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DIALOGUE AND DEBATE: SYMPOSIUM ON COMMODIFICATION AND EU LAW

Facing the fiction: can the European Union regulate fictitious commodities and capital?

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Abstract

The years following the financial crisis of 2008 have witnessed a revival of interest in both the Polanyian concept of 'fictitious commodities' and the Marxian concept of 'fictitious capital'. The former, with its focus on the consequences of markets for the 'fictitious commodities' of land, labour, and money, appears as a plausible explanation for our present instability along environmental, social, and economic axes. The latter, with its focus on what sets financial capitalists apart from their industrial counterparts, sheds light on what really separates Wall Street from Main Street, and what it all means for the prospects of class struggle in the 21st century. Building on a decade and a half of discourse on the role of these phenomena in financialisation, this paper explores the kinds of limits the law can place on high finance's most flagrant flights of fancy. Taking as case studies the post-crisis efforts by the European Union (EU) to intervene in two key financial markets – private equity and securitisation – it asks how far current regulatory frameworks go, and what more can be done to protect Europe from capitalism's excesses.

Keywords: financial regulation; fictitious commodities; fictitious capital; securitisation; private equity

1. Speculative fiction

At some point during the weekend of 13–14 September 2008, the President of the United States (USA) Federal Reserve Bank (Fed), Timothy Geithner, made a phone call to Ben Bernanke, its chairman. The purpose was to inform him that neither Bank of America nor Barclays was willing to submit an offer to purchase Lehman Brothers, which was now on the verge of bankruptcy. Desperate, Bernanke asked Geithner if there was anything the Fed could do 'to try to keep the firm afloat'.[1] The answer was no – the firm was beyond rescue. Bernanke recalls it as a 'terrible, almost *surreal* moment'.[2] Surreal in the sense that never, in his wildest dreams, had he imagined the stock price of one of the largest investment banks in the USA, with over $600 billion in assets, could plunge by 93 per cent in a single day's trading.[3] Surreal in the sense that reality no longer conformed with the conventional wisdom on Wall Street and in Washington that banks, with the aid of 'increasingly sophisticated techniques that make use of extensive data analyses and a variety

[1]B Bernanke, *The Courage to Act: A Memoir of a Crisis and its Aftermath* (W.W. Norton and Company 2015) 267 (emphasis added).

[2]Ibid., 268.

[3]AE Jeffers, 'How Lehman Brothers Used Repo 105 to Manipulate Their Financial Statements' 8 (5) (2011) Journal of Leadership, Accountability and Ethics 44, 44.

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of new financial instruments' (including 'over-the-counter derivatives'), had – as Bernanke himself had declared – 'made substantial strides. .. in their ability to measure and manage risks'.[4]

The collapse, however, was no hallucination. On the contrary, it shattered illusions. When chaos hit, Lehman Brothers' equity capital, the amount of money it had collected from its shareholders to fund its investment activities, was only $22.5 billion.[5] Using the lingo of financial regulation, Lehman Brothers was 'highly leveraged', meaning they relied heavily on debt instruments as a means of bankrolling investment opportunities.[6] However, the full extent of Lehman Brothers' vulnerabilities cannot be captured by a simple leverage ratio. Piles of debt were not the only problem. On the other side of the ledger, there was something surreal about many of Lehman Brothers' assets. They did not actually exist – at least not yet. They were pure products of faith in an 'imagined future'.[7] Reuters was wrong that week when they wrote about 'hundreds of billions of dollars vanishing overnight'[8] This value did not 'vanish' – it was never there. It was a work of speculative fiction; one that still threatens to produce a surreal dystopia.

It is even clearer today that the fallout from speculative fervour spreads beyond the financial sector. Least cost location, tax base shifting, regulatory arbitrage, and other such manoeuvres by multinationals have widened wealth gaps and social divides. Unsustainable investments have pushed our planet to the brink of ecological collapse.[9] A dilemma in three dimensions – economic, social, and environmental – has emerged, appearing to vindicate Karl Polanyi's dire predictions about the consequences of establishing markets for his three 'fictitious commodities' – land, labour, and money.[10]

Scholars on both sides of the Atlantic have noted this dynamic, including Bob Jessop[11] and Nancy Fraser.[12] However, they have also detected a peculiar departure from the Polanyian paradigm. In his magnum opus, *The Great Transformation*, Polanyi argued that, as *laissez faire* capitalism advances and the free market becomes less and less 'embedded in social relations',[13] the resulting social instability leads even the capitalists themselves to begin calling for regulation. The constant drive to expand market society thus stands in dialectic relation with the constant need to safeguard humanity from being destroyed in the process, a countervailing tendency Polanyi calls the 'double movement'.[14] It is this aspect of Polanyi's framework that the likes of Jessop and Fraser find lacking in our present context.[15] How has financial capitalism proven so

[4]B Bernanke, 'Modern Risk Management and Banking Supervision' (Stonier Graduate School of Banking, Washington, DC, 12 June 2006), https://www.bis.org/review/r060615a.pdf, accessed 26 February 2023, 2, 5.

[5]S Morris and HS Shin, 'Financial Regulation in a System Context' 39 (2) (2008) Brookings Papers on Economic Activity 229, 243.

[6]See 'Leverage', *Oxford Advanced Learner's Dictionary* (10th rev edn, Oxford University Press 2020), https://www.oxfordlearnersdictionaries.com/definition/english/leverage_1, accessed 1 July 2023.

[7]J Beckert, *Imagined Futures: Fictional Expectations and Capitalist Dynamics* (Harvard University Press 2016).

[8]R MacMillan, 'The Great Depression of 2008? Not Quite' (*Reuters*, 19 September 2008), https://www.reuters.com/article/us-wallstreet-depression-idUSN1952961620080919, accessed 26 February 2023.

[9]See G Ceballos, PR Ehrlich and PH Raven, 'Vertebrates on the Brink as Indicators of Biological Annihilation and the Sixth Mass Extinction' 117 (2020) PNAS 13596 (blaming 'human activities' such as 'overexploitation, … toxification, and pollution' for the 'extinction crisis' the authors characterise as an 'existential threat to civilization').

[10]See K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (first published 1944, Beacon Press 1975) 75–6.

[11]B Jessop, 'Hard Cash, Easy Credit, Fictitious Capital: Critical Reflections on Money as a Fetishised Social Relation' 1 (2015) Finance and Society 20, 23; B Jessop, 'A Polanyian Paradox: Money and Credit as Fictitious Commodities, Financialization, Finance-Dominated Accumulation, and Financial Crises' in R Atzmüller et al (eds) *Capitalism in Transformation: Movements and Counter movements in the 21st Century* (Edward Elgar 2019) 75.

[12]See N Fraser, 'Can Society Be Commodities All the Way Down? Post-Polanyian Reflections on Capitalist Crisis' 43 (2014) Economy and Society 541; N Fraser, 'A Triple Movement: Parsing the Politics of Crisis after Polanyi' in M Burchardt and G Kirn (eds) *Beyond Neoliberalism: Social Analysis after 1989* (Palgrave Macmillan 2017) 546–55.

[13]Polanyi (n 10) 57.

[14]Ibid., 136.

[15]Fraser, 'Can Society Be Commodities All the Way Down?' (n 12) 554; Jessop, 'A Polanyian Paradox' (n 11) 87.

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resistant to global efforts to re-embed fictitious commodity markets within the protective framework of cultural institutions?

The answer may be lurking in the closely related concept of 'fictitious capital'. Often attributed to Karl Marx, the term is in fact of older pedigree, invoked for instance in an 1804 Article in William Cobbett's *Political Register* as a moniker for 'those pecuniary relations and contrivances, by means of which men trade beyond their real capital, and, sometimes, without any real capital at all'.[16] Nonetheless, it is Volume III of Marx's *Capital* that has ensured its survival – or, perhaps more accurately, its revival, as the term received scant attention for much of the 20th century.[17] David Harvey, an exception to this rule, has promoted its pertinence since the early 1980s,[18] calling it 'one of Marx's important concepts'.[19] It increasingly seems so, for it allows us to grapple with what really separates Wall Street from Main Street, and what it all means for the prospects of class struggle in the 21st century.

Building on a decade and a half of discourse on the role of fictitious commodities and fictitious capital in financialisation, this paper explores what kinds of limits the law can place on high finance's most flagrant flights of fancy. Taking as case studies the post-crisis efforts by the European Union (EU) to intervene in two key financial markets – private equity and securitisation – it asks how far current regulatory frameworks go, and what more can be done to protect Europe from capitalism's excesses.

