more accessible financing to European companies as a way to "support a green, digital, inclusive and resilient economic recovery". Post-Covid-19 economic recovery is

[10] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

[11] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) n. 1060/2009 and (EU) n. 648/2012. Recital 2 notes the Commission's "intention to restart high-quality securitisation markets, without repeating the mistakes made before the 2008 financial crisis".

[12] Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) n. 575/2013 on prudential requirements for credit institutions and investment firms.

[13] P Jenkins, 'Can the EU's Failed Capital Markets Union Be Revived?' (4 November 2019) Financial Times www.ft.com. Jenkins refers to the Association for Financial Markets in Europe (AFME), according to which 88 per cent of European companies' new funding in 2018 came from banks. Only 12 per cent came from capital markets, dropping from the average 14 per cent in 2013-2017.

[14] See generally JN Gordon and K Judge, 'The Origins of a Capital Markets Union in the United States' in F Allen, E Faia, M Haliassos and K Langenbucher (eds), *Capital Markets Union and Beyond* (The MIT Press 2019) 89 ff. Gordon and Judge explain that while a "financial system is a product of rules […] the relationship among law, financial system design, and financial development is complex and iterative". And further: "Law's greatest impact is often indirect and context dependent; its repressions can be more important than its explicit permissions. Law matters, but not necessarily in the ways lawmakers intend".

[15] Next CMU High-Level Group, Report to Ministers and presented to the Finnish Presidency: Savings and Sustainable Investment Union, October 2019 nextcmu.eu.

[16] High-Level Forum on the Capital Markets Union, 'Final Report: A New Vision for Europe's Capital Markets' (10 June 2020) ec.europa.eu.

[17] Communication COM(2020) 590 final from the Commission of 24 September 2020 on a Capital Markets Union for people and businesses – new action plan.

particularly emphasised. The other two objectives focus on improving the safety of saving and investing long-term for individuals in Europe and integrating national capital markets into a "genuine" single market, respectively.[18]

The present *Article* takes a general view of CMU and examines its motivational and justificatory basis. The focus is on motives and justifications that have been present in CMU from the beginning and can be called its "EMU rationale". Indeed, CMU has been and is still being attributed with objectives of supporting the Economic and Monetary Union (EMU), even though CMU, its initiatives and legislation resulting from them are not limited to the euro area but, as a rule, concern the whole EU. However, the expressions of these EMU objectives tend to be unspecified and unclear in terms of their concrete implications. This *Article* seeks to specify and clarify them, thereby explicating the EMU rationale for CMU.

As discussed in several parts of the *Article*, EMU objectives embrace the role of private risk-sharing in promotion of financial stability. Private risk-sharing can be understood as the capacity of integrated financial and capital markets to absorb country-specific economic shocks. This may be the effect of internationally diversified investment portfolios, which generate income independent of the performance of the domestic economy, or the effect of international lending compensating for domestic shortages in credit supply.[19]

The *Article* proceeds as follows. Section II points out expressions of EMU objectives in official CMU documents, mainly in those by the Commission. The reason for the particular relevance of Commission documents is the Commission's role as "the *primum mobile* in the making of CMU".[20] Section III discusses the role of EMU objectives in creating legislative momentum for CMU and its initiatives in the context of conflicting Member State interests as well as of supranational policymaking. Section IV traces EMU objectives, and complications in that respect, in the legislative process and content of selected initiatives. In this way, sections III and IV seek a partial answer to the special section's question of how EMU may have affected the EU legal order. Section V concludes the *Article*.

II. Objectives in documents

Official CMU documents often suggest that EMU objectives are central to CMU as a whole, but they usually refer to these objectives as though in passing. The 2015 Green Paper

[18] *Ibid.* 1, 6-14.

[19] J Cimadomo, O Furtuna and M Giuliodori, 'Private and Public Risk Sharing in the Euro Area' (ECB Working Paper Series 2148/2018) 2.

[20] See L Quaglia and D Howarth, 'The Policy Narratives of European Capital Markets Union' (2018) Journal of European Public Policy 990, 991. Quaglia and Howarth note, in contrast, that "the Commission was a marginal actor during the sovereign debt crisis [...] and in the construction of Banking Union" (references omitted). On the relationship between CMU and Banking Union, see D Busch, E Avgouleas and G Ferrarini, 'Capital Markets Union After Brexit' in D Busch, E Avgouleas and G Ferrarini (eds), *Capital Markets Union in Europe* cit. 4-5.

simply states that "well integrated capital markets will contribute to the resilience of the Economic and Monetary Union".[21] The 2015 Action Plan, almost as plainly, envisions CMU as "buttressing Economic and Monetary Union by supporting economic convergence and helping to absorb economic shocks in the euro area, as set out in the report of the Five Presidents on Completing Economic and Monetary Union".[22]

