

Increasing private risk sharing through a **EUROPEAN SAFE ASSET**

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**CEPS-ECMI Task Force on Capital Markets Union
6 February 2019, Centre for European Policy Studies**

* The content of this presentation is exploratory and cannot be attributed to the institution of affiliation

Outline

1. Rationale

- Which problems could a safe asset address? What could be the added value?

2. Approach

- How to best approach this issue (building on the EMU reflection paper)?

3. Properties

- What are the relevant elements to consider? And their implications?

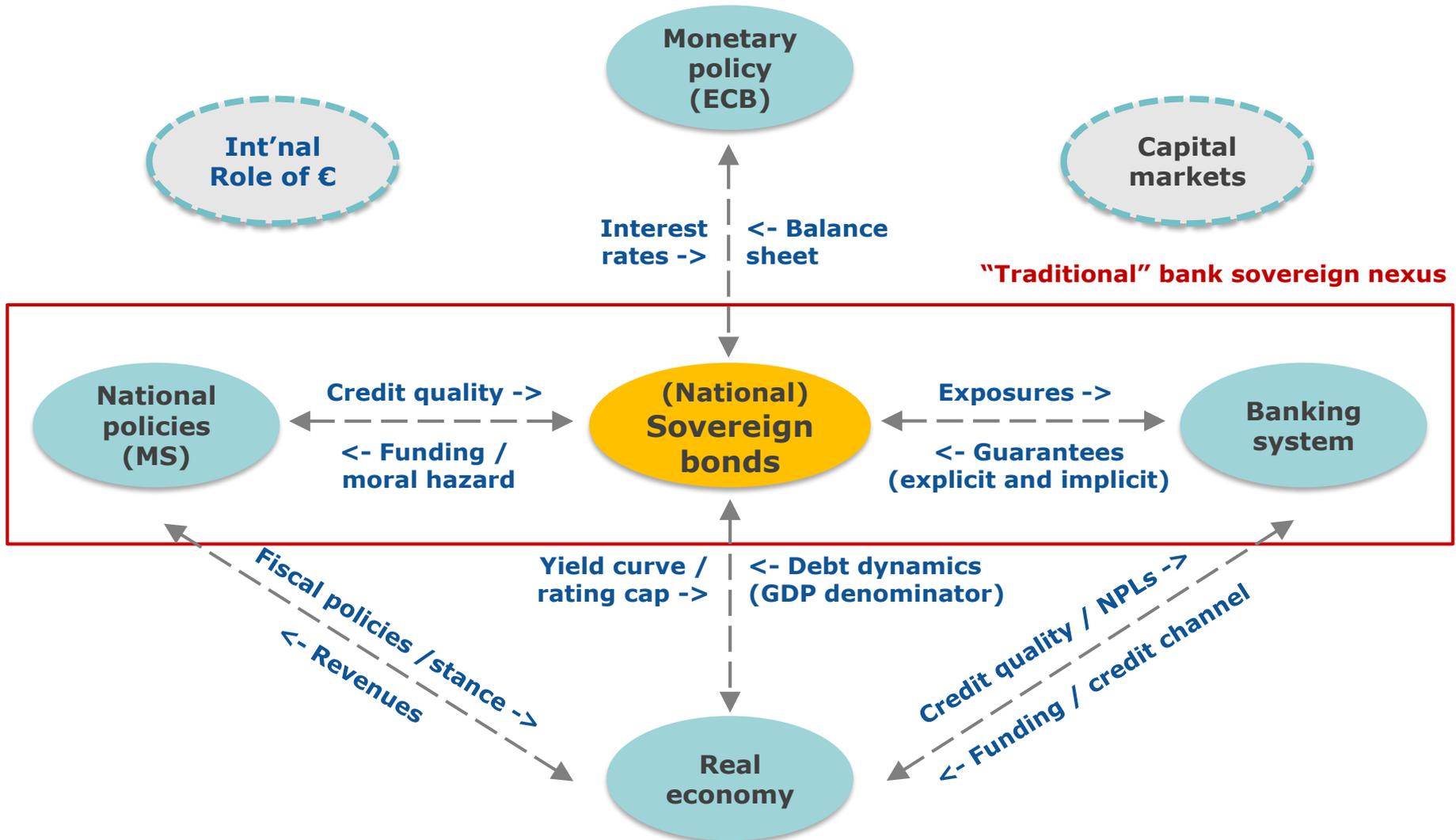
4. Constructions

- What can we learn from the existing work? Which are potential avenues?