2. Fictitious capital, real consequences

Fictitious capital is a contingent claim to wealth that relies on an assumption of liquidity: the prospect of exchanging a purported asset for money or means of production. The precise concept is difficult to pin down, for over the years it has meant different things to different people. For classical liberal economists, up to and including Friedrich Hayek, fictitious capital was more or less synonymous with credit money, and its dangers were a matter of degree rather than kind.[20] Marx, by contrast, drew a bright line between interest-bearing and fictitious capital.[21] Interest-bearing capital – that is, money loaned to productive capitalists in exchange for repayment with interest – is not itself fictitious. Nonetheless, it is 'the mother of every insane form',[22] because it is through moneylending that 'the capital relationship reaches its most superficial and fetishized form'.[23] Bankers grow accustomed to what Harvey calls money's 'magical and occult power to create ever more money in and by itself'.[24] They lose sight of the fact that interest is not an inherent quality of

[16]The reference appears in an Article entitled 'The Effects of Paper-Money in Times of Scarcity' from the 13 October 1804 edition. *Cobbett's Political Register*, vol 6 (Cox and Baylis 1804) 563.

[17]François Chesnais counts David Harvey, Robert Guttman, and Louis Gill 'among the few scholars to have explored the notion of "fictitious capital"' during the decades leading up to the crisis. F Chesnais, *Finance Capital Today: Corporations and Banks in the Lasting Global Slump* (Brill 2016) 81. The concept's neglect is corroborated by the Google Books Ngram Viewer, which displays a long period of decreased usage stretching, curiously enough, from about 1929 to 2008, followed by a roughly three-fold increase over the ensuing ten years. 'Google Books Ngram Viewer: "fictitious capital"' (Google), https://books.google.com/ngrams/graph?content=fictitious+capital&year_start=1800&year_end=2019&corpus=en-2019&smoothing=3, accessed 26 February 2023.

[18]D Harvey, *The Limits to Capital* (first published 1982, Verso 2018) 326.

[19]D Harvey, *A Companion to Marx's Capital: The Complete Edition* (Verso 2018) 591.

[20]C Durand, *Fictitious Capital: How Finance Is Appropriating Our Future* (Verso 2017) 43–9.

[21]As Yair Kaldor has noted, this fact is often overlooked by his Marxist followers. Y Kaldor, 'Financialization and Fictitious Capital: The Rise of Financial Securities as a Form of Private Property' 54 (2022) Review of Radical Political Economics 239, 241–2.

[22]K Marx, *Capital: A Critique of Political Economy*, vol III (first published 1894, D Fernbach (trans), Penguin 1991) 596.

[23]Ibid., 515.

[24]Harvey, *A Companion to Marx's Capital* (n 19) 523. *See also* K Blomberg, 'Tertiarization, Financialization, and Economic Imperialism' in Z Cope and I Ness (eds), *The Oxford Handbook of Economic Imperialism* (Oxford University Press 2022) 358 ('this "complete" fetishism produces the impression that capital as money has a magical quality to grow on its own, even without the value generated from the exploitation of labour in production').

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money capital. Only in the sphere of production can the capitalist extract surplus value by exploiting labour and appropriating its fruits. Interest is merely the moneyman's negotiated share of the spoils.[25]

This habituation to receiving passive income in exchange for loaned money capital paves the way for 'capitalization', which, according to Marx, is how 'true' fictitious capital is formed.[26] From the banker's perspective, any stream of income – from coupon payments on government bonds and dividends on shares of capital stock to agreements to exchange cash flows in different currencies at prevailing spot rates[27] – can be reckoned as capital by simply multiplying its present value by the going rate of interest.[28] The product represents the value of the present property right over future receipts. However, this value is hypothetical; its holder has conjured capital out of thin air. Any money ultimately earned in this fashion is not interest – it is the appropriation of surplus value that did not even exist at the time it was pledged.[29] It is the product of pure speculation.

Fictitious capital, however, can become real in the blink of an eye. The missing link is liquidity. Fictitious capital may be an illusion, but it can be sold for cold hard cash. By availing themselves of secondary markets, speculators can exchange fictitious capital for the real thing. Fictitious capital becomes, as Marx states it, 'a commodity *sui generis*'.[30] These new markets reify the social relations of the sphere of production.[31] Capitalism itself is commodified, and the commodity fetish casts its mystifying shroud over its own maker. Far from the root of all evil, money becomes the root of all value. The implications are far reaching, not merely for the economy, but for class struggle and for our very survival.

A. How liquidity preference keeps finance afloat

Fictitious capital does not merely conceal capitalist social relations, it alters them. The purpose of production shifts from maximising profits in primary markets for industrial commodities to inflating prices in secondary markets for claims against these profits. Corporations are steered towards maximising 'shareholder value', a pursuit that deals more directly with how value is distributed than how it is generated.[32] Even if dividends ultimately depend on the corporation's capacity to create value, shareholder interests do not necessarily align with the financial health of the corporation – especially in the long term. Since the fictitious capitalist's endgame is liquidity, their goal is to appropriate as much value as possible and get out while the getting is good. In a competitive market where companies must pledge profits to obtain working capital, they succumb to a cycle of value extraction that keeps them reliant on self-defeating forms of financing.[33]

[25] Marx, *Capital*, vol III (n 22) 475.

[26] Ibid., 597.

[27] The two traditional examples are explicitly cited by Marx in Volume III of *Capital*. Ibid., 608. Their more modern counterpart is an example of a derivatives contract (specifically a non-deliverable forward), a category of asset that has been cited by several contemporary commentators as a species of fictitious capital. Jessop, *See eg* 'Hard Cash, Easy Credit, Fictitious Capital' (n 11) 34; G Moura de Cavalcanti Mello and M de Souza Sabadini, 'Profit, Interest, Rent, and Fictitious Profit' in G Moura de Cavalcanti Mello and M de Souza Sabadini (eds), *Financial Speculation and Fictitious Profits: A Marxist Analysis* (Palgrave Macmillan 2019) 150; P Nakatani and G Moura de Cavalcanti Mello, 'Crypto-Currencies: From the Fetishism of Gold to Hayek Gold' in Mello and Sabadini (eds) (n 27) 194; M Nishibe, 'Marx's Financial Capitalism' 45 (2019) The Japanese Political Economy 68, 69.

[28] Marx, *Capital*, vol III (n 22) 608.

[29] *See* J Milios, 'Value, Fictitious Capital and Finance. The Timeless of Karl Marx's Capital' 40 (2019) Filozofski Vestnik 111, 122; Kaldor (n 21) 240.

[30] Marx, *Capital*, vol III (n 22) 460.

[31] DP Sotiropoulos et al, *A Political Economy of Contemporary Capitalism and its Crisis* (Routledge 2013) 150; Milios (n 29) 122.

[32] Kaldor (n 21) 249; *See also* Jessop, 'A Polanyian Paradox' (n 11) 86.

[33] M Hudson, 'From Marx to Goldman Sachs: The Fictions of Fictitious Capital, and the Financialization of Industry' 38 (2010) Critique 419, 437.

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Meanwhile, efforts to inflate fictitious capital values, coupled with their unavoidable indeterminacy (as contingent on unknowable futures), cause their price to diverge from the value of the capital from which they derive.[34] This volatility makes secondary markets for fictitious capital appealing sites for speculation, exacerbating the separation.[35] These markets soon take on a life of their own, 'spiral[ling] onwards and upwards into the stratosphere of compounding asset and fictitious capital values'[36] to 'assume proportions incompatible with the real production potential of economies'.[37] However, the financial sector's apparent independence from the sphere of production finally reveals itself as a fallacy when people lose faith in the fiction, liquidity dries up, and the commodity *sui generis* becomes a commodity *invendibilis* – in plain English: unsaleable.

At least, that is what *would* happen were the capital-as-commodity fetish not 'complete'.[38] As it is, fictitious capital does not come labelled as such. Instead, it comes with contracts that entitle its owners to priority creditor status in bankruptcy,[39] or opportunities to close out their constellations of criss-crossing positions before such proceedings even commence.[40] These protections, reinforced by central bank bailouts, enable holders of fictitious capital to continue appropriating value even as the economy contracts. This explains Marx's apparent paradox that 'depreciation in crisis is a powerful means of centralizing money wealth'.[41] Defaulting homeowners face foreclosure, but the firms that placed bets on their future solvency benefit from 'bankruptcy remoteness' because they funnelled their investments through special purpose vehicles (SPVs).[42] Consumers bear the consequences of crisis.