The Five Presidents' Report is somewhat more elaborate. It states that a well-functioning CMU "will strengthen cross-border risk-sharing through deepening integration of bond and equity markets, the latter of which is a key shock absorber". "Truly integrated capital markets would", so the argument continues, "also provide a buffer against systemic shocks in the financial sector and strengthen private sector risk-sharing across countries". This then "reduces the amount of risk-sharing that needs to be achieved through financial [*sic*: what is meant is probably 'fiscal'] means (public risk-sharing)".[23] The Report mentions two ways in which increased cross-border investment flows may strengthen private sector risk-sharing, namely a "capital market channel" and a "credit market channel". The capital market channel refers to desirable effects of geographically diversified portfolios of financial assets. Returns of such portfolios are expected to be of lower volatility and correlate less with domestic income. The credit market channel suggests that cross-border investment flows improve the situation of a country hit by an economic shock. This is so because they enable residents of that country to offset the shock by lending or borrowing.[24]

While the Five Presidents' Report emphasises the benefits of integration of capital markets and removal of national barriers, it also notes that these developments may bring about new risks to financial stability. Accordingly, the Report recognises "a need to expand and strengthen the available tools to manage financial players' systemic risks prudently (macro-prudential toolkit) and to strengthen the supervisory framework to ensure the solidity of all financial actors". The Report sees "a single European capital markets supervisor" as an ultimate goal.[25]

[21] Green Paper COM(2015) 63 final cit. 5. The Green Paper also notes that improved effectiveness of markets could result in, among other things, "a more efficient distribution of risk and better risk-sharing" and that further integration of capital markets, especially equity markets, "would enhance the shock-absorption capacity of the European economy and allow more investment without increasing levels of indebtedness". However, the Green Paper does not seem to link these effects to EMU in particular. *Ibid*. 9.

[22] Communication COM(2015) 468 final cit. 3. In another passage, the Action Plan suggests that the improved ability to "share the impact of shocks" could concern Member States in general, but "especially those inside the euro area".

[23] European Commission, 'Completing Europe's Economic and Monetary Union, Report by: Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz' (22 June 2015) ec.europa.eu 12. The report proposes private risk-sharing through integrated financial and capital markets as a short-term solution and enhancing public risk-sharing through a fiscal stabilisation mechanism for the euro area as a medium-term goal. *Ibid*. 4.

[24] *Ibid*. 12. For a more detailed account of risk-sharing and the potential impact of capital market integration on it, see D Valiante, 'CMU and the Deepening of Financial Integration' cit. 13-19.

[25] European Commission, 'Completing Europe's Economic and Monetary Union' cit. 12.

The above references to EMU objectives may strike as overly general and lacking evidence. However, a Staff Working Document accompanying the 2015 Action Plan shows that they are backed by economic literature.[26] The cited literature identifies capital markets and bank credit markets as potentially important in cushioning economic shocks,[27] finds that risk-sharing in the euro area is underdeveloped and was ineffective in the financial crisis,[28] and links together financial integration, risk-sharing, and higher economic growth.[29]

The 2017 Mid-Term Review repeats some of the EMU objectives stated in earlier documents, including that on the absorption of economic shocks in the euro area.[30] In addition, it refers to a Commission Reflection Paper on the Deepening of the Economic and Monetary Union, which regards CMU as "an opportunity to strengthen our single currency".[31] The Reflection Paper emphasises financial stability through private risk-sharing, but also discusses the eventuality of Brexit: "The prospect of Europe's largest financial centre leaving the single market makes the task of building the CMU more challenging, but all the more vital". Like the Five Presidents' Report, the Reflection Paper calls for more integrated supervision of the financial sector. However, the Reflection Paper stresses that regulatory reform is only one part of creating "a new financial eco-system that is truly integrated and less dependent on bank financing". What is also needed is "the full involvement of all parties, including corporates, investors and supervisors".[32]

EMU objectives are no less prominent in recent CMU documents. For example, in a 2019 Communication on progress on CMU, the Commission emphasises that "private risk-sharing mechanisms play a particularly important role in cushioning country-specific shocks in the Economic and Monetary Union and contribute to risk-reduction in the financial sector". In addition, the Commission connects CMU to strengthening "the international role of the euro".[33] The 2020 Action Plan repeats the main message as follows: "Finally, the CMU is essential for building resilience against future asymmetric shocks affecting only a few Member States. By laying down strong foundations for better and more

[26] Commission Staff Working Document SWD(2015) 183 final of 30 September 2015, Economic Analysis, Accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union, 11-12.

[27] Y Demyanyk, C Ostergaard and BE Sørensen, 'Risk Sharing and Portfolio Allocation in EMU' (2008) Economic Papers ec.europa.eu.

[28] N Anderson, M Brooke, M Hume and M Kürtösiová, 'A European Capital Markets Union: Implications for Growth and Stability' (2015) Financial Stability Papers www.bankofengland.co.uk.

[29] M Obstfeld, 'Risk-Taking, Global Diversification, and Growth' (1994) The American Economic Review 1310.

[30] Communication COM(2017) 292 final cit. 2-3.