5. Conclusion

- Possible role of this task force and next steps in coming months and beyond

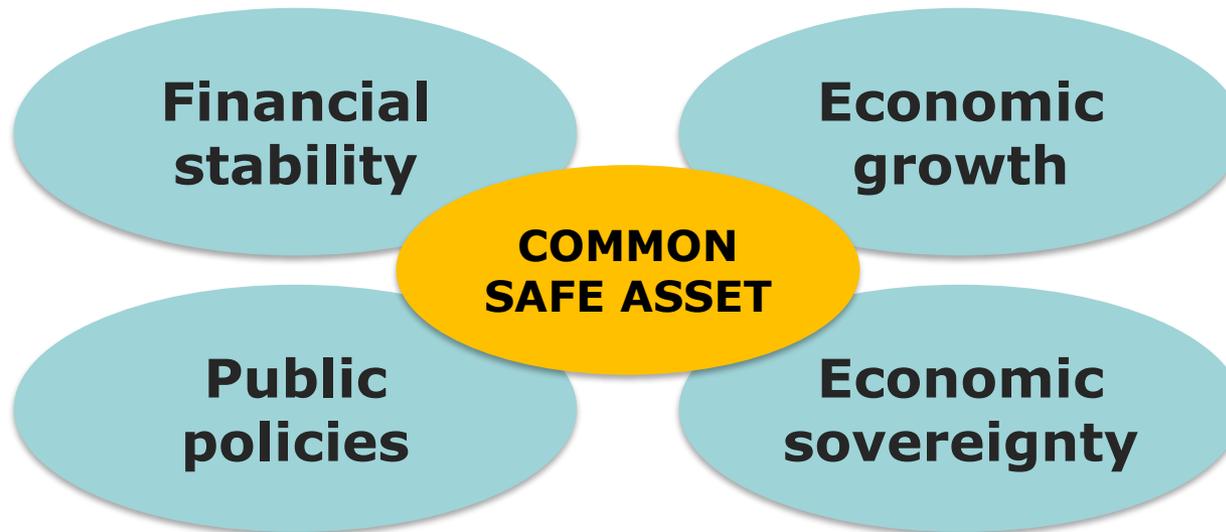
1. Rationale: Shortcomings in national bonds fulfilling multiple roles in EMU



1. Rationale: A central element with possible benefits in four areas

- Bank-sovereign nexus
- Flights-to-safety
- Monetary policy
- Fear of redenomination

- Financing costs
- Banking Union
- **CMU & risk-sharing**
- Convergence



- Financing of sovereigns
- Borrowing costs and fiscal responsibility
- EMU architecture

- Safe store of value
- Global standing of financial sector
- Autonomy & resilience

