Fortressing on Markets

Financial Supervision in the Capital Markets Union

by

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Declaration

I, the undersigned Dominik Brenner, candidate for the degree of Doctor of Philosophy at the Central European University Doctoral School of Political Science, Public Policy and International Relations, declare herewith that the present thesis is exclusively my own work, based on my research and only such external information as properly credited in notes and bibliography. I declare that no unidentified and illegitimate use was made of work of others, and no part the thesis infringes on any person's or institution's copyright. I also declare that no part the thesis has been submitted in this form to any other institution of higher education for an academic degree.

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Dedicated to my mother, Mirjana.

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Acknowledgments

While focusing on supervisory developments in the post-crisis years, this dissertation itself is a product of crises. Shortly after the beginning of my PhD in Budapest, CEU became the target of government attention and, after a year of uncertainty, forcefully relocated to Vienna. Little did I know back then that the biggest crisis was yet to come. Halfway through a research stay at the European University Institute in Florence, COVID-19 hit the world. Indeed, the pandemic changed everything and forced me to re-conceptualize my project - both theoretically and empirically - at the very last stage.

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Working on a PhD comes with joy and pain, enthusiasm and frustration. But, once the last words are written, it also opens up a new chapter in life. I vividly remember how, after the end of the first Italian lockdown in May 2020, a local newspaper in Florence celebrated that day with a famous quote from Dante's Vita Nova which stated that herewith "a new life is beginning". What would be more fitting than to end this project of mine with those very same words.... *incipit vita nova.*

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Abstract

The financial crisis became a true turning point in EU finance that moved the EU away from market liberalization towards financial stability. While the scope and depth of banking supervision after the financial crisis peaked in the creation of the Banking Union, the post-crisis emphasis on financial stability came at the cost of sluggish economic growth. Born out of the idea that the strengthening of non-bank finance can close this funding gap, the European Commission proposed a Capital Markets Union (CMU) which, in conjunct with the Banking Union, should create a true single market for capital based on market integration and increased supranational supervision. Yet while regulatory progress emerged, supervision remained de facto unchanged. This begs the question what can account for this status quo bias in non-bank financial supervision in the context of the CMU? The existing literature on the political economy of the CMU tends to either focus on member states preferences or takes a constructivist perspective on the CMU. This dissertation, in contrast, relies on a neofunctional perspective based on prior evidence from the Banking Union. The main argument is that in the context of low internationalization, or higher foreign competition relative to their own expansion, functional pressures for supranational supervision among non-bank finance are lacking and the status quo is sustained. In such a case, the financial industry is 'fortressing' on their home markets to reap the potential benefits of national supervisory forbearance. The analysis is based on a novel dataset from public registers of the European Supervisory Authorities and maps the outward expansion and foreign penetration of non-bank finance in the EU27. The results show overall low levels of internationalization and a tendency for higher foreign competitive pressures for the main types of non-bank finance. Even in those non-bank segments where partial supervisory reform occurred, the outcome sustained an overall status quo bias through reform. These findings thereby contribute to the literature by demonstrating the strength of neofunctionalist explanations beyond mere spill-overs

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effect in the realm of non-bank financial integration and add to a better understanding of the drivers behind limited supervisory reform. Since the creation of a CMU is an ongoing project, future research should update the current findings with new empirical evidence and bridge the gap between the first CMU period (2015-2019) and ongoing efforts to finalize the Capital Markets Union in the years to come.

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1 Introduction

Financial markets are often portrayed as truly global with financial institutions that operate across borders and push national politics towards ever more financial liberalization. Yet, as a consequence of the financial crisis, and spurred by legislative deliberalization on the national level, much of EU finance refocused on national markets and increased national fragmentation in the EU. Like a pendulum, the crisis years led to a partial retreat of European finance to the national level. Even though the EU has encouraged cross-border capital mobility for decades, national regulatory and supervisory specificities continue to sustain fragmented national markets and shape the expansion of finance in Europe to this day.