[31] *Ibid.* 3, 8. Reflection Paper COM(2017) 291 final from the Commission of 31 May 2017 on the Deepening of the Economic and Monetary Union, 23 (emphasis omitted).

[32] Reflection Paper COM(2017) 291 final cit. 23.

[33] See Communication COM(2019) 136 final from the Commission of 15 March 2019 on Capital Markets Union: progress on building a single market for capital for a strong Economic and Monetary Union, 1 (emphasis omitted).

geographically spread private risk sharing, the CMU supports the functioning of the Banking Union and the Economic and Monetary Union".[34]

III. Legislative momentum

As shown in the previous section, the Commission has consistently referred to EMU objectives in its CMU documents. The most prominent of these objectives relate to promotion of financial stability through private risk-sharing, albeit that the documents are not very explicit about why it should be regarded as particularly important for euro area Member States, as opposed to Member States in general. The following discussion assesses the significance of EMU objectives as arguments in debates and decision-making regarding CMU. This is expected to shed light on their role in creating momentum for legislative action.

Assessing the significance of EMU objectives requires context, no matter how persuasive one considers their content as such. Their contextualisation should start with the recognition that CMU, like legislative projects generally, can be assumed to create winners and losers, or at least to benefit some actors more than others. The relevant actors can be private parties as well as states.

Related to this, Lucia Quaglia, David Howarth and Moritz Liebe have studied connections between national preferences on CMU and the variants of financial capitalism across EU Member States. They worked on two hypotheses and found evidence for both. The first and main hypothesis was that "Member States with large non-bank-based financial sectors" were the keenest promoters of CMU and, more generally, supporters of financial sector liberalisation in the EU. The second hypothesis was that "Member States with more open banking systems – and thus lower levels of banking nationalism" – typically supported liberalisation and diversification measures of CMU.[35]

A comparison of, for example, UK and German positions in early discussions and negotiations on CMU illustrate these regularities. Quaglia, Howarth and Liebe show that the UK government and the City of London supported CMU enthusiastically, whereas the German government was more cautious and expressed reservations. The UK was expected to be the main winner of CMU due to new European business opportunities for its diverse financial sector, with considerable capacity in wholesale finance, private equity and hedge funds.[36] Germany, for its part, apparently had less to benefit from CMU, given

[34] Communication COM(2020) 590 final cit. 4 (emphasis omitted).

[35] L Quaglia, D Howarth and M Liebe, 'The Political Economy of European Capital Markets Union' (2016) JComMarSt 185, 187-192. According to Quaglia, Howarth and Liebe, the two hypotheses "largely hold with a couple of partial exceptions". Generally on bank-based and market-based finance in the EU, see N Moloney, *EU Securities and Financial Markets Regulation* (Oxford University Press 2014) 13-19. Moloney also discusses the explanatory power of "Varities of Capitalism" analysis.

[36] L Quaglia, D Howarth and M Liebe, 'The Political Economy of European Capital Markets Union' cit. 192-193. The attitude of the UK was shared by other Member States with developed and diverse financial sectors,

its stronger reliance on bank credit, less developed alternative finance, and closed banking system, with savings banks and cooperatives playing a central role in financing SMEs. National policy preferences behind these financial sector features could be threatened by CMU and increased market access. Another more cautious Member State was France. Quaglia, Howarth and Liebe consider this a kind of surprise, given France's more developed financial sector, but they explain it by a policy of national champions in banking and a lower foreign presence than in any other financial system in the EU.[37]

In another study, Quaglia and Howarth argue that the Commission has strategically employed different policy narratives on CMU in different Member State and financial industry contexts so as to gather political support for it. According to Quaglia and Howarth, the aim has been to present CMU as "a positive-sum game, rather than a zero-sum game with potential winners and losers".[38] They identify potential winners and losers, both in kinds of financial firms and in Member States and appear to suggest that the Commission's communications and policy narratives were based on similar observations. Potential winners in financial firms included non-banks, larger universal banks capable of "non-traditional banking activities", such as securitisation, and insurance companies. Conversely, traditional and smaller banks with less engagement in capital markets were among the potential losers. Indeed, CMU explicitly aimed at increasing funding alternatives to non-financial firms beyond bank credit. Of course, international players were more likely to be potential winners and domestically oriented players potential losers. Expected advantages and disadvantages of CMU to national financial sectors also appeared to divide Member States into potential winners and losers. This influenced the positions of Member State governments on CMU.[39]

Somewhat simplified, the first policy narrative was presented to potential winners and the second policy narrative to potential losers, or those with less to win. Quaglia and Howarth introduce the two as follows:

> "The Commission articulated the first narrative which focused upon boosting the size, the competitiveness and the openness of EU capital markets. With this narrative, the Commission mainly targeted the UK, the City of London, large cross-border universal banks and other international financial players. The Commission's second narrative concerned the provision of (non-bank) funding to the real economy, which mainly targeted Continental

including Ireland, the Netherlands, Sweden and Luxembourg. Quaglia, Howarth and Liebe note that the second hypothesis is contradicted by the very low presence of foreign banks in the Netherlands and Sweden.

