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Freedom of Contract and Financial Stability through the lens of the Legal Theory of Finance

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Non-Technical Summary

The close interplay between contractual freedom and market structure as it became particularly clear throughout the financial crisis of 2008/09 has been raising fundamental questions about the relation between law and finance, as it has been at issue for quite some time now. It has only recently been put into a new institution-based framework in the Legal Theory of Finance (LTF), which therefore forms the basis of this research endeavor that is based on a related broader project comprising individual projects on the topics addressed in this paper.

The ensuing basic assumption of the paper is that financial markets are legally constructed. This becomes clear when one looks at the generation of liquidity that results from the use of asset-backed securities. Another case in point is the use of pari passu and collective action clauses because their differential application according to the hierarchical status of the respective market participant brought about a danger of deadlock of sovereign debt restructuring. Other examples of legal rules that aim to resolve the tension between market discipline and financial stability include the regulation of OTC derivatives markets and the role of minimum capital requirements under Basel III.

Freedom of Contract and Financial Stability through the lens of the Legal Theory of Finance

– LTF Approaches to ABS, Pari passu clauses, CCPs, and Basel III

Brigitte Haar*

Abstract: This paper is the outcome of a related broader project, exploring the explanatory power of the Legal Theory of Finance, which proposes a new institution-based analytical framework for the analysis of phenomena of financial markets. One of its most important theoretical assumptions, the legal construction of financial markets, is highlighted by the example of the private creation of money by structured finance products in this paper. Further implications can then be shown referring to pari passu clauses and collective action clauses, which are both exhibit a differential application of these legal rules according to the hierarchical status of the respective market participant, and can therefore endanger sovereign debt restructurings. Legal instruments to avoid this are briefly explored. An example of another key role of the law in crisis that is the task to resolve the tension between market discipline and financial stability is exemplified by the regulation of the OTC derivatives market and proposals of effective loss-sharing among CCPs. Related questions about the significance of legal rules to ensure financial stability are raised in the analysis of minimum capital requirements under Basel III.

Keywords: law and finance, financial stability, financial contracts, structured finance, asset-backed securities, pari passu clauses, collective action clauses, otc derivatives markets, central counter parties, Basel III, Coco bonds, trust law, China

JEL Classification: G38, K12, K20, K22, N20, O16

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1. Legal Foundations of Financial Markets – Institutional Context

The assumption of an interaction between contracts and market structure requires first of all a clarification of the underlying institutional understanding of the role of law in financial markets. LTF looks at law as endogenous to financial markets,[1] implying its institution-building role and highlighting this by referring to the "legal construction of financial markets"[2]. This has been a very familiar way to look at law and product markets, as becomes clear in antitrust where it is often a private contract that constrains competition. Still, there seems to be something special about the interrelation between private contracts and financial markets which may call this institutional correlation into question.

At first sight, the legal construction of financial markets appears to be a truism. As becomes particularly clear in the securities markets, it is by force of law that parties can enter into securities purchase agreements and purchase agreements on financial products that accommodate their specific needs for corporate finance, thus creating tradeable assets whose vindication solely relies on law. This does not only apply to the long-standing case of over-the-counter (OTC) derivatives, as evidenced by their enforceability fostered by regulation, which becomes particularly clear from the implications for the resulting regulatory competition.[3]

1.1. Private creation of money by structured finance products

One more recent case in point involves structured finance products, such as asset-backed securities, that had increasingly been gaining in importance up until the financial crisis of 2008/09.[4] After having been looked at as an exogenous determinant aiming at the reduction of transaction costs, the law in its formative role for the structuring of asset-backed securities came into focus throughout the crisis.[5] The success of a securitization transaction is based on the legal separation of the special purpose vehicle (SPV) from the originator thus ensuring

[1] Pistor 2013; for the roots of the controversy about the relation between law and finance cf. LaPorta et al (1998); Pistor et al (2002); Roe (2003); Roe and Siegel (2011); Beck, Demirgüc-Kunt, Levine (2003); for a collection of the essential contributions cf. Deakin and Pistor (2012).
[2] Pistor 2013, p 317-318.
[3] See for the example of the regulatory competition between the US and the UK industry Weber 2016, p 79-80.
[4] For this shift in perspective cf. Bonavita 2016, p 29-30.
[5] Pistor (2013).