B. How mobile capital demobilises labour

In contrast to the industrial capitalist, who directly confronts the labourer in the sphere of production, the money capitalist exploits labour indirectly.[43] His direct relations are with the other capitalists who deal in capital as a commodity. Here, Marx says, different 'factions of capital'[44] meet and haggle over how they will share the spoils of exploitation. The outcome is not determined by economic principles, but by power relations – 'it stands as a purely empirical fact, pertaining to the realm of chance'.[45] Nonetheless, the bargains struck in bank boardrooms have a profound influence on the conditions found on factory floors. This is because they alter the dimensions of the class struggle between labour and capital, a point Harvey claims, 'cannot be overemphasized'.[46]

[34]Marx, *Capital*, vol III (n 22) 608. *See also* R Hilferding, *Finance Capital: A Study of the Latest Phase of Capitalist Development* (first published 1910, M Watnick and S Gordon (trans), Routledge 1981) ch 7 s 2; B Fine, 'Financialization from a Marxist Perspective' 42 (2014) International Journal of Political Economy 47; Mello and Sabadini (n 27) 149.

[35]Fine (n 34) 51.

[36]Marx, *Capital*, vol III (n 22) 553.

[37]Durand (n 20) 55.

[38]Marx, *Capital*, vol III (n 22) 516.

[39]Hudson (n 33) 442.

[40]For an overview of how such 'close-out netting' arrangements 'puts certain fortunate creditors into a position of super-priority far preferable to the position of most creditors of a bankrupt estate', see VR Johnson, 'International Financial Law: The Case Against Close-Out Netting' 33 (2015) Boston University International Law Journal 101, 102.

[41]Marx, *Capital*, vol III (n 22) 599.

[42]For a recent overview of the nature and limits of bankruptcy remote structures, see Committee on Securitization and Structured Finance, ABA Business Law Section, 'Bankruptcy Remoteness: A Summary Analysis' 77 (2002) The Business Lawyer 1105.

[43]Marx, *Capital*, vol III (n 22) 503.

[44]Ibid., 536.

[45]Ibid., 486.

[46]Harvey, *A Companion to Marx's Capital* (n 19) 546.

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Heeding Harvey, Yair Kaldor places these considerations at the centre of his recent appraisal of fictitious capital and financialisation.[47] In his account, fictitious capital facilitates a dispersion of ownership that conceals the identity of the oppressor.[48] Just as the money capitalist confronts only other capitalists, wage-labourers confront only other (higher-paid) wage-labourers: hired managers,[49] whose hands are (purportedly) tied by dictates from above.[50] Instead of concrete individuals, rage is directed at spectral cadres like 'Wall Street' or 'the 1 per cent', and is dismissed in the same breath as conspiracy theories about chimerical 'illuminati'. Underneath lies the irony that labourers increasingly finance their own domination. Their mortgages, credit cards, and retirement accounts, now indispensable elements of social reproduction, place their wages immediately back at the disposal of their oppressors (sometimes even before the taxman takes his cut).[51]

When Alfred Weber, younger brother of Max, advanced his 'least cost' theory, he posited that industrial location was principally determined by 'two general regional factors, the costs of transportation and of labor'.[52] The increasing concentration of manufacturing on the peripheries of the global capitalist system[53] suggests that the more closely the global economy is interconnected, the more the latter consideration takes precedence. Production is shifted to locations where labourers are least equipped to resist exploitation, where local elites have capitulated to demands from foreign firms, backed by international financial institutions, to 'improve their "investment climate"'.[54] The lion's share of the profits flow back to the core via convoluted value chains whose intricacy not only shields their beneficiaries from accountability, but also reinforces the fetishistic impression that 'intellectual capital', not labour power, is what fuels profitability.[55]

This dynamic has thrived as both physical goods and money capital have become more mobile. Value extracted from the production process can now metamorphose through myriad forms and reappear in faraway places in the blink of an eye. Often, it ends up in very specific points on the global periphery that seek to claim their piece of the pie by setting themselves up as tax and secrecy havens. Along the way, it may pass through one or more so-called conduit jurisdictions, including EU Member States the Netherlands and Luxembourg, who together with the United Kingdom (UK) and Switzerland make up what the NGO Tax Justice Network calls the 'axis of tax avoidance'.[56] Concrete policy choices in these jurisdictions, such as the decision not to impose taxes on international transfers of revenue streams like intellectual property royalties or corporate dividends, provide an escape hatch through which capital can flow from high tax jurisdictions to offshore havens.[57]

[47]Kaldor (n 21) 249.

[48]Ibid.

[49]Kaldor (n 21) 245.

[50]Harvey *A Companion to Marx's Capital* (n 19) 546.

[51]See Hudson (n 33) 439–42; JP Watkins, 'Financialization and Society's Protective Response: Reconsidering Karl Polanyi's Double Movement' 51 (2017) Journal of Economic Issues 98, 109–11.

[52]A Weber, *Theory of the Location of Industries* (first published 1909, CJ Friedrich (trans), University of Chicago Press 1929) 35.

[53]See eg A Roberts, 'Peripheral Accumulation in the World Economy: A Cross-National Analysis of the Informal Economy' 54 (2014) International Journal of Comparative Sociology 420.

[54]Kaldor (n 21) 249.

[55]See Ibid., 249–50 for the proposition that 'the growing use of arm's length contracting, also known as "non-equity modes of production", makes the extraction of surplus value from low-wage workers in the Global South completely invisible, since most of the product's value is attributed to the branding and marketing activities of lead firms in advanced economies'.

[56]'State of Tax Justice 2023' (Tax Justice Network 2023), https://taxjustice.net/wp-content/uploads/2023/07/State-of-Tax-Justice-2023-Tax-Justice-Network-English.pdf, accessed 30 July 2023, 26.

[57]J Garcia-Bernardo et al, 'Uncovering Offshore Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network' 7 (2017) Scientific Reports no 6246, 2. To its credit, the Netherlands has recently taken steps to crack down on tax evasion, including by introducing a withholding tax on interest and royalties in 2021, which the Dutch Ministry of Finance aims

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The two capitalist factions Marx identifies are, like most Marxist dualities, abstractions. In practice, the line between money capitalist and industrial capitalist becomes blurry, as non-financial firms embrace derivatives trading to hedge their operating risks and diversify their investments.[58] Take, for instance, GE Capital, the financial services division of General Electric, which in 2013 was designated by the USA Treasury's Financial Stability Oversight Council as a 'systemically important' financial institution under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).[59] The imagined binary of finance versus industry risks invoking nostalgia for an industrial Arcadia that never was.[60] Even if Marx appears to argue in Volume III that finance distorts the production process, he unequivocally asserts in Volume I that this production process at its purest simply exploits labour to appropriate surplus value. Finance does not necessarily ramp up or diminish the rate of this exploitation. It merely disguises the true dimensions of capitalist domination, damaging society's capacity to resist.

3. Double movement, or doubling down? Fictitious capital in the post-crisis EU

Marx and Polanyi based their work on different economic postulates. The Marxian distinction between real and functioning capital is premised on the labour theory of value, according to which the value of (non-*sui generis*) commodities is dictated by the quantity of socially necessary labour time committed to their production.[61] Polanyi, for his part, seized upon the subjective measure of value advanced by the marginalists around the time of Marx's writing, according to which commodities are only those objects produced for purchase on the market by consumers seeking to satisfy a particular need.[62] Land, labour, and money are 'fictitious' commodities because they are not produced for sale, and any attempt to calibrate their supply to fluctuations in demand carries immense social implications.[63] Fictitious capital and fictitious commodities can still perhaps be reconciled. Bob Jessop, for instance, points to Marx's portrayal of 'labour power as a living subject rather than a passive victim' as evidence that he would have agreed with Polanyi on the inevitability of social pushback against the sale of labour as a commodity.[64]

Both Polanyi and Marx were optimistic on the prospects of social resistance, albeit in a strange sense. As his follower Fred Block has expressed it, Polanyi's optimism blossomed, ironically, from his 'extreme skepticism'.[65] Convinced *laissez faire* economics would engender extreme social upheaval, he felt equally sure society would mobilise in self-defence, reintroducing protective institutions to curtail the market's excesses.[66] For Marx, these excesses would prove to be capitalism's own spectacular undoing, sparking a revolution that would yield a new mode of economic organisation – perhaps, as he imagines at the end of his chapter on the commodity form

to follow with another one on dividends in 2024. C Persia, 'The Netherlands: A Warm Investment Climate' (ACFE Insights 2022), https://www.acfeinsights.com/acfe-insights/2022/12/2/the-netherlands-a-warm-investment-climate, accessed 30 July 2023. Nonetheless, according to Jan Vleggeert of Leiden University, 'the Netherlands remains an important conduit country'. 'The Netherlands Remains a Key Player in the World of Tax Evasion' (Universiteit Leiden 2023), https://www.universiteitleiden.nl/en/news/2023/07/the-netherlands-is-a-key-player-in-the-world-of-tax-evasion, accessed 30 July 2023.

