I want to make 4 points:

I.

## II. Here my agreement ends.

My understanding of the model:

- Banks post government bonds first for their liquidity needs, while non-government assets are only posted when no more bonds are available.
- If the haircut grows up to 100 per cent, banks suffer an important liquidity shock and the yield on government bonds increases significantly aggravating debt sustainability and creating the risk of default and a financial crisis.

I see N'cpf "Qøu" ingenious model as a way to dramatize the effect of collateral: Orphanides in 2017,

because of its collateral policy.

The transformation of a relevant effect of collateral on market equilibrium into dramatic crisis risk is based on two assumptions, which are factually wrong.

**The two factually wrong assumptions** are:

- Banks depend mostly on government bonds to satisfy their liquidity needs, for instance to redeem withdrawn deposits, by accessing central bank liquidity by means of temporary operations ($L=(1-h)B/r$) and
- Banks are the only purchasers of government bonds ($G=B/r$)

Showing that both assumptions are wrong is easy.

Credit: based on daily data

Since Q1 2013, the category "Non-marketable assets" is split into two categories:

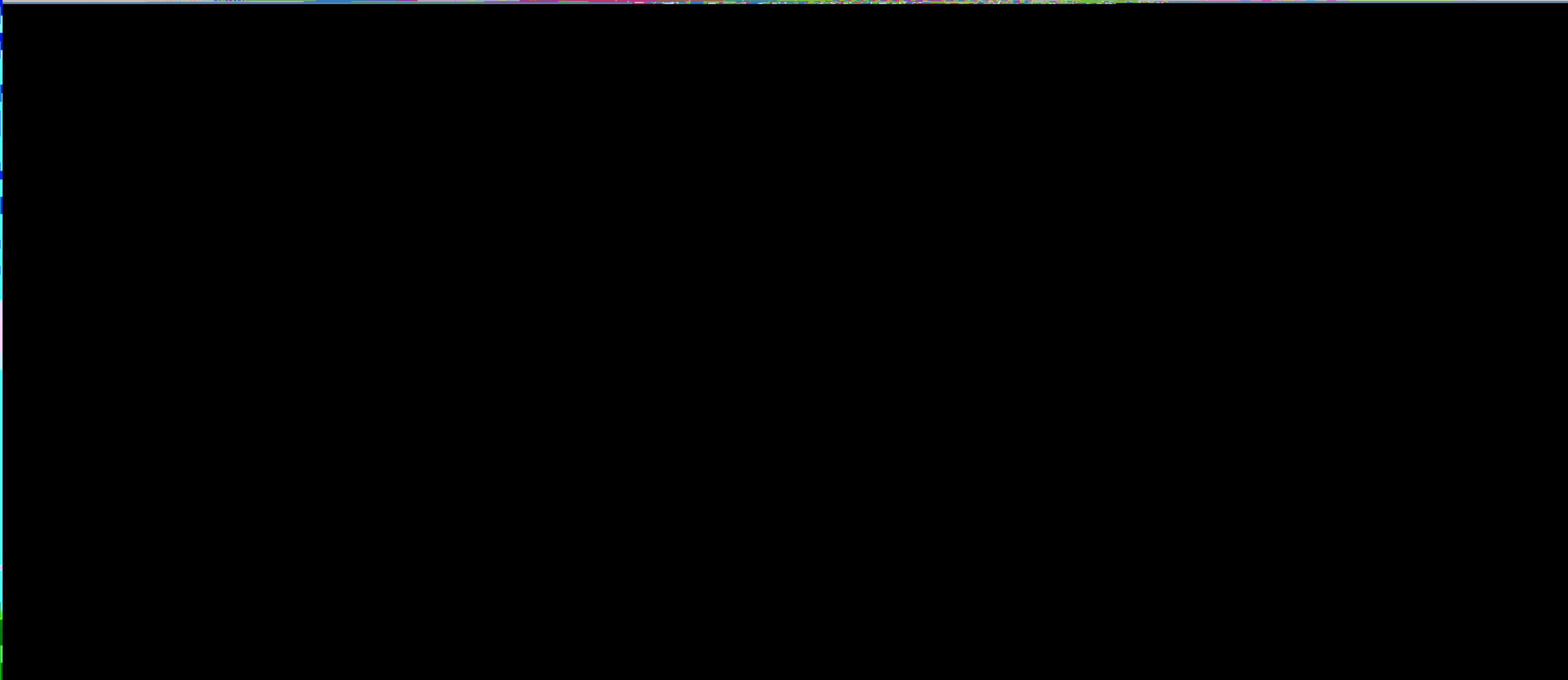
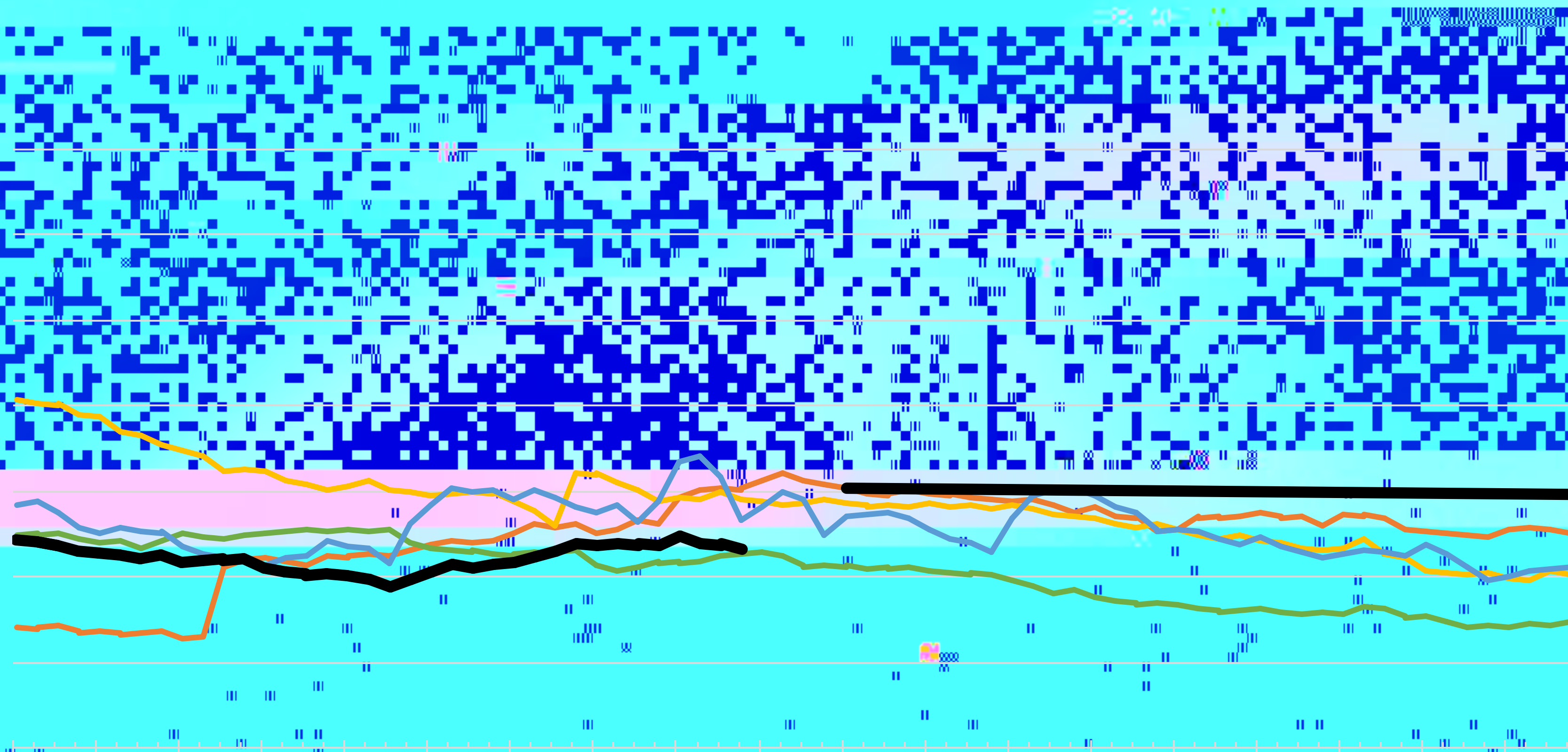
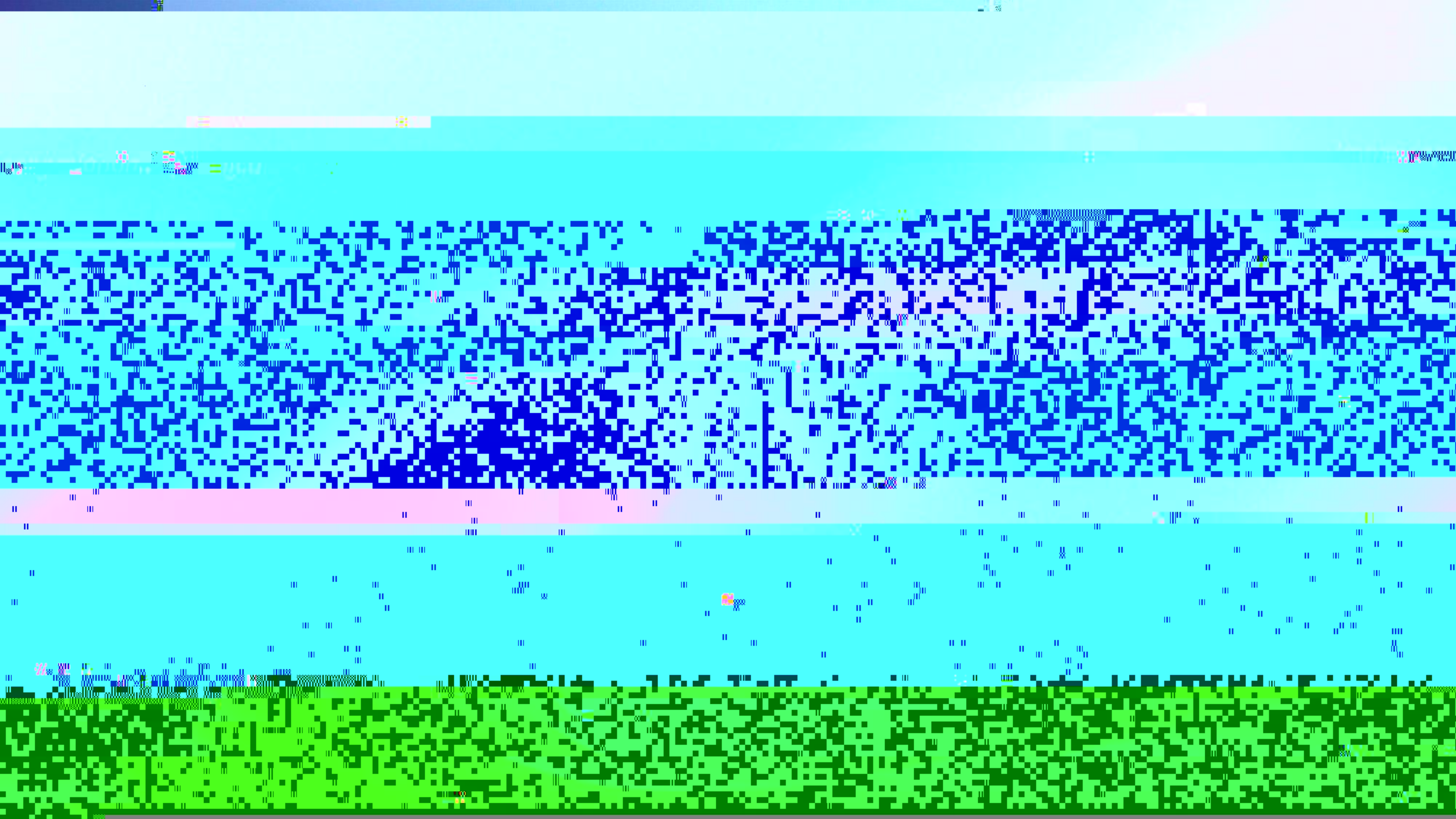


Fig. 2. Non-banks in the euro area hold more than 80% of the stock of government bonds. In Italy, they hold 75%.



The effect of haircut increases, up to 100 % ineligibility, is muted:

- The haircut is little relevant for banks, which use bonds in a very limited way for refinancing, and
- It is irrelevant for other investors in the sovereign bond market, which cover a



## My practical conclusions about the ECB collateral framework (II):

6. I do not think that in all circumstances government debt should be eligible (Buiter and Sibert 2005).
7. I cannot see any better system than the current one, which is very bad except for all the others.
8. The ECB follows the FSB suggestion to *avoid mechanistic approaches that could lead to unnecessarily abrupt and large changes in the eligibility of financial instruments and the level of haircuts that may exacerbate cliff effects*. The ECB did this for Greece in 2010 and 2020, it allowed the use of Greek collateral for ELA and uses the best of 3 ratings,.

## IV Some minor points:

- There was no temporary suspension of the collateral framework in April 2020, just an adaptation of it.
- The rating was not introduced in 2005, it preexisted. This was, however, not properly communicated.

# Thanks, and ready for discussion