This post-crisis momentum towards deliberalization in the EU emerged as consequence of the devastating effects of the financial and European sovereign debt crisis that showed vividly how unchecked financial liberalization can pose a severe risk for financial stability. At the same time, harmonizing capital market regulations, liberalizing investment choices and easing cross-border funding opportunities would come with various advantages. From an industry perspective, it enables economies of scale which provide a more efficient allocation of assets and resources, provides easier access to foreign markets, as well as a new client pool and higher profits. From a political perspective, the internationalization of finance increases funding opportunities for the real economy. Most importantly, such cross-border asset diversification should

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ultimately result in higher economic growth.

Half a decade after the beginning of the financial crisis, the EU still did not catch up to its pre-crisis productivity levels, despite conventional and unconventional monetary policy tools by the ECB and the creation of the Banking Union to stabilize and strengthen confidence in EU financial markets. Since EU finance is bank-based, market channels couldn't compensate for the lack of bank-to-real economy lending and a strengthening of alternative, non-bank channels seemed urgently needed. First introduced in 2014, the Capital Markets Union (CMU) was one of the flagship projects of the European Commission under Jean-Claude Juncker and should create a "true single market for capital" that provides barrier-free cross-border investment choices and funding opportunities for capital market actors. The CMU was envisioned as a transformative project to counterbalance the banking dominance and consisted of 16 legislative acts between 2017 and 2019 to strengthen market channels, ease market access for firms, and boost investment to the real economy. At the same time, creating a single market that removes national regulatory barriers for capital market participants requires a balance between financial integration and financial stability on the EU level. The European Commission therefore highlighted the need to accompany the CMU with a robust supervisory framework.

The reality diverged from these stated goals nonetheless. While the CMU liberalized national regulatory barriers, no robust supranational supervisory framework emerged. The reform of financial supervision led to mixed results that display a status quo bias rather than a decisive step toward increasing centralization. Consequently, calls for a 'reboot' of the CMU were increasingly articulated with the start of the Von der Leyen Commission in 2019 when it became clear that the CMU did not fully succeed in its ambitions and national resistance impeded the creation of a true Capital Markets Union (ECOFIN, 2019; Jenkins, 2019).

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1.1 Puzzle and Research Question

Together, the Banking Union and the Capital Markets Union should have advanced finance in the EU through a closely regulated and supervised banking sector, more efficient non-bank supervision, as well as a multitude of alternative funding opportunities for small and medium-sized enterprises. Since promoting investment and easier access to capital markets was at the heart of the project, the primary goal of the CMU was a deepening of financial integration; that is, national level de-regulation and harmonized supranational re-regulation. But the harmonization of rules also requires harmonized monitoring of these rules. There is an academic tendency to ignore the question of supervision when it comes to the CMU since the original proposal by the European Commission did not explicitly envision any further supervisory delegation to the supranational level (Darvas, Schoenmaker, & Veron, 2016; Allen, Faia, Haliassos, & Langenbucher, 2019). While this may hold for the very beginning of the project, questions of supervisory reforms soon entered the picture.

Even though the European Commission perceived the CMU first and foremost as a mean to improve financial integration in terms of further regulations of various capital markets sectors and products, supervision in the first CMU period (2016-2019) was permanently a latent question and indeed perceived as needed. The Capital Markets Union thereby included supervisory reform proposals for all major institutional investors through proposals for pan-European investment funds and a pan-European personal pension scheme that combined market-making with rule-policing. While the former tackled investment fund managers, the latter targeted pension funds and insurance companies. Together, the European Supervisory Authorities (ESAs) would have experienced a significant upgrading in terms of direct supervisory powers. Yet, while progress towards further market integration occurred, the intended supervisory

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reform for non-bank finance largely failed. Institutional investment - pension funds, insurance companies, and fund managers - remained de facto under national control and reform occurred only partially for investment firms, a subsegment of asset management, and central counter-parties (CCPs) as a main financial infrastructure. Looking at the historical trajectory of financial integration, that displays a continuous deepening both in terms of market making and rule-monitoring, it is puzzling why the CMU did not continue this trend in terms of supervision (Figure 1.1).