[37] *Ibid.* 193-194.

[38] L Quaglia and D Howarth, 'The Policy Narratives of European Capital Markets Union' cit. 990 ff. However, Quaglia and Howarth admit that their evidence "does not prove definitely the existence of strategic motives on the part of Commission officials". *Ibid*. 1003.

[39] *Ibid.* 995-998.

countries and notably countries in the EU periphery, as well as domestically oriented banks and smaller capital markets".[40]

The first policy narrative also included an external dimension, envisioning the potential of CMU to increase the global competitiveness of the EU. In contrast, the second policy narrative appears far more locally oriented. Provision of non-bank funding to SMEs and infrastructure projects was emphasised, but carefully presented as complementary to bank funding so as to avoid opposition of banks.[41]

How should EMU objectives be assessed against the background of "winners", "losers", and the two policy narratives? One remarkable point is that the objective of financial stability through private risk-sharing has the appearance of being generally acceptable and almost unquestionable. Potential winners and potential losers alike, be they private parties or states, should benefit from improved stability brought about by increased shock absorption capacity. What is more, those stability improvements would result from potential winners exploiting their new European business opportunities opened by CMU. Thus presented, the objective suggests a positive-sum game and may play a significant role in creating legislative momentum for CMU.

Proposing such a role for the objective of financial stability through private risk-sharing is not just guesswork. Suffice it here to quote the following observations by Benjamin Braun and Marina Hübner: "Crucially, the discourse of private risk sharing has been received positively in Germany, EMU's largest creditor country. The German government conceives of CMU as the lowest common denominator for short-term EMU-internal risk sharing, a fact that has contributed to Germany's support for CMU. This view has repeatedly been expressed by the German Council of Economic Experts, an influential advisory body to the German government, and by the Bundesbank".[42]

A question yet to be addressed is why CMU should be regarded as particularly important for EMU, although it is not limited to the euro area. Here, Braun and Hübner propose an elaborate answer. They explain CMU as an attempt to address a "structural capacity gap" in the governance structure of EMU as it currently stands. This gap refers to severe limitations at both national and supranational levels on macroeconomic stabilisation, which is understood as levelling the business cycle, preserving economic growth and employment, and alleviating the impact of output shocks on consumption. At national level, limitations result from "the full centralization of monetary policy, the partial

[40] *Ibid.* 998. Quaglia and Howarth have divided Commission speeches, interviews and articles on CMU presented in different Member State contexts between September 2014 and September 2016 into the following focus categories: "Only on financial sector opportunities/competitiveness", "Principally on financial sector opportunities/competitiveness", "Equal focus", "Principally on SMEs and/or infrastructure funding" and "Only on SMEs and/or infrastructure funding". *Ibid*. 1000-1001.

[41] *Ibid.* 998-1003.

[42] B Braun and M Hübner, 'Fiscal Fault, Financial Fix? Capital Markets Union and the Quest for Macroeconomic Stabilization in the Euro Area' (2018) Competition & Change 117, 129 (references omitted).

but consolidation-oriented centralization of fiscal policy, and the neutralization of labour market policy in creditor countries". At supranational level, then, the EU has failed to develop tools for macroeconomic steering.[43]

Braun and Hübner start their account from mid-2012, when the threat of an uncontrolled breakup of the euro area had receded, following Mario Draghi's "whatever it takes" speech. At the same time, reform ambitions had weakened. This weakening is visible in discussions of the need for stronger public risk-sharing, where "Germany, supported by the other creditor countries, feared that increased fiscal leeway at the European level would establish a permanent transfer system from the North to the South, plagued with moral hazard problems". As the political reality did not allow creation of a fiscal union, policy makers and central bankers, along with private interest organisations, started to look for other options. It is in this context that Braun and Hübner examine the emergence of CMU as "a financial fix for EMU's fiscal faults", focusing on two processes in which important parts of the CMU agenda were set.[44]

The first process framed securitisation and market-based finance more generally as "a budget-neutral instrument for the new European growth agenda".[45] Securitisation is a financing technique which generally involves pooling together of credit claims or receivables and then refinancing the pool by selling it to a specially established company or other entity. This entity, in turn, finances the purchase by issuing debt securities backed by the pool, to be bought by investors in capital markets.[46] Although an unlikely candidate for a solution in view of its part in the run-up to the global financial crisis, securitisation became seen as an opportunity to address two issues, namely the need to deleverage banks and the scarcity of credit for SMEs.[47]

The second agenda-setting process identified financial market integration as a way to bring about private risk-sharing, in the sense discussed in section II above. Public risk sharing, which would have required national budgets to be at least partially centralised, was out of reach. Braun and Hübner trace the theory behind private risk-sharing to the mid-1990s and the then dominant "neoclassical worldview".[48]

Braun and Hübner note that the structural capacity gap of macroeconomic stabilisation has damaged EMU output legitimacy, especially in the euro area periphery countries

[43] *Ibid.* 117-118, 121.