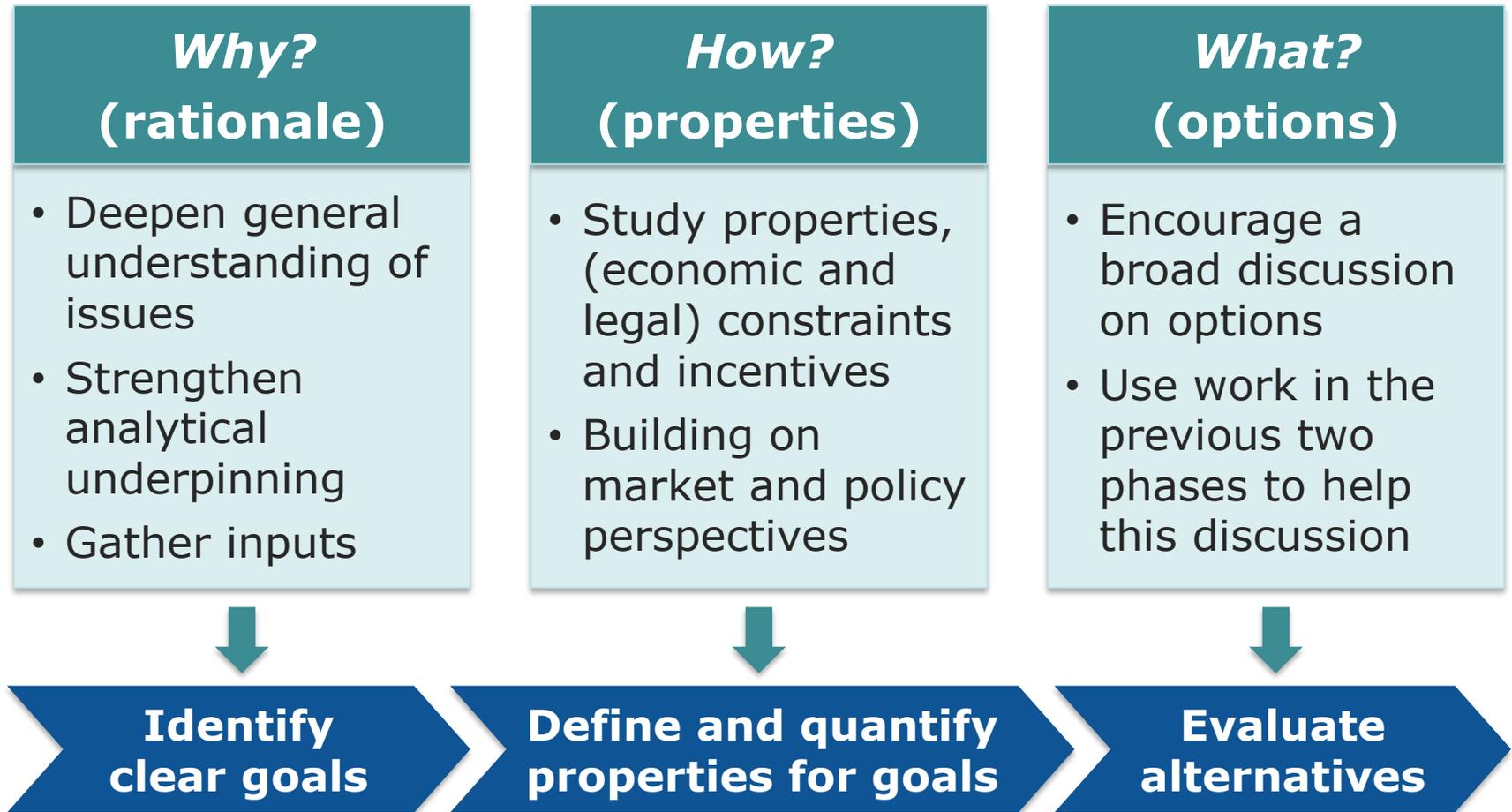
2. Approach: How soon is the medium-term for EMU? How to prepare for that?

- **Reflection paper on EMU deepening (May 2017)**
 - ❖ “A new financial instrument for the common issuance of debt, which would reinforce integration and financial stability”
 - ❖ “Any further reflections would need to focus on the necessary features, to make potential benefits materialise”
 - ❖ “Further reflect on different options of safe assets for the euro area in order to encourage a discussion on the possible design”

- **Roadmap with 4 medium-term measures (2020-2025)**
 - ❖ Implementation of **Capital Markets Union** initiatives
 - ❖ Roll-out of the **European Deposit Insurance Scheme**
 - ❖ Transition to the issuance of a **European safe asset**
 - ❖ Changes to the Regulatory **Treatment of Sovereign Exposures**

See https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu_en.pdf

2. Approach: Building from the EMU reflection paper (May 2017)



3. Properties: Main criteria to consider and possible implications

❖ Safety

- Both high credit quality and liquidity



- is triple-A rating necessary?