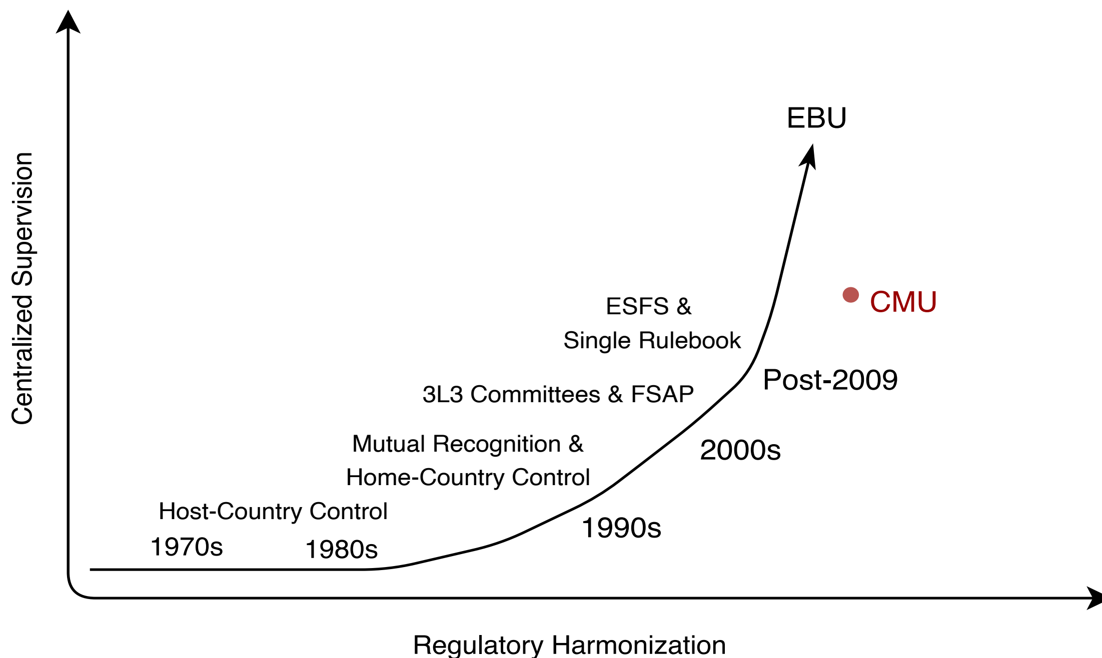

Figure 1.1: Puzzle

The first decades of the European Union were largely dominated by concerns over national sovereignty and financial supervision remained under full national control. At this earliest stage of European financial integration, national preferences were strongly shaped by the logic of national financial dominance and financial integration was seen as an efficient way to provide foreign market access for national firms. This should support and strengthen the market position of *national* finance in an ever more internationalized financial world. Yet, such integration was limited to a first attempt

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at regulatory integration and in particular the reduction of entry barriers across member states. If financial institutions entered foreign markets, they were still supervised by the host country's national competent authority. This host-country principle has the advantage that national supervisors remain in full control over foreign financial institutions in their national financial markets. While this can have some added value for national financial stability, it has negative effects on financial integration overall. If financial institutions have to comply with a variety of distinct national regulatory and supervisory regimes, the compliance costs may not justify the efficiency gains of easier foreign market access and cross-border financial activities remain limited.

As a consequence of this, the 'black box' of national supervision was slowly opened since the 1970s by moving from host-country control to the home-country principle in financial supervision which allows national supervisors to supervise their own national financial firms in foreign markets. From this point onwards, a deepening of regulatory financial integration was accompanied by some form of supervisory reforms. While such 'coupled' integration in rule-making and rule-monitoring progressed over time, the financial crisis accelerated the pace of that progress.