[44] *Ibid.* 123, 128.

[45] *Ibid.* 120, 123-124, 127.

[46] See Association for Financial Markets in Europe (AFME), 'High-quality Securitisation for Europe: The Market at a Crossroads' (9 June 2014) AFME Finance for Europe www.afme.eu.

[47] B Braun and M Hübner, 'Fiscal Fault, Financial Fix?' cit. 124, 126-127. See E Engelen and A Glasmacher, 'The Waiting Game: How Securitization Became the Solution for the Growth Problem of the Eurozone' (2018) Competition & Change 165 ff.

[48] B Braun and M Hübner, 'Fiscal Fault, Financial Fix?' cit. 127-129. Braun and Hübner mention as "particularly influential" P Asdrubali, BE Sørensen and O Yosha, 'Channels of Interstate Risk Sharing: United States 1963–1990' (1996) The Quarterly Journal of Economics 1081.

that have suffered most from recessions, unemployment and the decline of real wages.[49] They emphasise that their analysis does not imply full commitment on the part of the Commission to "the theory that CMU will actually solve the problem of macroeconomic stabilization", or belief in private finance as the "first-best solution" to that problem. However, they consider it shown that policymakers have made major efforts to validate the narrative of CMU as a macroeconomic stabiliser.[50]

To sum up, the above discussion suggests two overlapping reasons why EMU objectives, especially those related to financial stability through private risk-sharing, appear as weighty considerations and are likely to contribute to legislative momentum for CMU and its initiatives. First, financial stability through private risk-sharing can be presented as a generally acceptable objective in that it promises to benefit actors regardless of whether they are otherwise expected to be on the "winning" or "losing" side of CMU. Second, increased market-based finance and financial market integration can be presented as substitutes for the macroeconomic stabilisation capacity that EMU is lacking due to its current governance structure. While the macroeconomic stabiliser narrative may leave doubts, it is backed by the Commission and some economic theory.

The weight of EMU objectives may have increased as a result of Brexit, as anticipated by the 2017 Reflection Paper on the Deepening of the Economic and Monetary Union.[51] In this vein, Wolf-Georg Ringe even argues that Brexit has changed the purpose and motivation behind CMU. He plausibly suggests that one significant initial purpose was a political bid to convince the City of London and the British public of the benefits of European integration and to vote remain in the Brexit referendum. Since this purpose failed (other than in winning over the City), he sees a case for redefining and re-explaining CMU "in an entirely new context", as "measures to strengthen the architecture of the eurozone". This strengthening would be based on private risk-sharing.[52]

Moreover, the weight of EMU objectives is unlikely to decrease due to the public risk-sharing elements in the Covid-19 recovery instrument, Next Generation EU, which was

[49] B Braun and M Hübner, 'Fiscal Fault, Financial Fix?' cit. 118, 124.

[50] *Ibid*. 119, 131. For recent economic analysis of risk-sharing in the context of EMU, see J Cimadomo, O Furtuna and M Giuliodori, 'Private and Public Risk Sharing in the Euro Area' cit.

[51] Reflection Paper COM(2017) 291 final cit. 23. See Section II above.

[52] W-G Ringe, 'The Politics of Capital Markets Union: From Brexit to Eurozone' in F Allen, E Faia, M Haliassos and K Langenbucher (eds), *Capital Markets Union and Beyond* cit. 341 ff. Ringe suggests a timeline that differs from what has been discussed in this *Article*. He writes that "different from the original plans, the *CMU Mid-Term Review* for the first time mentioned that the CMU initiative could also 'strengthen … Economic and Monetary Union (EMU) by supporting economic and social convergence and helping absorb economic shocks in the euro area'". However, he also notes that the "same idea was floated in the famous 2015 *Five Presidents Report*". *Ibid*. 347. As discussed in Section II above, EMU and shock absorption are mentioned in the 2015 Action Plan and other documents of that time, rather than being Brexit-related reorientation. See also B Cœuré, 'Capital Markets Union in Europe: An Ambitious but Essential Objective' in A Dombret and PS Kenadjian (eds), *The European Capital Markets Union: A Viable Concept and a Real Goal?* (De Gruyter 2015) 6. Cœuré argues that "a genuine capital markets union is in fact essential for the good functioning of a monetary union".

agreed on by the Council on 21 July 2020. While Next Generation EU "establishes a joint funding model to support government spending and reform" and directs "sizeable net financial support for those euro area countries that face the biggest economic and fiscal challenges after the pandemic", this is meant to happen only once.[53] The institutional rhetoric supporting CMU and its EMU objectives seems even strengthened in the context of Covid-19, as exemplified by the following excerpt from a speech by European Central Bank (ECB) Vice-President Luis de Guindos:

> "First, while we should be realistic that some measures will take longer to yield noticeable benefits than others, a more developed CMU is key to funding the post-COVID-19 recovery, as private funding from the capital markets will complement public funding and bank funding – both under pressure from the pandemic. This will also help limit the risk of growing asymmetries among euro area countries in the recovery from the COVID-19 shock. [...] Second, CMU would improve and diversify funding conditions, creating prospects for jobs and growth, including for a more sustainable and digitalised economy".[54]

IV. Legislative process and content

In 2015, the then Commissioner for Financial Stability, Financial Services and Capital Markets Union, Jonathan Hill, stated that the "direction" needed for CMU was "to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one".[55] Accordingly, CMU has grown into a broad variety of legislative initiatives, ranging from various aspects of financial regulation to private law and private international law.[56] This section considers the role of EMU objectives in the legislative process and content of selected initiatives and of CMU more generally.

EMU objectives appear differently in different legislative initiatives of CMU. For example, this can be seen in a comparison between two key pieces of CMU, namely the

[53] A Giovannini, S Hauptmeier, N Leiner-Killinger and V Valenta, 'The Fiscal Implications of the EU's Recovery Package' (2020) ECB Economic Bulletin, issue 6, 81-82. However, Giovannini, Hauptmeier, Leiner-Killinger and Valenta note that the fiscal innovation of Next Generation EU, "while a one-off, could also imply lessons for Economic and Monetary Union, which still lacks a permanent fiscal capacity at supranational level for macroeconomic stabilisation in deep crises". *Ibid*. 84.

[54] L de Guindos, 'Keynote speech of 12 November 2020 at the CIRSF Annual International Conference 2020 on Major Trends in Financial Regulation' (12 November 2020) www.ecb.europa.eu. See also Communication COM(2020) 590 final cit. 2-4, 7-8.

[55] European Commission, Press release IP/15/4433 - *Unlocking Funding for Europe's Growth. European Commission consults on Capital Markets Union* (2015)**.**

[56] On "general laws" and the CMU agenda, with particular focus on company law and corporate governance, see E Ferran, 'A Legal Framework for Financial Market Integration: Resetting the Agenda Beyond the Sectoral Single Rulebook' in F Allen, E Faia, M Haliassos and K Langenbucher (eds), *Capital Markets Union and Beyond* cit. 45 ff.

Commission Proposals for a Prospectus Regulation and a Securitisation Regulation.[57] Both Regulations (and Proposals) are based on art. 114 TFEU, that is, the "general" internal market legal basis.

The Commission Proposal for a Prospectus Regulation connects the initiative to EMU by first describing how the prospectus reform complements CMU objectives and then stating as follows: "A more diversified funding mix will also deliver additional benefits: it will support financial stability and reduce the dependence of the business sector and wider economy on bank lending. For this reason, Capital Markets Union is also an important part of the work on the completion of the European Economic and Monetary Union".[58] In contrast, the Commission Proposal for a Securitisation Regulation makes no explicit reference to EMU.[59] This difference may reflect the idea, expressed in the Five Presidents' Report discussed in section II above, that while integration of both bond and equity markets strengthens cross-border risk-sharing, it is equity markets that function as "a key shock absorber".[60]

Arguably, EMU objectives are less connected with individual initiatives of CMU than with CMU as a whole. This would entail that EMU objectives can be used as a wholesale justification for initiatives, even if the relationship of particular initiatives with, say, shock absorption is vague or distant. In other words, the justification would primarily concern the CMU agenda itself, and would concern individual initiatives only secondarily and largely owing to their place on the agenda.

This could help to explain the revival of efforts to develop uniform conflict rules (that is, private international law rules determining the applicable substantive law) on assignments of claims in the EU, most recently as part of CMU.[61] The need for a legislative solution at the EU level stems from diverging Member State conflict rules on third-party effects of

[57] Commission Proposal COM(2015) 583 final of 30 November 2015 for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading; Commission Proposal COM(2015) 472 final of 30 September 2015 for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) n. 1060/2009 and (EU) n. 648/2012.

[58] Proposal for a Regulation COM(2015) 583 final cit. 4.

[59] Proposal for a Regulation COM(2015) 472 final cit.

[60] European Commission, 'Completing Europe's Economic and Monetary Union' cit. 12. See CM Buch and F Bremus, 'Capital Markets Union and Cross-Border Risk Sharing' in F Allen, E Faia, M Haliassos and K Langenbucher (eds), *Capital Markets Union and Beyond* cit. 30-31, 42. Buch and Bremus argue that "the share of equity in the overall mix of finance plays an important role for risk sharing and for the financing of innovation".

