



DE-RISKING THE FUTURE OF EUROPE

REFORMING THE MACROFINANCIAL ARCHITECTURE

Safe banking to safe assets

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1. Context: Fiscal stimuli and safe assets

- Calls for fiscal stimuli ...
- ... but complex governance framework and role of legal arguments (art. 122-126 TFEU)
- In OCA theory, capital markets as coordinating device (financial integration is geared towards providing clear rights and equal treatment to enhance “market liquidity”) ...
- ... but destabilizing role of capital movements and bank-sovereign nexus (home bias, flight-to-quality, ...)
 - Banking Union completed by calls for a single safe asset: market-based vs mutualization
 - Use of regulatory tools (SBBS)

2. The debate of Rights v Policy in Financial Regulation

- Legal ambiguity of “financial stability”
- Legal harmonization and financial market integration: focus on regulatory barriers and market frictions (single passport, ...)
- Trade-off between “clear and homogenous rights” and (credit) policy (ECJ, *Casati*, 1981; *Sanz de Lera* 1995)

Example: REPO market

legal regime of collateral is based on providing for more legal certainty in Europe. At the same time, collateral management framework supports sovereign debts markets (is a kind of macro policy of credit)

3. The stakes of law

- Conceptualizing a trade-off between market-based solutions and policy is misleading. It is not that you cannot have both, it is that you always have both.
 - The work that lawyers do provides legal certainty. Interpreting and making law is also policy work, it shapes and expresses policies: lawyers make choices, create consensus or postpone tensions.
 - Legal work is distributive.
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- Analyzing the distributive stakes that happen in the legal background
 - A single safe-asset: strengthening creditors' rights and (banks') leverage

4. Liquidity: transformation and distribution

Financial reform in the EU is oriented towards strengthening rights to provide for “deep and liquid” financial markets:

- The legal regime of capital movements in the EU played a distinct role in the expansion of financial leverage: (private) foreign liabilities were made “safer” through various legal mechanisms (settlement finality, exception to bankruptcy regimes, close-out netting, ...)
- “One market, one currency, one law”: Financial assets provided as collateral can be liquidated easily and promptly in the case of default.
 - Use of specific contracts (Master Agreements) and collateral management (daily marking to market, margining, etc.) enhanced both the liquidity of short-term funding markets and of the markets for assets used as collateral through mutual indebtedness.

5. Distributed Mutual Indebtedness

Background 2:

- Mutual indebtedness increases netting opportunities for payments and settlements of securities.
 - *Netting and off-setting of reciprocal obligations can be legally equivalent to the reception of funds.*
 - Offsetting opportunities change the liquidity constraint of financial intermediaries engaged in multiple and reciprocal trades (DvP/PvP).
- Mutual indebtedness is distinct from both safe assets and safe liabilities...
 - ... and drives their respective market liquidity and funding liquidity.
- Role of financial infrastructures in selecting and coordinating mutual indebtedness: active credit policy for the Eurozone based on capital market regulations.

6. Reorienting Mutual Indebtedness

- Changing focus in financial regulation: not only institutions and their solvency/liquidity, but their coordination to actively steer credit (a “stronger Banking Union”).
 - Micro tools: legal regimes of financial assets (private law and financial regulation) and governance of financial infrastructures (selectivity of assets and financial flows)
 - Meso tools: banking structures (an “active Banking Union”)
 - Macro tools: ECB/ESM selectively issuing debts that backstop mutual indebtedness (a “more comprehensive Banking Union”).

Shifting the complex governance framework: making legal arguments on deepening inter-dependence.



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