In the post-2009 period, it became clear that the existing approach to financial integration does not suffice to tackle financial instabilities. In terms of regulatory integration, the EU began to rely less on directives, that provide member states some leeway for the transposition into national law, and increasingly utilized regulations that need to be directly adopted by member states. As a consequence of this, the post-2009 period saw a significant move towards the development of a single rule-book. In terms of supervisory integration, the EU not only further institutionalized the existing system of national supervisory coordination on EU level through a new system of European financial supervision (ESFS) but also extended the focus beyond the micro-level to macro-prudential supervision. Born out of necessity, an increasing

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trend from coordination to centralization became apparent that peaked in the creation of the European Banking Union (EBU) based on a single banking rulebook as well as direct supervision.

It would not have been implausible for the CMU to follow the EBU. In terms of supervision, both the EBU and the CMU are - in theory - closely related. For the European Commission the European Banking Union did imply a Capital Markets Union. In order to have successful prudential supervision, capital markets need to be taken into account too. The CMU, just like EBU, should have therefore achieved a relocation of supervisory authority away from Member States to a supranational authority. Instead, the CMU displays a status quo bias in financial supervision. Such limited progress in supranational supervision is particularly puzzling in the context of this general integration trajectory and the post-crisis trend towards increased supranational supervision. The close ties between the Banking Union and a future Capital Markets Union should have created supervisory spill-over effects that ultimately failed to materialize.

As mentioned before, the CMU should overcome the fragmentation in non-bank finance and create a single market for capital. Removing national regulatory barriers would support the expansion of domestic financial institutions (outward internationalization) and increase foreign penetration into domestic markets (inward internationalization/foreign penetration). This begs the question whether national fragmentation is the very reason for the ultimate lack of supervisory reform. In other words:

Can the level of internationalization in non-bank finance account for the 'status quo bias' in supranational supervision?

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1.2 Literature Gap and Contribution

The political economy literature on the Capital Markets Union remains overall rather limited and tends to cluster around three main research foci. The first research takes a constructivist perspective on the CMU and/or focuses on the CMU as a tool towards increased financialization. Despite the merit in such research, most of the existing evidence focused on the first years of the CMU which does not support any general explanations about the status quo bias in supervisory reform over all.

A second research focus is on the role of national preferences in the design of the CMU. Such intergovernmental work on the CMU rests on a well established literature for both the Banking Union and the broader post-crisis integration trajectory and account for member states preferences on the EU level either based on power relations or the structure of domestic financial markets. In the latter case, varying levels of internationalization in national markets are increasingly used as an explanatory factor for state preferences. That is, countries with more internationalized markets should favor further market integration.

While no process can occur without the approval of national governments, this very fact does, in itself, not necessarily provide a sufficient explanation for the status quo bias with the Capital Markets Union. While the intergovernmental argument is attractive to explain final outcomes, earlier stages of the European policy making process are very much shaped by supranational institutions and organized industry interests. The European Commission, for example, started several public consultations in order to receive feedback from stakeholders on their proposals for a CMU. As such, the European Commission incorporated the expertise of stakeholders from the very beginning and a purely state-centric perspective on the status quo bias in supervision lacks insights at this crucial, earlier stage of the EU legislative process.

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Neofunctionalism highlights the functional role of supranational institutions and private, transnationally organized interests. Transnational interest groups recognize the benefits for deeper integration and supranational institutions, rather than national governments, are the main respondents of these demands that create incremental progress rather than one big integration leap. Within the neofunctional literature, spill-over effects dominate the explanatory framework of integration. The idea behind spill-over effects is that once integration in specific sectors occurred, the ever increasing complexity of problems requires integration to other sectors in order to find solutions for these problems (Niemann & Ioannou, 2015; Tranholm-Mikkelsen, 1991). Spill over effects require that actors see previous steps as imperfect (Scholten & Scholten, 2017). As such, functional dissonances emerge that push for further integration to overcome previous, imperfect integration steps.