[58]See eg GM Bodnar et al, 'Wharton Survey of Derivatives Usage by US Non-Financial Firms' 24 (1995) Financial Management 104.

[59]'Designations' (USA Department of the Treasury), https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations, accessed 28 February 2023.

[60]As expressed in Milios (n 29) 127, financialisation 'is not a deviation from or distortion of some 'good' industrial capitalism, or equally a new, predatory, method of exploitation (exploitation by dispossession etc), a 'bad' exploitation as opposed to the 'good' exploitation by the 'productive' industrial capital'.

[61]K Marx, *Capital: A Critique of Political Economy*, vol I (first published 1867, B Fowkes (trans), Penguin 1990) 129.

[62]Polanyi (n 10) 75.

[63]Ibid.

[64]Jessop, 'A Polanyian Paradox' (n 11) 78–9.

[65]F Block, 'Introduction' in Polanyi (n 10) xxviii.

[66]Ibid.

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that opens Volume I, 'an association of free men, working with the means of production held in common, and expending their many different forms of labour-power in full self-awareness as one single social labour force'.[67] There is irony here as well, for one of the capitalist's own constructs – the joint-stock company – could serve to smooth the transition to a more associative alternative.[68]

Such optimism seems absent from the works of their contemporary exponents. Polanyi's progeny seems to ask, 'why isn't the "double movement" working this time around'?[69] Meanwhile, a Marxist might ask, 'what is it that is making the workers of the world *dis*unite?' The answers offered to both questions often invoke the capture of state regulatory capabilities by financial institutions.[70] Emphasis is placed on the central bank bailouts of banks who place bad bets on exotic credit instruments, only to emerge emboldened to bet some more.[71] Less attention is devoted to the host of other regulatory authorities – state-based or otherwise[72] – that operate between the crises to influence what kinds of fictitious capital can be trafficked and enforced in the first place.

At the same time, critical legal scholarship in general is increasingly focused on the complicity of lawyers and lawmakers in developing capitalism's historically contingent market configurations. Prominent strands within this movement include the Law and Political Economy project, which argues that 'law is central to the creation and maintenance of structural inequalities in the state and the market',[73] and legal institutionalism, which sees law as 'constitutive of social relations' and responsible 'for many of the results and structures of modern capitalist society'.[74] Especially germane here is the 'legal theory of finance' posited by leading legal institutionalist Katharina Pistor, who argues that financial contracts ultimately depend on 'validation' from a legal system that 'defines the contours of their enforceability'.[75] Drawing from these currents, the remainder of this Article assesses, as efforts to set the boundaries of financial markets, the post-crisis regimes developed by the EU to regulate two key forms of contemporary fictitious capital: private fund interests and asset-backed securities.

A. Signed in triplicate: can we protect workers in private equity takeovers?

A private equity firm is an organisation that offers investment opportunities to customers who invest in pooled investment vehicles referred to as funds. These funds allow the firm to place money collected from many individuals and firms under the control of a single legal entity, usually a limited partnership organised under the laws of an offshore jurisdiction with a low rate of taxation on investment-based income. Each ordinary investor – often a limited partner (LP) – enters into a subscription agreement with the firm, in which they agree to invest in the fund in exchange for a share of the profits from its investment activities. Profit sharing is dictated by a series of provisions in the limited partnership agreement (LPA) colloquially referred to as the 'waterfall'. Usually, around 20 per cent of profits generated by the fund's investment activities go to the managing firm, a cut colloquially referred to as 'carry'. The managing firm also charges the LPs a flat management fee, usually about 2 per cent of the total invested capital. Waterfalls get complicated, reflecting negotiations between the firm, who wants to attract LPs but also maximise

[67]Marx, *Capital*, vol I (n 61) 171.

[68]Marx, *Capital*, vol III (n 22) 572.

[69]See above text accompanying n 15.

[70]For a Polanyian perspective, see Watkins (n 51) 113–6. For a Marxist framing, see Chesnais (n 17) 84–8.

[71]*See* Hudson (n 33) 423; Durand (n 55) 19; Watkins (n 51) 116.

[72]*But see* Fraser, 'Can Society Be Commodities All the Way Down?' (n 12) 553, citing the perception of 'the modern territorial state as the principal arena and agent for social protection' as 'a major blind spot' for 'Polanyi's perspective'.

[73]AP Harris and JJ Varellas III, 'Introduction: Law and Political Economy in a Time of Accelerating Crises' 1 (2020) Journal of Law and Political Economy 1, 10.

[74]S Deakin et al, 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' 45 (2017) Journal of Comparative Economics 188, 189.

[75]K Pistor, A Legal Theory of Finance 41 (2013) Journal of Comparative Economics 315, 324.

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its carry, and the LPs, who want to maximise their profit share but also incentivise the manager to maximise the total profits.

The bottom line is that all parties to the LPA want to see the firm generate significant profits by buying and selling companies, and they want to see this happen quickly, because they do not want their money stuck in the fund forever. Accordingly, private equity funds come with an expiration date, usually about ten years after formation. For the first half of the fund's term, its managers go out on the market and find operating companies to invest in. For each one, the fund manager develops a plan to boost its market valuation so it can maximise the revenue it extracts through dividends and eventual sale proceeds. When the fund term expires, the manager must liquidate remaining investments and distribute all proceeds in accordance with the waterfall. Since this can be challenging, there is now a growing market for so-called secondary transactions, where one firm sells a fund to another at a discount so it can settle accounts with its LPs.[76]

In theory, the relationship between private equity funds and their operating companies is mutually beneficial – the operating company becomes more profitable, and the fund enjoys its share of these profits. However, the tight timescale means that the profitability boost need not be permanent. Aggressive cost-cutting through massive layoffs or relocation to low-cost jurisdictions can serve the needs of the fund but leave the operating company a shell of its former self, stripped of its capital, workforce, and community ties. This is a common critique of private equity. It has been voiced by, among others, Christoph Scheuplein, who has studied the impact of private equity investment in the German automotive sector. Echoing conversations on the reification of capitalist social relations,[77] he calls private equity 'a form of financialization in which companies become commodities'.[78] Private equity ownership, he asserts, 'puts companies in a state of permanent crisis, with employees having to bear the entrepreneurial risk with their jobs'.[79]

Marx did not live long enough to offer an opinion on private equity, but already in Engels' lifetime the seeds of the strategy had started to blossom. In a footnote he added to Volume III, Engels observed that 'companies have even come to be formed which invest a million pounds, say, or even a few million, in the shares of [companies], subsequently issuing new shares for the nominal value of these shares bought, but with one half preferred and the other half deferred'.[80] This aside immediately follows an assertion in Marx's main text that, '[w]ith the development of interest-bearing capital and the credit system, all capital seems to be duplicated, *and at some points even triplicated*, by the various ways in which the same capital, or even the same claim, appears in various hands in different guises'.[81] Marx cites joint-stock companies as a prime example of this kind of duplication of capital, as their stock represents 'titles to real capital' but 'give no control over this capital'.[82] If stock certificates are 'paper duplicates of real capital',[83] then private equity subscription agreements are, so to speak, signed in triplicate.

In the throes of the 2008 crisis, the European Commission sought to place more stringent regulations on managers of so-called alternative investment funds, a category that includes private

[76]In his forthcoming work on private equity investments in carceral services, Sandeep Singh Dhaliwal makes the important point that secondary transactions offer more than a mere solution to fund end-of-life issues. Because these swaps involve only 'sophisticated' investors, they are subject to less stringent disclosure requirements than other types of buyouts, and thus provide firms to exchange interests in controversial corporations away from the prying eyes of the public. SS Dhaliwal, 'Investing in Abolition' (2023) Georgetown Law Journal (forthcoming).