[61] Commission Proposal COM(2018) 96 final of 12 March 2018 for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims. See H Labonté, 'Third-Party Effects of the Assignment of Claims: New Momentum from the Commission's Capital Markets Union Action Plan and the Commission's 2018 Proposal' (2018) Journal of Private International Law 319, 321-323.

assignments of claims.[62] These divergences weaken the legal certainty of assignments of claims and the predictability of commercial and financial transactions based on them, given that substantive rules on third-party effects of assignments of claims also vary between Member States. Indeed, the third-party effects of an assignment of claims may vary depending on the Member State (or other jurisdiction) whose courts may eventually have to adjudicate on those effects. The EU is not entirely without conflict rules on assignments of claims, for they are dealt with in art. 14 of the Rome I Regulation.[63] However, art. 14 is silent as to the law applicable to third-party effects. Conflict rules on third-party effects were omitted from the article because the negotiating Member States failed to agree on the most suitable rules (or, more technically, connecting factors) for that purpose.[64]

The search for uniform conflict rules on third-party effects has remained on the agenda pursuant to the "review clause" of art. 27(2) of the Rome I Regulation, but in a rather dormant state. Only recently, in the context of CMU, has this search turned into an actual legislative initiative.[65] The recent Commission Proposal for a Regulation on the law applicable to the third-party effects of assignments of claims strongly emphasises the importance of assignments on capital markets.[66] This connection seems to have been far less prominent in drafting and negotiating the Rome I Regulation, although for example securitisation was discussed then as well.[67] Moreover, the recent Commission Proposal contains a special rule for claims arising from financial instruments and for the securitisation context.[68]

The legal basis of this Commission Proposal is art. 81(2)(c) TFEU, which establishes competence for "measures, particularly when necessary for the proper functioning of the internal market, aimed at ensuring: [...] the compatibility of the rules applicable in the Member States concerning conflict of laws and jurisdiction". The Rome I Regulation, in

[62] The notion of third-party effects includes, for example, the question of effectiveness of an assignment of claims against the assignor's creditors (other than the assignee) or a competing assignee.

[63] Regulation (EC) n. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). See Communication COM(2015) 468 final cit. 23, 30.

[64] For an account of this failure, see PMM van der Grinten, 'Article 14 Rome I: A Political Perspective' in R Westrik and J van der Weide (eds), *Party Autonomy in International Property Law* (Sellier European Law Publishers 2011) 145 ff.

[65] See Report COM(2016) 626 final from the Commission of 29 September 2016 on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over the right of another person, 3. This report fulfils the Commission's reporting obligation set in art. 27(2) of the Rome I Regulation more than six years late. Interestingly, the Commission explains that adoption of the report "was postponed in order to await the political opportunity to follow its publication by a legislative proposal, which is now undertaken in the Action Plan on a Capital Markets Union".

[66] Proposal for a Regulation COM(2018) 96 final cit. 1-12. See Report COM(2016) 626 final cit. 2, 4-6.

[67] Commission Proposal COM(2005) 650 final of 15 December 2005 for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I) 8, 19; PMM van der Grinten, 'Article 14 Rome I' cit. 159; J Perkins, 'A Question of Priorities: Choice of Law and Proprietary Aspects of the Assignment of Debts' (2008) Law and Financial Markets Review 238, 239-242.

[68] Proposal for a Regulation COM(2018) 96 final cit. 27, 31 (recitals 27 and 28, art. 4(2) and (3)). Cf. Proposal for a Regulation COM(2005) 650 final cit. 8, 19 (art. 13(3)).

turn, found its legal basis in the same article's predecessor, art. 65(b) TEC. All in all, it can be argued that recent efforts share some of the more general legislative momentum of CMU. Since EMU objectives contribute to that momentum as a wholesale justification, they also lend support to this particular initiative.

EMU objectives may thus increase the likelihood that legislative initiatives will succeed, but is their functioning as a wholesale justification for CMU merely positive? This should be discussed initiative by initiative, but caution seems advisable even at a general level. The reason is easy to grasp if the objective of financial stability through private risk-sharing – the core of EMU objectives – is observed in a temporal context. As Braun and Hübner note, the theory behind private risk-sharing was developed in the mid-1990s, in a "less financialized time period" than ours.[69] Therefore, employing the theory today may lead to overlooking the risks caused by integration of financial markets as such.[70]

Indeed, financial stability concerns have arisen, and have been addressed to some extent, in legislative processes for individual initiatives of CMU. The making of the Securitisation Regulation provides an example. In its Proposal for a Securitisation Regulation, the Commission embarked on "creating a sustainable market for securitisation, without repeating the mistakes made before the crisis". The Commission's concerns included preventing the recurrence of originate-to-distribute models where "lenders grant credits applying poor and weak underwriting policies as they know in advance that related risks are eventually sold to third parties".[71] The main feature of the proposed (and later adopted) Regulation to "restart markets on a more sustainable basis" was to identify simple, transparent and standardised (STS) securitisations, so that these can be made eligible for more risk-sensitive prudential requirements.[72]

However, the co-legislators disagreed on sufficient safeguards for financial stability, which resulted in several delays. In terms of content, the legislative process culminated in the interinstitutional compromise of 30 May 2017. This compromise added further safeguards in the Regulation text, including a ban on re-securitisations (albeit with limited exceptions), broadened powers to competent authorities, and the explicit task of macro-

[69] B Braun and M Hübner, 'Fiscal Fault, Financial Fix?' cit. 128.