bankruptcy remoteness of the SPV, so that the originator can be certain to have its illiquid debt removed from its balance sheet in return for an increase of liquid funds.[6] Hand in hand with this bankruptcy remoteness necessarily comes the role of an SPV to provide "money market funding for capital market lending".[7]

This opens up a wider perspective on shadow banking not only as a circumvention strategy of banks with respect to their regulatory burdens, but also as something close to a "parallel system of private money creation"[8]. It sheds light on the maturity transformation of shadow banks outside the regulated depositary sector, so that broader monetary implications do not seem to be too far-fetched.[9] Unlike regular banks, these private entities including among others asset-backed commercial paper (ABCP) conduits, in particular SPVs, money market mutual funds, and repo-financed credit funds are not subject to the requirements that are key to the banking safety net, such as capital requirements and strict portfolio limitations.[10] Financial instability inevitably results as became especially clear throughout the financial crisis when this liquidity based on short-term funding made government bail-out measures necessary – at the expense of taxpayers.[11]

Apparently the application of quite a few of these measures requires the suspension of legal commitments captured by another characteristic of law vis-à-vis finance according to LTF, i.e., its elasticity.[12] The latter makes legal rigidity dependent on the hierarchical status of its addressee within the system. Whereas market participants at the apex of the system have benefitted from the elasticity of law throughout the crisis, those at the periphery had to confront illiquidity, default, and exit.[13] These distributive repercussions of the elasticity of law have recently been replicated with respect to asset-backed securities which now qualify as eligible collateral under the newly amended ECB Monetary Policy Guidelines, even if only

[6] For detail cf. Bonavita 2016, p 28-35.
[7] Mehrling et al. 2013, p 2.
[8] Ricks 2011-2012, p 744; for the broader context cf. Bonavita 2016, 29-31.
[9] Ricks (2011-2012).
[10] Ricks 2011-12, p 744.
[11] For an overview of the various measures of the US government from the summer 2007 to the summer 2008, ranging for ex. from negotiations to establish a Master Liquidity Enhancement Conduit, the establishment of the Term Auction Facility and the Primary Dealer Credit Facility cf Adrian and Ashcraft (2012); for an illustration using the example of the government bailout of AIG see Pistor 2013, p 318.
[12] Pistor 2013, p 320-321.
[13] For more detail see Pistor 2013, p 320.

rated triple-B as opposed to triple-A before.[14] Access to the discount window, the crucial credit facilities maintained by central banks, is however only granted to commercial banks. Even though ECB monetary policy has moved from discount window lending to open market operations, the list of ECB-eligible collateral applies all the same.[15] In any case, this elasticity of collateral guidelines that lowers the eligibility requirements for collateral of the ECB benefits only those market players who have access to the resulting liquidity. The apex of this system is populated by banks who turn out to be not only the beneficiaries of the underlying elasticity of law, but also the recipients of the thereby generated privately created money.[16]

1.2. Contracts and political power

1.2.1 Sovereign debt restructuring on the basis of pari passu clauses

Another example where the clash of the needs for financial stability and political power may be reflected by the elasticity of law is the field of sovereign debt restructuring and the underlying contracts. In fact, one way to persuade potential creditors of sovereign debt of the unlikelihood of the threat of a later cessation of payments following a restructuring was considered to be the inclusion of a pari passu clause in the underlying contract. Such a clause would stand in the way of selective payment of restructuring participants and of other techniques to encourage bondholders to assent to a restructuring proposal. At the same time, however, this seemed to play out the other way in *Republic of Argentina v. NML Capital, Ltd.*[17] where Argentina passed the Lock Law, thus trying to avoid any resumption of negotiations with holdouts. Instead of adhering to a narrow interpretation of the pari passu clause to the effect that it would only prohibit formal subordination, the Second Circuit Court of Appeals went so far as to rely on a broader interpretation of the clause, namely that it did not allow Argentina to pay other bondholders without paying the holdouts.[18] Such a broad "elastic" interpretation thus results in differential payments to creditors and ultimately undercuts promising and fruitful restructuring practices.[19] On a larger scale, this may pose a risk to financial stability as a public good. Looking at numerous and certainly varied cases in