[77]See above text accompanying n 31.

[78]C Scheuplein, 'Private Equity as a Commodification of Companies: The Case of the German Automotive Supply Industry' 24 (2021) Journal of Economic Policy Reform 472, 472.

[79]Ibid., 483.

[80]Marx, *Capital*, vol III (n 22) 601 n 3 (inserted by Friedrich Engels).

[81]Ibid., 601 (emphasis added).

[82]Ibid., 608.

[83]Ibid.

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equity funds and other vehicles like hedge funds.[84] The financial crisis was a wake-up call, exposing 'the extent to which [alternative investment fund managers ('AIFM')] are vulnerable to a wide range of risks'.[85] In spite of these risks, however, the Commission made clear that, in its estimation, '[t]he impact of AIFMs on the markets in which they operate is largely beneficial'.[86]

The Commission's initiative was heavily influenced by a report issued by a high-level expert group chaired by former European Bank for Reconstruction and Development chief Jacques de Larosière.[87] This report dealt mainly with the systemic risks posed by financial contagion, emphasising the degree of entanglement among banks and hedge funds.[88] Private equity funds barely received mention. In view of this animating impulse, it is unsurprising that the Commission's main concern in the sector was the consequences of insolvency on fund investors[89] and collateral damage to 'creditors, trading counterparties and to the stability and integrity of European financial markets'.[90] Its solution was to protect investors by mitigating conflicts of interest and strengthening fund governance.[91]

The Commission shied away from any far-reaching criticism of the conflicts of interest between private equity funds and their portfolio companies. Rather, in its impact assessment, it concluded that '[t]here is nothing inherent to the private equity model that should mean that privately owned businesses must be less sustainable or less responsible than public companies'.[92] In support of this assertion, the assessment cited a 2008 study of buyouts led by a team involving researchers at the Centre for Private Equity and Management Buyout Research at Nottingham University.[93] This study, which involved a 'pan-European survey of managers' perceptions', yielded several publications.[94] Its overarching finding was that 'negative perceptions of private equity is [*sic*] at variance with the systematic evidence':

> [P]rivate equity investment overall does not result in changes to union recognition, membership density or changes in management attitudes to union membership. Managers in firms recognizing unions after private equity buyouts also do not report reductions in the terms and conditions subject to joint regulation. Rather, under private equity ownership more firms report consultative committees and managers regard these as more influential on their decisions.[95]

These findings, seized upon by the impact assessment, have been called into question by certain subsequent research. For instance, another UK-based team of researchers criticised its reliance on 'industry surveys', which they claim 'are less reliable as managers are likely to overstate

[84]Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/38/EC and 2009/ . . . /EC' (COM/2009/207 final), 30.4.2009 (AIFMD Proposal) 2.

[85]Ibid., 2.

[86]Ibid., 12.

[87]The High-Level Group on Financial Supervision in the EU, 'Report' (25 February 2009) (de Larosière Report). The influence of this report on the Commission's approach is acknowledged on the very first page of its proposal. AIFMD Proposal 2.

[88]*See eg* de Larosière Report (n 87) para 88.

[89]*See* AIFMD Proposal 2.

[90]Ibid., 2.

[91]Ibid., 3.

[92]AIFMD Impact Assessment, annex X, s 1.

[93]*See* Ibid., s 3.2.6.

[94]*See eg* N Bacon et al, 'The Effects of Private Equity and Buy-Outs on HRM in the UK and the Netherlands' 61 (2008) Human Relations 1399; M Wright, N Bacon and K Amess, 'The Impact of Private Equity and Buyouts on Employment, Remuneration and Other HRM Practices' 51 (2009) Journal of Industrial Relations 501; N Bacon et al, 'Assessing the Impact of Private Equity on Industrial Relations in Europe' 63 (2010) Human Relations 1343; N Bacon et al, 'The Impact of Private Equity on Management Practices in European Buy-outs: Short-termism, Anglo-Saxon, or Host Country Effects?' 51 (2012) Industrial Relations 605.

[95]Bacon et al, 'Assessing the Impact of Private Equity' (n 94) 1365–6.

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performance and downplay limitations in order not to draw attention to any failings on their behalf'.[96] This later group opted instead to couple econometric analysis of company reports with broader stakeholder interviews, ultimately concluding that 'firms subject to a specific type of private equity acquisition – institutional buyouts – are associated with job losses, lower wages and lower productivity'.[97]

In some ways, these findings are more consistent with the Nottingham study than they may appear, reinforcing some of the nuance hiding beneath bold headlines. In at least one article, the Nottingham team insists that 'buyouts and private equity are heterogeneous phenomena' whose impact is influenced by factors like how the acquisition is funded and who drives forward the deal.[98] When management takes the lead, they may be more inclined to carry on business as usual; when the impetus comes from the outside, the result may be 'more problematical'.[99] More concretely, 'buyouts backed by private equity firms report fewer increases in high commitment management practices' than those initiated by insiders.[100] Much also depends on the 'anticipated time to exit': Portfolio companies introduce fewer 'high-performance work practices' when their private equity investors are gunning to get out quick.[101]

Despite expressing faith in the private equity business model, the Commission did not entirely ignore the concerns raised in this section. Rather, it sought to include in its proposal measures to moderate the '[i]mpact on companies controlled by AIFM', including by addressing potential conflicts of interest between private equity fund managers and their portfolio companies.[102] It even showed awareness of the heterogeneity of the sector by zeroing in on the 'exponential growth of private equity activity in the leveraged buyout (LBO) sector'.[103] LBOs are acquisitions in which the buyer incurs a substantial amount of debt to fund its investment in a target company. This can ultimately damage the financial prospects of the acquired company because a generous portion of its receipts must be diverted to satisfy the acquirer's debt service obligations.[104]

As the impact assessment acknowledges, the LBO model came in for criticism around the time of the financial crisis.[105] A prominent example is the 2005 takeover of Manchester United Football Club by the family of American investor Malcolm Glazer, which took out £540 million in loans to acquire the company at a £798 million valuation.[106] The takeover so inflamed the club's supporters that Glazer's three sons needed a police escort to escape protests when they visited the stadium two days after it was announced.[107] Aside from its publicity, however, the sale was no anomaly – according to data cited in the impact assessment, its 67.7 per cent debt-to-equity ratio actually fell just shy of the 70 per cent average for buyout deals concluded in the build-up to the crisis.[108]

To address this issue, the Commission proposed a set of 'reporting obligations' designed to 'address the perceived deficit of strategic information about how private equity managers intend

[96] M Goergen, N O'Sullivan and G Wood, 'The Consequences of Private Equity Acquisitions for Employees: New Evidence on the Impact on Wages, Employment and Productivity' 24 (2014) Human Resource Management Journal 145, 145.

[97] Ibid.

[98] Wright, Bacon and Amess (n 94) 512.

[99] Ibid., 513.

[100] Ibid., 506.

[101] Bacon et al, 'The Impact of Private Equity on Management Practices' (n 94) 621.

[102] The proposal even asserted that 'risks associated with the governance of portfolio companies are mostly closely associated with private equity', as opposed to other alternative investment fund models. AIFMD Proposal 3.

[103] AIFMD Impact Assessment, annex X, s 1.

[104] Ibid., annex X, s 2.5.

[105] Ibid., annex X, s 1.

[106] 'Glazer Gets 98% of Man Utd Shares' (*BBC*, 28 June 2005), http://news.bbc.co.uk/2/hi/business/4629401.stm, accessed 1 August 2023.

[107] 'Glazers Escape after Fans Protest' (*BBC*, 30 June 2005), http://news.bbc.co.uk/sport2/hi/football/teams/m/man_utd/4635727.stm, accessed 1 August 2023.

[108] AIFMD Impact Assessment, annex X, s 1.