So far, the application of neofunctional explanations for the post-crisis trajectory of supervisory reform remain limited. Among the notable exceptions is Rachel Epstein's work on the Banking and Capital Markets Union (Epstein, 2017; Epstein & Rhodes, 2018). In her book *Banking on Markets*, for example, Epstein argued that the persistence of state-bank ties (in Western Europe) enabled supervisory forbearance, protectionism and state guarantees for failing banks. This has intensified the consequences of the financial crisis for the banking sector through a bank-state doom loop. The combination of such bank-state ties with the increasing liberalization of the sector created a vicious cycle between banks and their sovereigns, enabled contagion across borders, compounded downturns and increased the likelihood of failed monetary policy transmission by the EBU (Epstein, 2017, p.15). As such, these state-ties created functional dissonances in the context of national control that required the delegation of regulatory and supervisory authority to the EU level. The Banking Union, through the Single Supervisory Mechanism, tackled these functional dissonances by delegating authority to the EU level and diminishing national control over banks

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(Epstein, 2017). Yet such functional dissonances are not solved by chance, in the case of the EBU, multinational banks joined the efforts of the European Commission to delegate supervisory control to the supranational level.

Both the European Commission and the ECB have repeatedly highlighted the close links between a EBU and CMU. Both projects should complement one another. A CMU supports the Banking Union, while a fully functioning Banking Union allows for more efficient capital allocation and a more effective Capital Markets Union. In order to create a true single market in capital, both bank and non-bank finance should rest on harmonized rules and robust regulatory framework with supranational supervision. From a neofunctionalist perspective, this raises the question why we observe a status quo bias rather than spill-over effects in terms of supranational supervision from the EBU to CMU. To the best of my knowledge, this question has so far remained unanswered in the literature.

This dissertation contributes to the literature in three ways. First, by taking a neofunctional perspective, this PhD project advances functional explanations that move away from national interests and/or purely constructivist accounts of financial integration. Second, existing neofunctional explanations tend to focus almost exclusively on the banking sector. Thus, by focusing on non-bank finance, this dissertation advances the literature on the CMU by testing whether existing neofunctional explanations can travel beyond the banking sector. Lastly, neofunctionalism still remains predominantly associated with the concept of spillovers, that is, functional dissonances from previous integration steps that lead to integration pressures and enable a 'falling forward'. While neofunctional explanations are often used for positive integration episodes, the CMU represents a status quo bias when it comes to supranational supervision. As such, this project provides a neofunctional account that goes beyond mere spill-over effects and puts forward an explanation for failed delegation.

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1.3 Main Argument

The main theoretical task is to find an explanation to the question of why national control did not give in to functional pressure in the CMU, when it did so in the EBU. I argue that this is due to the fact that the Commission-industry alliance that was present in the EBU broke down for the Capital Markets Union. The functional dissonances that were present ahead of the EBU and aligned the reform preferences of the European Commission with the interests of internationally-oriented banks were differently perceived by the Commission and non-bank finance in the case of the CMU.

To theorize the functional pressures for the European Commission, I will rely on the financial trilemma as a theoretical heuristic and adjust it to the Capital Markets Union (Schoenmaker, 2011).[1] The gist of his trilemma is that financial stability and financial integration cannot be secured through national-level supervision; one needs to go. Since both financial integration and financial stability are central objectives for the European Commission, the functional dissonance is linked to national control. While the Banking Union and the CMU differed in their primary goals - financial stability versus financial integration - the functional dissonance for the European Commission was in both cases the presence of national supervision. This, in turn, enabled policy proposals for the delegation of supervisory powers to the EU level. Thus, for the European Commission, the EBU and CMU should combine financial integration and financial stability for both bank and non-bank finance in a financial union by delegating national control to the EU level.

[1]The financial trilemma is often used a theoretical tool to explain national policy makers' policy choices towards EU banking integration but there is no theoretical justification within the trilemma that limits its application to national policy makers or the banking sector.