❖ Volume

- Main instrument in bank balance sheets



- 20-30% of euro area GDP enough?

❖ Maturities

- Ultimately build euro area yield curve



- start short and build from there?

❖ Liquidity

- Deep and liquid market, also for futures



- scope for gains in funding costs?

❖ Constraints

- Article 125 discards "mutualisation"



- how to operate in this framework?

❖ Incentives

- Avoid moral hazard but preserve funding



- should the common asset be senior?

4. Design options: Main references in the current literature



ESRB high level task force

- Sovereign bond-backed securities (SBBS)
- Primarily an instrument for diversification
- Useful development of analytical methods
- Commission proposal enabling framework

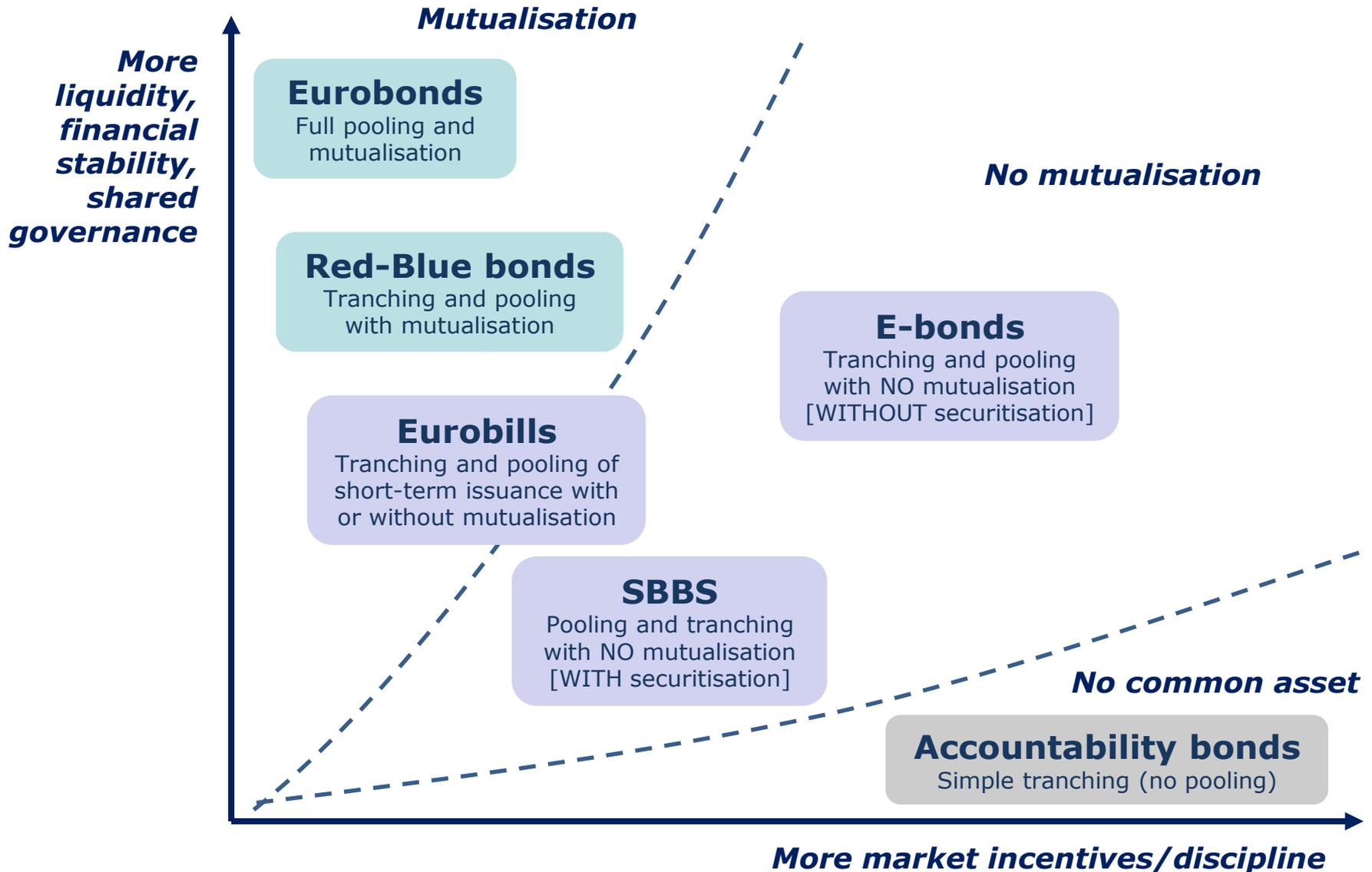


PIIE and CEPR working papers

- Several options (SBBS, E-bonds and others)
- Quantitative and political economy analysis
- Additional developments in the analytical front and first comparison of different options

Other contributions: Eurobills (with and without mutualisation), Red-Blue Bonds, Purple Bonds, Eurobonds

4. Design options: Indicative mapping



5. Conclusion: Role for this task force and next steps beyond

- **Debate has evolved in the past few months**
 - ❖ Increased media presence: Financial Times, Euro Intelligence, The Economist and national media
 - ❖ Ongoing think-tank work: CEPS-ECMI, PIIE, CEPR...
 - ❖ Clear interest from central banks

- **This task force could bring market perspectives**
 - ❖ Is the common safe asset an important element to develop the CMU? What is the link with BU and CMU?
 - ❖ What properties should it have?
 - ❖ How do you assess the existing research on options?

- **Possible links with other discussions**
 - ❖ European Deposit Insurance Scheme, ESM reform...

Thank you



Additional slides

1. Rationale: Recap of main goals and benefits

➤ FINANCIAL STABILITY

1. Address banks' sovereign exposures

- ❖ Ensure a sufficient supply of safe assets in Europe