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to, or currently, manage portfolio companies'.[109] In concrete terms, this meant that AIFMs who acquired at least a 30 per cent stake in a portfolio company would be required to disclose not only to the company and its shareholders, but also to representatives of its employees, among other things, their communications policy for the company ('in particular as regards employees') and, in the case of non-listed companies, their 'development plan'.[110] Furthermore, each fund would be required to include in its annual report, with respect to each controlled portfolio company, information on 'operational and financial developments' (including its earnings and activities), 'financial risks associated with capital structure' and, more crucially, 'employee matters' (such as 'turnover, terminations, [and] recruitment') and any 'significant divestment of assets'.[111] This, the Commission maintained, would help satisfy the 'need for private equity and buy-out funds to account publicly for the manner in which they manage companies of wider public interest'.[112]

The Commission's proposal, however, included a carve-out for 'small and medium enterprises that employ fewer than 250 persons, have an annual turnover not exceeding 50 million euro and/or an annual balance sheet not exceeding 43 million euro'.[113] The decision to exempt these transactions was not explained in the proposal document, and indeed cut against the observation in the impact assessment that 'the bulk of companies concerned by buyout transactions are actually small and medium size enterprises – the mid market'.[114] The European Economic and Social Committee (EESC) protested its inclusion in its opinion on the proposal, insisting that 'protection of investors and market integrity are non-negotiable principles which must be applied to all companies that manage alternative investment funds'.[115] It also argued that the information obligations should apply at a lower threshold (25 per cent of voting rights), go even further (requiring acquirers to 'explicitly safeguard collective labour agreements in force'), and carry as a penalty for non-compliance the automatic invalidation of relevant decisions.[116]

In the end, the Alternative Investment Fund Managers Directive (AIFMD),[117] which was enacted in 2011 and entered into force in 2013, maintained the Commission's basic framework of notification to management, shareholders, and employee representatives in the event of acquisition of control of any portfolio company, including listed firms.[118] However, rather than *decrease* the threshold for applicability, the Parliament opted to *increase* it to 'more than 50 per cent of the voting rights of the companies'.[119] On the other hand, it went beyond the Commission proposal by requiring notification to the competent authorities of an AIFM's home Member State whenever an acquisition or divestiture causes the AIFM's ownership interest to cross any of five

[109]AIFMD Proposal 9.

[110]Ibid., Art 28(1).

[111]Ibid., Art 29(2).

[112]Ibid., 9.

[113]Ibid., Art 26(2).

[114]AIFMD Impact Assessment, annex 10, s 1.

[115]Opinion of the European Economic and Social Committee of 29 April 2010 on a proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/ . . . /EC (CON/2009/81) (CESE/2010/631), 29.4.2010, para 4.10.

[116]Ibid., para 4.9.5. The European Central Bank (ECB) was less enthusiastic, however, warning against 'a potential risk of regulatory arbitrage' in introducing requirements of this nature in an instrument that regulated only AIFMs and did not apply to other participants in the market for corporate control. Opinion of the European Central Bank of 16 October 2009 on a proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/ . . . /EC (CON/2009/81), OJ C272/01, paras 7–8.

[117]Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, OJ L174/1 (AIFMD).

[118]Position of the European Parliament adopted at first reading on 11 November 2010 with a view to the adoption of Directive 2011/ . . . /EU of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (EP-PE_TCI-COD(2009)0064) PE 443.867 (Position of the European Parliament on AIFMD) Art 28.

[119]Ibid., Art 26(5).

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specified percentage thresholds,[120] together with an obligation to provide 'information on the financing of the acquisition'.[121] In the case of non-listed portfolio companies only, the AIFM is further required to disclose to the company and its shareholders 'its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment'.[122] It must also include in the annual reports of such non-listed portfolio companies 'at least a fair review of the development of the company's business representing the situation at the end of the period covered by the annual report,' as well as 'an indication of … any important events that have occurred since the end of the financial year', 'the company's likely future development', and 'information concerning acquisitions of own shares'.[123]

In zeroing in on LBOs, the Commission's framework set aside other sources of concern flagged even by the Nottingham researchers, namely the lower levels of human resource investment following deals instigated by outsiders or involving short time horizons. In addition, it relied solely on transparency, eschewing any binding limitations on the types of deals private equity firms conclude, and the types of policies they implement at the portfolio companies they acquire. This changed somewhat at the behest of the European Parliament, which inserted a provision designed to protect controlled portfolio companies against so-called 'asset stripping'.[124] This prohibition prevents AIFMs, at least for the first two years after gaining control of an operating company, from using dividends and other manoeuvres to transfer a substantial portion of its resources to the fund and its investors.[125]

While this may foreclose flagrant forms of corporate raiding, it is far from ensuring that private equity managers, by and large, will operate in the long-term best interests of operating companies and their stakeholders, particularly employees. It certainly does not afford any protection against downsizing or relocation. On top of this, a 2015 blog post by the UK law firm of Reynolds Porter Chamberlain LLP creates the impression that any protections it may provide to operating companies are tenuous, for '[t]here are a number of factors which may allow a buyer to mitigate the effect of the AIFMD asset-stripping rules'.[126] Their suggestions include structuring acquisitions to avoid triggering the applicable ownership threshold, as well as using intercompany loan arrangements to replicate the income streams offered by the specifically disqualified transaction structures.[127] Perhaps most depressingly, the post points out that the AIFMD's asset-stripping restrictions, like its transparency requirements, do not apply to small and medium-size enterprises with fewer than 250 employees and less than €43 million in assets.[128] At least it stops short of explicitly encouraging AIFMs to focus their pillaging efforts on the little guys.

In a 2010 memo supporting its initiative, the Commission highlighted the indirect benefits AIFMs provide to the working class – at least, the pensioned working class – by 'managing a large quantity of assets on behalf of pension funds'.[129] That well may be, but if the broader role private equity plays in labour's precarity is not addressed, this benefit becomes a trade-off. If dislocation of

[120]Ibid., Art 27(1).

[121]Ibid., Art 28(5).

[122]Ibid., Art 28(4). While the AIFM is not required to furnish this information directly to employees, it is required to do so indirectly by employing 'best efforts to ensure that the board of directors of the non-listed company makes available the information … to the employees' representatives or, where there are none, the employees themselves'. Ibid.

[123]Ibid., Art 29(2).

[124]Ibid., Art 30(1)(a).

[125]AIFMD Art 30.

[126]P Hill and G Belcher, 'Private Equity Acquisitions – Asset Stripping Rules' (Reynolds Porter Chamberlain LLP 2015), rpc.co.uk/perspectives/corporate-insurance-and-financial-services/private-equity-acquisitions–asset-stripping-rules/, accessed 28 February 2023.

[127]Ibid.

[128]Ibid.

[129]'Directive on Alternative Investment Fund Managers ('AIFMD'): Frequently Asked Questions1' (European Commission 2010), https://ec.europa.eu/commission/presscorner/detail/en/MEMO_10_572, accessed 28 February 2023.

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labour is the price of protecting pensions, we are simply sacrificing the present to provide for an (imagined) future. Through its transparency requirements, AIFMD may help activists shine a light on short-termism, but only in high-profile cases where private equity takes on a majority stake. Through its asset-stripping provision, it protects large portfolio companies from egregious forms of corporate raiding, but still leaves even them exposed to more sophisticated manoeuvres.

Recently, the Council and the Parliament reached a provisional agreement to amend AIFMD.[130] A Council press release reveals that these new amendments will 'enhance the availability of liquidity management tools', introduce an 'EU framework for funds originating loans', set forth 'enhanced rules for delegation by investment managers to third parties', provide for 'enhanced data sharing and cooperation between authorities', 'identify undue costs that could be charged to funds', and 'prevent[] misleading names to better protect investors'.[131] So far, there is no indication that the transparency and asset stripping measures protecting private equity portfolio companies and their stakeholders will be strengthened or supplemented – a missed opportunity, it seems, to seize upon a growing sense that private equity may be 'operating in an alternate reality'.[132] As interest rates rise, a decade of relentless secondary market expansion[133] starts to look more and more like a bubble. If it bursts, who will take the fall to keep our nest eggs from cracking?

B. At the origins of the issue: can we seal off the escape hatch for irresponsible lenders?

Private equity is not the only sector with a secondary market; there is a massive one for debt. Instead of waiting for borrowers to pay them back, securitisation allows lenders to transfer loan contracts to a bankruptcy remote SPV, which issues securities entitling investors to payments based on the revenues it receives by collecting from the debtors. While the security can be as simple as a fixed coupon bond, it more commonly takes a more complex form such as a collateralised debt obligation, which is sliced into 'tranches' that determine the sequence of payments from cash flows. 'Senior tranche' investors usually receive regular payments at a relatively low coupon until maturity, when they get back their full principal. 'Junior tranche' investors face progressively greater risks, offset by potentially greater returns. They get paid at a higher coupon but are first to forfeit their rights if the SPV's assets are insufficient to cover its obligations. Thanks to bankruptcy remoteness, even if the sponsoring bank goes the way of Lehman Brothers, the SPV's assets are shielded from ordinary creditors. While other stakeholders scramble for scraps in protracted proceedings, securitisation investors – at least those in the senior tranche – continue collecting their coupon.