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In the case of the Banking Union, this functional dissonance overlapped with the preferences of large, internationally-oriented banks that enabled a Commission-industry alliance against national control in banking. Capital mobility and a common currency created tensions for finance-state ties that are only resolved for multinational banks through the delegation of national control to supranational authorities (Epstein, 2017). But non-bank finance is not necessarily exposed to the same level of cross-border capital mobility in the EU (or the Euro area). Ultimately, whether or not national control is seen as a functional dissonance for non-bank finance depends on the level of the internationalization. The level of internationalization, in turn, determines the presence or absence of a Commission-industry alliance.

This dissertation makes two main arguments. First, the reason for the delegation of supervision is not merely found in member state preferences but in the position of non-bank finance. Rather than being a natural ally of supranational institutions in their endeavor for more integration, finance can also support political settings that sustain the fragmentation of national markets. Whether or not supranational institutions gain the support of the financial industry shapes the delegation of supervision. The presence of a Commission-industry alliance can nudge member state preferences towards more supervisory delegation. In the case of a conflict between the position of the Commission and the industry, supervisory delegation becomes unlikely. A Commission-industry alliance is thereby a necessary but in itself insufficient condition. Even in the case of such an alliance, member states can still resist supervisory integration but in the absence of a Commission-industry alliance, supervisory delegation should fail.

Second, the driving factor behind the position of the financial industry is the level of outward internationalization and competitive pressures from foreign firms (inward internationalization) in those domestic markets with large enough non-bank financial

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sectors to influence politics - both on the national and supranational level. If national non-bank finance is highly outward oriented, supranational supervision becomes a supportive force in such outward expansion and a Commission-industry alliance is likely to emerge. Yet if outward internationalization remains low or if the number of foreign firms in the domestic market exceeds the number of domestic firms moving outwards, national control can gain traction for domestic non-bank finance in the conflict between competition and financial stability. In this case, the European Commission cannot count on financial industry support to move national preferences towards more supranationalism. In the worst case, the financial industry can actively lobby against a Commission proposal on the national level.

Low internationalization is a necessary condition for the absence of functional dissonances. High internationalization, in contrast, does not suffice in itself to trigger functional dissonances and a push for supranational control. If foreign penetration is higher than internationalization, the competitive disadvantages from a supranational supervisor are higher than the efficiency disadvantages that arise from capital mobility for internationally-oriented, domestic firms when they are controlled by national supervisors. Thus, with a high number of foreign competitors in domestic markets, the advantages of supervisory forbearance in national supervision are seen as an advantage and lead to the absence of functional dissonances despite increasing financial integration with the CMU. Only if foreign penetration is (on average) lower than internationalization, will non-bank finance perceive a functional dissonance between national control and the increasing integration of financial regulation via the CMU. In the context of competitive pressures, finance is 'fortressing on markets' by advocating for the status quo (i.e. national control); that is, they will discourage EU policy makers the move to supranational supervision since EU supervisors would emphasize a level-playing field and market competition.

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1.4 Operationalization and Case Selection

The main focus in this dissertation is on non-bank finance and will include insurance companies, pension funds, and asset managers (in particular investment fund managers and investment firms). Moreover financial infrastructures became a crucial actor since the financial crisis. Central counter-parties (CCPs), for example, are placing themselves in the middle of a capital market transaction by becoming the buyer to every seller and the seller to every buyer. They thereby reduce the risk exposure between buyers and sellers. Each of these types of non-bank finance was selected due to its exposure to supervisory reform proposals in the CMU. While the outcome of interest - supervisory delegation - varies to a certain extent, non-bank finance overall shows a status quo bias. Supervisory reform (partially) succeeded only for investment firms and CCPs. But, as I will argue later, even in these two cases, supervisory reform actually reinforced a status quo bias.