- ❖ Combine diversification with de-risking

2. Provide a common anchor for flight-to-safety flows

- ❖ A safe asset de-linked from any particular sovereign
- ❖ Preserve monetary policy transmission in crisis times

3. Eliminate the risks or fears of redenomination

- ❖ From banking-sector events outside the government's control

➤ ECONOMIC GROWTH

4. An appealing investment proposition

- ❖ Large and liquid bond market could generate additional demand from investors (lower funding costs for sovereigns)
- ❖ Access for smaller Member States to international investors

1. Rationale: Recap of main goals and benefits

➤ ECONOMIC GROWTH (continued)

5. Mitigate distortions in financing costs

- ❖ Reduce link between the financing costs for sovereigns and for the rest of the economy (business and households)
- ❖ Create a new European anchor for corporate credit ratings
- ❖ More similar costs for equivalent firms across Member States

6. Enable the integration of banking markets

- ❖ Reduce the incentives for the ring-fencing of liquidity
- ❖ Geographically-diversified banks, better able to absorb shocks
- ❖ Homogeneous access and transmission of monetary policy

7. Facilitate the development of capital markets

- ❖ Genuine euro area yield-curve, serving as pricing reference
- ❖ Based on a common savings (banking) market

(Ultimately => more private-sector risk sharing, deeper CMU, lower capital misallocations and more economic convergence)

1. Rationale: Recap of main goals and benefits

➤ FINANCIAL SOVEREIGNTY

7. Anchor for the international role of the euro

- ❖ Provide a safe store of value (in sufficient supply)
- ❖ Reinforce governance and credibility of EMU architecture

8. Key complement to Banking Union and CMU

- ❖ More capable of exploiting economies of scale and deliver the investment needed for innovation
- ❖ Able to compete and withstand globally

RISK MITIGATION

**Financial
stability**

**Financial
sovereignty**

OPPORTUNITY

**Economic
growth**