Securitisation is a peculiar species of fictitious capital because the underlying asset consists not of industrial, but of interest-bearing capital. It constitutes, as Teemu Juutilainen has stated, 'the commodification of debt'.[134] He argues that this treatment of debt as a tradable asset is a singular and historically contingent feature of contemporary capitalism.[135] Moreover, in his estimation, the 'most significant developments' in this commodification process 'have been caused or enabled by

[130]'Press Release: Capital Markets Union: Provisional Agreement Reached on Alternative Investment Fund Managers Directive and Plain-Vanilla EU Investment Funds' (*Council of the EU*, 20 July 2023), https://www.consilium.europa.eu/en/press/press-releases/2023/07/20/capital-markets-union-provisional-agreement-reached-on-alternative-investment-fund-managers-directive-and-plain-vanilla-eu-investment-funds/.

[131]Ibid.

[132]J Fontanella-Khan, 'Private Equity's Biggest Problem' (*Financial Times*, 25 September 2022), https://www.ft.com/content/5608ec19-1011-49ba-ba0d-ea19d389e73b.

[133]The secondary market grew fivefold from 2012 to 2022, from an annual aggregate net asset value of roughly $20 billion to more than $100 billion. These figures represent roughly 0.5 per cent and 2.5 per cent, respectively, of the applicable annual net asset value of the private equity sector. R Smith, 'What Does Secondary Market Growth Mean for You?' (*Hamilton Lane*, 4 April 2023), https://www.hamiltonlane.com/en-us/insight/secondary-market-growth.

[134]T Juutilainen, 'Law-Based Commodification of Private Debt' 22 (2016) European Law Journal 743, 744.

[135]Ibid.

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changes in the law'.[136] The proliferation of off-the-shelf, one-size-fits all contractual instruments to structure diverse debt relationships in identical ways has transformed what was once a social obligation into a transferable private property right for which the identity of the debtor is increasingly irrelevant.[137] Instead of a cultural institution bound up in moral, ethical, political, and religious traditions, debt is now an abstraction associated only with complex financial products, whose esotericism helps ensure that their management and regulation will be entrusted to a narrow community of specialists. Channelling Polanyi, Juutilainen calls this the 'disembedding of debt relations'.[138]

While he does not go further with Polanyi's framework, his critique can easily be couched as a cautionary tale about debt as a fictitious commodity. When you start bundling debt and selling it to the highest bidder, you create demand for more debt. This demand, however, cannot be satisfied without serious social consequences. Securitisation makes 'loan origination' tantamount to mining raw materials to produce debt-based securities for sale. This has been labelled 'the originate-to-distribute model'.[139] It undermines incentives to engage in proper due diligence on borrower creditworthiness, 'because the loans made will be sold to securitisers, and the risks passed on even further in the securitisation chain, to investors in [fictitious] capital markets'.[140] When the social relation between creditor and debtor is subordinated to secondary market demand, predatory practices like subprime lending emerge, sowing the seeds of financial collapse and intensifying what Harvey calls 'accumulation by dispossession'.[141] In the USA, the latest frontier seems to be higher education – as of the end of 2022, more than $1.75 trillion in student loan debt has been securitised.[142]

In 2015, the European Commission proposed a dedicated regulation to address securitisation. Despite the criticism of these instruments for their role in the financial crisis, the Commission's main purpose was not to restrain recourse to them, but rather to encourage their greater adoption. According to the impact assessment, 'EU securitisation markets have suffered a significant reduction in issuance since 2008 and have not recovered yet'.[143] The problem, apparently, was bad press. The court of public opinion had found European securitisations guilty by association. The 'strong consensus among European and international supervisors, regulators, central banks and market participants' was that 'the post-crisis reputation of securitised products issued in Europe was severely tarnished by practices and events taking place in the US'.[144] Securitisation transactions were increasingly viewed with suspicion by would-be investors. They were 'too complex and subject to too many conflicts of interest and asymmetry of information among securitisers, originators and investors'.[145]

[136]Ibid.

[137]Ibid., 750–2.

[138]Ibid., 754.

[139]For an overview of this concept and its origins, see VM Bord and JAC Santos, 'The Rise of the Originate-to-Distribute Model and the Role of Banks in Financial Mediation' 18 (2) (2012) Federal Reserve Bank of New York Economic Policy Review 21.

[140]Juutilainen (n 134) Ibid., 752.

[141]Harvey, *A Companion to Marx's Capital* (n 19) 585.

[142]'Student Loans Owned and Securitized' (*St. Louis Fed*, 7 February 2023), https://fred.stlouisfed.org/series/SLOAS, accessed 28 February 2023.

[143]Commission Staff Working Document, Impact Assessment Accompanying the document Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple and transparent securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 and a Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (COM(2015) 472final) (SWD/2015/185 final), 30.9.2015, 12.

[144]Ibid.

[145]Ibid.

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The Commission's solution was to encourage what it called 'Simple, Transparent and Standardised' (STS) securitisation.[146] The flagship feature of what would become the Securitisation Regulation (SecReg),[147] STS is a special label designed to entice sponsors to comply with optional requirements in exchange for a certification that can be used to attract investors and, in certain contexts, afford preferential capital treatment.[148] Juutulainen's Article criticises the STS programme, which had just been proposed at the time of his writing. Seizing upon the Commission's own stated objectives, he portrays it as an effort to 'revive' securitisation markets, thereby encouraging a 're-commodification' rather than a 'de-commodification' of debt.[149] So far, at least, SecReg has not spurred an increase in overall volumes of securitisation transactions in Europe, though the Covid-19 pandemic has distorted matters considerably.[150] The uptake of the STS label seems relatively strong, with an increase from just under 35 per cent of total issuance in 2019 to just over 45 per cent in 2021.[151] At least for now, however, the majority of European securitisation transactions do not comply with the optional STS framework. To appraise the overall impact of SecReg on the securitisation market, we must look at its default provisions that apply to all securitisations, STS or otherwise.

From a fictitious commodity standpoint, the key risk posed by the securitisation market is its potential to encourage irresponsible loan origination practices. The aspect of SecReg that comes closest to addressing this concern is the principle of 'risk retention'.[152] The idea, as summarised in SecReg's recitals, is to require either the loan originator, or the sponsor of the securitisation transaction, 'to retain a significant interest in the underlying exposures of the securitisation'.[153] SecReg sticks to the Commission's proposal, which called for the retention of at least 5 per cent net economic interest in the securitisation, with some optionality for how this could be achieved within the context of multi-tranche transaction structures.[154] The European Parliament had sought to increase these percentages to 7.5 per cent and 10 per cent for some structures, and to provide a mechanism whereby the European Banking Authority (EBA) and European Systemic Risk Board could increase rates as high as 20 per cent 'in light of market circumstances',[155] but this path was not taken. With regulatory arbitrage an important concern in these contexts, it is perhaps

[146]Proposal 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) No 1060/2009 and (EU) No 648/2012 (COM/2015/472 final), 30.9.2015 (SecReg Proposal) Art 1.

[147]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 standardized securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/201, OJ L347/35 (SecReg).

[148]'Simple, Transparent and Standardised (STS) Securitisations: What You Need to Know' (Arthur Cox 2018), https://www.arthurcox.com/knowledge/simple-transparent-and-standardised-sts-securitisations-what-you-need-to-know/?, accessed 28 February 2023.

[149]Ibid.

[150]P Desai, 'European Securitisation Issuance Report – Q4 2022' (DBRS Morningstar 2023), https://www.dbrsmorningstar.com/research/408342/quarterly-european-securitisation-issuance-report-q4-2022, accessed 28 February 2023.

[151]Ibid. While this figure fell to 31.5 per cent in 2022, this appears at least partially attributable to the disqualification of transactions involving United Kingdom entities after Brexit. M Craske et al, 'AMF Publishes Summary of its STS Securitisation Inspections; Notes Significant Shortcomings in Procedures' (*Morgan Lewis*, 20 September 2022), https://www.morganlewis.com/pubs/2022/09/amf-publishes-summary-of-its-sts-securitisation-inspections-notes-significant-shortcomings-in-procedures.

[152]SecReg Proposal, 14.

[153]SecReg, recital (10).

[154]Compare SecReg, Art 4(3) with SecReg Proposal, Arts 4(1)–(2).