The empirical evidence for testing my neofunctional argument deploys a novel data set, based on the official registers of the European Supervisory Authorities (ESAs), on inward/outward internationalization in non-bank finance. ESA registers provide information about the number of financial institutions in a home country and the number of branches (together with the country of origin). Based on this information, the level of outward internationalization and foreign penetration can be calculated. Outward internationalization is thereby measured as the percentage of domestic non-bank financial institutions that operate branches in at least one other EU market, while foreign penetration is calculated as the percentage of foreign branches from the total number of branches in a market. The exact data collection procedures, together with the main datasets, are provided in detail in the appendices.[2] Other empirical

[2]The reliance on ESA registers is also due to the lack of adequate alternative data on the both the inward and outward internationalization by type of non-bank finance in the EU27.

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data is taken from secondary sources and referenced accordingly.

In order to lend further empirical evidence to my argument, I also focus on public consultation feedback on the CMU that contains stakeholder responses to the question of supranational supervision. Public consultations are thereby a decisive device for the European Commission to determine what policy proposals are likely to survive further scrutiny by member states and the European Parliament. Moreover, the European Commission relies on the wide range of stakeholders and their expertise in public consultations to strengthen their bargaining position vis-a-vis the Council and the Parliament (Bunea & Thomson, 2015). The European Commission's need to receive expert input on their proposals constantly increased the importance of consultations since the early 2000s. At the same time, this allows the financial industry to affect policies before a proposal reaches either the Council or the European Parliament (Klüver, 2011; Røed & Hansen, 2018; Quittkat, 2011).

Financial institutions can either use 'outsider' or 'insider' strategies to lobby legislation. The former refers to protest outside the legislative arena via media or protest, while the latter is linked to direct access to politicians via meetings, expert rounds, or public consultations (Dür & Mateo, 2016; Eising, 2017). While the legislative procedure in the European Union provides ample 'insider' opportunities for financial institutions and associations to influence the European Commission, public consultations are particularly well-suited to influence the design of legislation (Røed & Hansen, 2018; Bunea & Thomson, 2015; Binderkrantz, Blom-Hansen, & Senninger, 2021; Van Ballaert, 2017).Given the outcome of interest, supporting evidence should therefore be visible within these industry feedbacks to the European Commission.

In terms of case selection, this dissertation focuses on the pattern of internationalization and foreign penetration in the EU27. Including the EU27, rather than the Euro Area only, is due to the fact that the Capital Markets Union was, in contrast

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to the Banking Union, proposed by the European Commission to apply to the EU as a whole. Nonetheless, the main data will be subdivided for the Euro area which allows for a comparison of non-bank finance structures between the EU-27 and the Euro Area to ensure that the overall focus does not hide patterns that are unique for the Euro area only. Another consequence is that the main empirical analysis chapter excludes the United Kingdom. Since the UK vote to leave the EU occurred before supervisory proposals were voted on, supranational supervision affected mainly the EU27. Thus, intra-EU industry dynamics, rather than the influence of UK finance, as a third-country entity, should matter. I nonetheless account theoretically for the potential influence of the UK on EU non-bank finance in a later chapter. Of course, excluding the UK changes the pattern of internationalization and leads to a mismatch with the real levels of internationalization in overall non-bank finance. Yet, for my case, this should have no consequences; my main argument focuses on intra-EU competitive pressures and expansion patterns rather than the real levels for international finance.

Lastly, this dissertation ignores the role of US (and Chinese) finance in the EU. Of course, on a general level, non-EU finance plays a central role. Since most of EU finance retreated to domestic markets, global finance is by now almost synonymous with US financial institutions, while Chinese finance is gaining grounds. Nonetheless, this should have little effect on supervisory reform within the EU and my measures of outward/inward internationalization. While non-EU finance would benefit from a single supervisor, it is hard to imagine that the EU would account for the interests of third-country finance as long as EU non-bank finance objects supervisory reform. Thus, inward/outward internationalization of EU non-bank finance within the EU27 should be the decisive empirical test for the delegation of supervisory authority to the EU level.