[70] See *ibid.*; W Schelkle, 'From Divorce to a Union of Unions: Too Much of a Good Thing' (Proceedings of OeNB Workshops n. 21, 2015) 42. See generally R Portes, 'Interconnectedness: Shadow Banking and Capital Markets Union' in F Allen, E Faia, M Haliassos and K Langenbucher (eds), *Capital Markets Union and Beyond* cit. 331 ff. Portes writes: "A fundamental issue in evaluating financial integration is the balance between its benefits – more efficient allocation of capital, risk sharing – and the potential dangers posed by interconnectedness. When we think in systemic terms of the buildup of financial stress and vulnerability, our concerns arise from interconnectedness".

[71] Proposal for a Regulation COM(2015) 472 final cit. 2, 23 (recital 19).

[72] *Ibid*. 3-5. Cf. E Engelen and A Glasmacher, 'The Waiting Game' cit. 172-175. Engelen and Glasmacher argue that "labelling any securitization as 'simple', 'transparent' and 'standardized' is misleading since it glosses over the fact that securitization is inevitably complex".

prudential oversight of the EU securitisation market assigned to the European Systemic Risk Board (ESRB).[73]

While compromises like this inevitably leave open questions as to the optimal balancing of enabling features and safeguards, or opportunities and threats, it is important that legislative processes involve real possibilities for balancing. Then again, one may ask whether such "pointillistic" balancing in connection with individual initiatives addresses financial stability concerns sufficiently in the broader CMU framework.[74] This is a matter for further discussion, but the analysis here suggests one general point with respect to the EMU rationale for CMU. That is, EMU objectives are incomplete and even paradoxical as justifications for CMU and its initiatives insofar as those objectives seek to promote financial stability but at the same time fail to address the causes of financial instability they entail. Therefore, the justificatory force of EMU objectives should not be exaggerated.

V. Conclusion

The purpose of this *Article* has been to specify and clarify EMU objectives in CMU and its initiatives. These are objectives that emphasise CMU's importance for EMU, although CMU, its initiatives and legislation resulting from them are not limited to the euro area. EMU objectives call for attention because their expressions are often unspecific and unclear in terms of their concrete implications.

A review of these expressions in (mainly) Commission documents on CMU revealed that the most prominent EMU objectives relate to promotion of financial stability through private risk-sharing. The *Article* then turned to assessing the significance of EMU objectives in creating momentum for legislative action. A brief review of political economy literature suggested two overlapping reasons why they are likely to appear as weighty considerations in that respect. First, financial stability through private risk-sharing can be presented as a generally acceptable objective in that it promises to benefit private parties and states regardless of whether those actors are otherwise expected to "win" or "lose" as a result of CMU. Second, CMU appears to substitute for the macroeconomic stabilisation capacity that EMU is lacking due to its current governance structure. It was also noted that the weight of EMU objectives may have increased as a result of Brexit, and that it is

[73] A Delivorias, 'Common rules and new framework for securitisation' (January 2018) Briefing: EU Legislation in Progress www.europarl.europa.eu 6-8. This briefing explains that re-securitisations are transactions where "a pool of securities, issued in earlier securitisations, is bought by an originator and securitised again (usually in the form of a collateralised debt obligation)" and that the "main products of re-securitisation are CDOs of ABSs and CDOs of CDOs (CDO^2)". *Ibid*. 2.

[74] See V Bavoso, 'Market-Based Finance, Debt and Systemic Risk: A Critique of the EU Capital Markets Union' (2018) Accounting, Economics, and Law: A Convivium 1. Bavoso argues (mainly in sections 4-6) that the CMU framework fails to address stability risks associated with market-based finance and its debt creation effects, especially excessive risk-taking and leverage. He calls for an institutional structure, including a strong supervisor, to match these risks.

unlikely to decrease despite the public risk-sharing elements of the Covid-19 recovery instrument, Next Generation EU.

Finally, the *Article* went on to observe the operation of EMU objectives, and complications in that respect, in the legislative process and content of selected initiatives. Most attention was paid to the Securitisation Regulation and recently revived efforts to develop uniform conflict rules on third-party effects of assignments of claims. Two general points arose from these observations. First, EMU objectives appear to be less connected with individual initiatives of CMU than with CMU as a whole. Accordingly, EMU objectives can be used as a wholesale justification for initiatives, even if the relationship of particular initiatives with private risk-sharing is vague or distant. Second, EMU objectives may promote financial stability but at the same time entail causes of financial instability, that is, risks resulting from integration of financial markets as such. Unless these concerns are sufficiently addressed in legislative processes of individual initiatives and, if needed, in the broader CMU framework, EMU objectives remain incomplete and paradoxical as justifications for CMU and its initiatives.