[155]Report on the proposal 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) No 1060/2009 and (EU) No 648/2012 (A8-0387/2016), 19.12.2016, Arts 4(1)–(2).

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no surprise that the 5 per cent threshold matches the one already imposed in the USA pursuant to regulations under Dodd-Frank.[156] This figure, however, is not uncontroversial. In a dissenting statement issued in connection with the USA regulations, Commissioner Michael S. Piwowar of the USA Securities and Exchange Commission called it 'imprecise and arbitrary', an unfortunate capitulation in the face of 'the clear need to appropriately calibrate the level of risk retention in order to avoid significant unintended consequences'.[157]

Setting aside the appropriateness of the 5 per cent figure for disciplining lending practices, more recent developments have seen this requirement relaxed in the very cases where it seems most essential. In the midst of the Covid-19 pandemic, the Commission issued a proposal to amend SecReg to address two issues it identified as 'very important for fostering economic recovery'.[158] Relevant for us is the Commission's conclusion that SecReg was 'not entirely fit for purpose for the securitisation of non performing exposures (NPEs)'.[159] This term refers to underlying loan obligations that are in default or otherwise unlikely to be paid back in full.[160] The Commission proposed two modifications to risk retention requirements for securitisations in which 90 per cent of the asset pool consisted of NPEs. First, the level of risk retention would be reduced from 5 per cent of the nominal value of the exposures to 5 per cent of the discounted value used to price the securities offered to investors in the transaction.[161] Second, this risk could be assumed by a loan servicer instead of an originator or sponsor.[162]

The Commission's proposals show its risk retention obligations are not primarily motivated by loan origination issues. Its priorities are made explicit in a recent report it issued on the functioning of SecReg, which stated that the risk retention requirements were intended 'to prevent a misalignment of incentives *between the issuers and buyers of a securitisation*'.[163] The Commission's concern is that sponsors will defraud investors by misrepresenting the probabilities of collecting the underlying debts. If this is what matters, there is no reason for the sponsor or originator to retain more than 5 per cent of the discounted value of the asset pool, because the discount already reflects the diminished odds of recovery. It also makes sense to impose the requirement on a loan servicer instead of the sponsor or originator, because this gives the incentive to collect to the party actually charged with doing so.

However, if we are also concerned about the incentives around loan origination, the Commission's amendments appear problematic. Reducing the risk retention requirement because the sponsor takes a haircut on the price of the transaction securities does nothing to disincentivise questionable lending practices. When you factor in the option for banks to pawn off risk retention requirements on a servicer, it get worse. Banks can make riskier lending decisions because they can move the resulting liabilities off their balance sheets and bear no further risk of default. Meanwhile, their borrowers fall prey to collection agencies, who now have even more incentive to bleed them for every last red cent.

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[156]12 CFR § 244.4(a).

[157]Commissioner MS Piwowar, 'Dissenting Statement at Open Meeting Regarding Final Rule on Credit Risk Retention' (USA Securities and Exchange Commission 2014), https://www.sec.gov/news/statement/2014-spch102214cmp, accessed 1 August 2023.

[158]Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 pandemic (COM/2020/282 final), 24.7.2020 (Proposal to Amend SecReg) 1.

[159]Ibid., 4.

[160]See Ibid., Art 1, incorporating by reference the definition of NPEs set forth in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L176/01, Art 47a(3).

[161]Proposal to Amend SecReg 6.

[162]Ibid.

[163]Report from the Commission to the European Parliament and the Council on the functioning of the Securitisation Regulation' (COM/2022/517 final), 10.10.2022 (Commission Report on functioning of SecReg), 7.

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The Commission argued that NPE securitisations were essential to the continent's post-pandemic recovery. It was imperative for banks 'to maintain and even enhance their capacity to lend to the real economy', and one way to accomplish this was to 'free up bank capital' through securitisation transactions.[164] Given the urgency, no impact assessment was performed.[165] Instead, the Commission proposal relied on an opinion published by the EBA on 23 October 2019 – more than a month before any human being was infected with Covid-19.[166] Either the EBA has extraordinary predictive powers in areas far beyond its competence, or else the initiative to encourage NPE securitisations was already in full swing before the pandemic added impetus. In any case, a global emergency greased the wheels for the amendments, which were enacted on 31 March 2021.[167] Though these were adopted through an expedited process, their application is permanent, not temporary. A subsequent review of SecReg found 'no evidence that any of the risk retention methods allowed by the Securitisation Regulation is inadequate',[168] so there is no reason to expect their revision any time soon.

Meanwhile, the next leap forward for securitisation already looms large, and it implicates another prong of Polanyi's triple crisis. Last year, the EBA delivered a report to the Commission proposing a dedicated framework for 'sustainable securitisation'.[169] Buried in a footnote are concerns over 'adverse green selection of assets' – the notion that reward systems based on use of proceeds could incentivise originators to generate securitisation pools composed of 'significantly environmentally harmful' assets.[170] Securitisation is a powerful way to mobilise resources. By clearing out banks' balance sheets, it allows them to issue more loan capital, unlocking funds needed to confront pressing societal problems. However, the moment securitisation ceases to be a means to an end, and becomes an end in itself, its value becomes self-defeating. No sustainable future can be built on a foundation of (financially or environmentally) unsustainable debt.

4. Concluding remarks

Fifteen years after the crisis, the capital fetish appears as mystifying as ever. No distinctions are drawn between present value and future speculation – discount rates make everything commensurable across the space-time continuum. In times of panic, fictitious capital is propped up and branded 'too big to fail'. The legislatures and regulators in capitalism's core countries possess the power to curb the market's excesses, if only they could rid themselves of the impulse to prop up play money fantasies. For when they do, they do not conjure money out of thin air – they extract it from the most vulnerable populations in our global society.

Limits could be placed on the permissible leverage in a private equity takeover. Funds could be required to disclose details of all investments, not just those large enough to pose systemic risks. Asset stripping could be understood to involve not only financial, but also – to borrow a reifying phrase from Gary S. Becker – human capital. Just as competition authorities obstruct transactions that threaten 'proper' market functioning, AIFM regulators could step in to restrict

[164]Proposal to Amend SecReg 1.

[165]Ibid., 5.

[166]C Zimmer, B Mueller and C Buckley, 'First Known Covid Case Was Vendor at Wuhan Market, Scientist Says' (*The New York Times*, 18 November 2021), https://www.nytimes.com/2021/11/18/health/covid-wuhan-market-lab-leak.html.

[167]Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis, OJ L116/01.

[168]Commission Report on functioning of SecReg, 8–9.

[169]European Banking Authority, 'Report on Developing a Framework for Sustainable Securitisation' (Report No. EBA/REP/2022/06, 3 March 2022).

[170]Ibid., 7.

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the most short-sighted business flipping strategies.[171] Risk retention rates could be raised across the board, but especially for NPE securitisations, where the risk of irresponsible lending is indeed at its highest. Last but not least, risk retention could be made the sole and unassignable obligation of the originator.[172]

Instead, in both the private equity and securitisation contexts, the EU continues to privilege the protection of investors over other stakeholders. Transparency and risk retention requirements, especially, are designed to motivate AIFMs and securitisation sponsors to maximise investor returns without running the kinds of risks that might cause the whole system to unravel. Ancillary benefits to workers and debtors are mere icing on the cake. Moreover, for these stakeholders, these instruments prove a double-edged sword. While they may afford protection against the innovative vanguard of capitalist exploitation, they also shield these unsustainable systems from becoming the source of their own destruction. In a desperate effort to salvage the economy, financial regulators prop up practices that exacerbate social inequalities and perpetuate ecological destruction, essentially exchanging one dilemma for three. Just like capital itself, capitalism's crises are not only duplicated, but triplicated.

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[171] After all, even Keynes once flirted with the idea 'that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be a useful remedy for our contemporary evils' (though this just leads him to the unresolved dilemma that such an extreme limitation on liquidity 'might seriously impede new investment'). JM Keynes, *The General Theory of Employment, Interest and Money* (Wordsworth Editions 2017) ch 12, s VI.

[172] Indeed, consumer debt protections in general could be strengthened to re-prioritise people over profits; for, as Finance Watch stressed in a briefing on NPE securitisation, 'each one of these loans is a debt owed by a European citizen or business'. Ten Years After: 'Would You Mind Holding This for Me?': The (Increasingly Desperate) Search for an Answer to Europe's Non-Performing Loans Problem, Finance Watch Policy Brief June 2018, 11.

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