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1.5 Structure of the Dissertation

Following up on this introduction, *Chapter 2* will outline the puzzle of this dissertation; that is, the status quo bias in supervisory reform within the CMU despite ever more centralization after the financial crisis that peaked with the Banking Union. The chapter presents a historical overview of financial integration in the EU to support the claim that regulatory and supervisory integration continuously deepened, albeit at different speeds and degrees. Regulatory integration always exceeded supervisory integration, but both deepened over time nonetheless. The main claim of this chapter is that such 'coupled deepening' discontinued with the CMU where we can observe progress in regulatory integration but limited reform in supervisory integration. The chapter ends with a detailed overview of the system of financial supervision for banks in the Banking Union and non-bank finance in the CMU.

In order to embed my work into the broader literature, *Chapter 3* provides a literature review of post-crisis financial integration and supervision with a focus on both intergovernmental and neofunctional explanations. I argue in this chapter that neofunctional explanations can provide a novel perspective on the outcome of the Capital Markets Union. By relying on neofunctionalism, the focus shifts from the national interests of governments to the role of supranational institutions and the financial industry in pushing integration forward. The chapter will conclude with a close reading of a recent neofunctional explanation for the Banking Union and adjust its main findings for non-bank finance to test the neofunctional argument on the Capital Markets Union.

Chapter 4 provides the main argument of this dissertation. In order to enable theory testing, this chapter will extend the neofunctional focus beyond banking to non-bank finance - in particular investment funds, insurance companies and pension funds. The

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first section will introduce the financial trilemma and the ”optimal” choice for supranational institutions between financial integration, financial stability and national supervision. For the European Commission, the choice is clear. In order to create a true single market for capital, national control needs to give in. But previous neofunctionalist work highlighted the importance of a Commission-industry alliance and for non-bank finance, this 'optimal' choice is conditional on the level of internationalization. The main argument is that internationalization is a necessary conditions to explain the functional pressure towards supranational control in non-bank finance. While low levels of internationalization should lead to sustained national control over supranational supervision, high levels of internationalization only create functional dissonances if foreign penetration remains lower.

Chapter 5 tests this neofunctional argument for the main institutional investors: investment fund managers, pension funds and insurance companies. The first section focuses on investment funds and the European Commission's proposal for a pan-European investment funds scheme that should not only create a single investment fund market but also delegate direct supervisory authority to ESMA. The second section concentrates on pension funds and insurance companies by analyzing the European Commission's proposal for a pan-European personal pension scheme that should create a single market in private pensions. The chapter shows that the lack of reform in both cases fits the overall argument. While investment fund managers and pension funds show low levels of internationalization, insurance shows higher levels of foreign penetration than outward internationalization. Both patterns result in a lack of functional pressures for supranational supervision. Additional evidence from public consultations shows that industry preferences for all three types of institutional investment were in favor of the status quo. Together, the benefits of national control outweigh the benefits of supranational supervision for these actors, leading to a lack of functional pressures.

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Chapter 6 focuses on the two areas where supervisory reform partially succeed - large investment firms and third-country central counterparties. For investment funds, supervisory reform placed the largest, systemically relevant firms under ECB supervision, while providing a more lenient prudential framework for smaller investment firms that remain dominated by national supervision. For central counterparties, supervisory reform delegated direct supervisory powers to ESMA for the largest third-country CCPs. Thus, despite supervisory delegation, neither investment firms nor CCPs became fully supervised on the EU level. Given the dominance of the UK in both markets, this chapter takes a closer look at the effect of Brexit on this reform pattern. While existing research emphasizes the role of politics, the chapter argues that the level of internationalization in these industries can still account for the ultimate outcome of reform since both cases of supervisory reform sustained the status quo within the EU27.

The dissertation ends with the *Conclusion* that summarizes the main findings of this project, emphasizes the contribution and limitations, addresses open questions and takes a look at the road ahead.

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