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Asset reuse: The AMF is vigilant of the impact of regulation on the collateral market

Asset re-use contributes to the smooth functioning of financial markets, but can also lead to financial stability risks or concerns associated with the protection of client assets. In this economic and legal study, with a particular attention being focused on the lessons learnt from the 2007 financial crisis, the AMF considers that further analysis of such operations is necessary.

Asset reuse : advantages and risks

The reuse of assets refers to transactions whereby banks or market infrastructures sell, pledge, or, more generally, transfer an asset that they have received from another market participant. Where this concerns assets provided as a form of collateral, it is a necessary transaction for the proper functioning of certain types of financial transactions, such as securities financing transactions.

From an economic perspective, the reuse of collateral has numerous benefits. Notably, it contributes to market fluidity, by mechanically increasing the supply of available securities in the market, which can be used for short-term financing, transaction clearing, transforming the credit quality of the securities held, or for optimising a portfolio's yield. Nevertheless, these transactions can bear risks for financial stability and for the protection of client assets: chain reuse of the same asset can lead to contagion risks, when a member of the chain runs into difficulties and thus contributes to the increased use of leverage.

In the end, it appears essential to assess the supervision as a whole of asset reuse within this double challenge: maintaining financial stability by limiting its risks and ensuring the availability of good-quality assets in the economy.

Rules not without consequences for the collateral market

At the end of the crisis, legislators adopted strengthened prudential rules/regulations (Basel III and Solvency II), as well as a European regulation to enhance the security of derivatives transactions (EMIR). These texts, which were essential to strengthen market resilience and improve transparency, as a consequence, heightened the requirement for quality assets as a form of collateral. Also, the matter of collateral protection became crucial. It is for this reason that multiple regulatory initiatives were launched, at both European and international levels, in order to increase transparency on asset reuse transactions and on the protection of assets, in some cases going as far as to quite simply ban/prohibit any form of reuse. Notably, within the frame of its work on shadow banking, the FSB established a group of asset reuse experts.

Review of issues under focus

In this context, the AMF wishes to examine what is at stake in terms of economic and regulatory issues linked to asset reuse.

The study is set out in three parts:

- concepts and conditions pertaining to asset reuse
- economic analysis of the benefits and risks associated with these transactions,
- overview of the regulatory initiatives related to these transactions

The AMF study establishes three main points:

- European regulation is consistent in its approach to the reuse of assets: beyond the sectorial regulations (on asset management, market infrastructure, supervision of investment firm activities), the overall objective is to preserve the informed consent of clients for the reuse of their assets and to ensure, where appropriate, that the reuse of collateral does not interfere with its primary guarantee function.

- At this stage and in the light of the impact of demanding post-crisis measures on market liquidity, it would not appear necessary to impose further constraints on reuse transactions. On the contrary, the AMF considers that the pressure on the collateral market linked to the application of the G20 commitments makes it necessary to assess the effects / impacts of these reforms, both in terms of availability of quality assets and in terms of developments in market practices.
- Given the real risks related to reuse transactions, keen focus will be given to the use of the data provided to the AMF, in keeping with the various texts, which should enable it to identify new risks, at both European and international levels

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