[14] Bonavita 2016, p 36.
[15] Tarkka 2009, p 61.
[16] For these redistributive effects also see Bonavita 2016, p 35.
[17] 727 F.3d 230 (2d Cir. 2013), cert. denied, 134 S. Ct. 2819 (2014).
[18] *Republic of Argentina v. NML Capital, Ltd.,* (2d Cir. Oct. 26, 2012) (Nos. 12-105) p 18.

the past, ranging from the Third World Debt Crisis of the 1980s involving governments in Latin America, Afria, Asia, and Eastern Europe to the Eurozone crisis,[20] it becomes quite clear that these barriers work against states and debtors on the periphery as opposed to the holdout creditors located at the apex. Again, elasticity of the law turns out to be a function of the addressee's closeness to the apex.

1.2.2 Collective action clauses (CACs) as safety valves

At the same time, the Argentine court tried to meet these possible objections regarding a potential increase of holdout litigation resulting from its decision by referring to collective action clauses (CACs) as a way to "to effectively eliminate the possibility of holdout litigation".[21] A CAC can pave the way for a super-majority of bondholders to approve a restructuring proposal, binding the dissenters, thus changing the repayment terms of the bond and making it applicable for all bondholders.[22] It can therefore fulfill the function of safety valve. Such safety valves are especially called for in cases of a significant change of circumstances, with respect to the distribution of risk that cannot be reasonably expected to be accepted by one of the parties, as illustrated by the example of the case law of the German Federal Court of Justice regarding the frustration of private contracts at the time of the hyperinflation in the 1920s and their necessary adjustment.[23]

In order to be able to achieve their aspired goals of furthering an effective restructuring process, safety valves have to be carefully designed and therefore the balance between the individual veto right of a single bondholder and the effective restructuring as a public good therefore has to be struck with a sense of proportion.[24] The design of traditional CACs goes back to English practice in 1879 and has some shortcomings. These are closely connected to the afore-mentioned necessary balance because in case of a relatively small outstanding amount of bond a creditor can relatively easily block the necessary majority vote and thus undermine any restructuring and renegotiation.[25] In contrast, New York law bonds first

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[19] Weidemaier 2013, p 6.
[20] For an account of banking crises cf. Gelpern 2014, p 3-14.
[21] *Republic of Argentina v. NML Capital, Ltd.,* (2d Cir. Oct. 26, 2012) (Nos. 12-105) p 27.
[22] For overviews cf. Buchheit and Gulati 2011; Drake 2014.
[23] Pistor 2013, p 329.
[24] On the importance of design of safety valves Pistor 2013, p 329.
[25] For details cf. Buchheit and Gulati 2011.

required unanimous consent for any amendment of the payment terms and started only in 2003 to shift to a 75% vote requirement which up till then had only been provided for under English law.[26] Looking at this marketlike evolution of contract clauses, one might tend to assume an effect of CACs on prices, increasing costs for borrowers who are seemingly prepared to enter into restructuring. Empirical studies point in either direction.[27] The perception of market participants may, however, differ in that higher borrowing costs are feared in emerging markets as a result of the use of CACs.[28]

In the absence of a CAC, the threat of default may pose its own risk. In view of such a development and public discussion about a sovereign's capacity to pay its debt, distressed-debt investors will come in and buy this sovereign's debt on the secondary market. As opposed to corporate distressed-debt investors that at times may actually promote the efficient reorganization of the respective corporation, the so-called sovereign vulture funds' interests differ from those of the sovereign because their presence leads to the holdout problems described above, thus making effective restructuring impossible.[29] This may indeed be another reason why CACs seem even less beneficial because these funds will be incentivised to purchase enough of the outstanding debt in order to be able to block any restructuring from going forward.

As indicated by the third party submission in *NML v. Argentina*, this deadlock might only be overcome when parties are involved that are not immediate parties to the bond issuance itself, but only to an agreement with the issuer, i.e. the trustee, who is an agent or fiduciary of the bondholders (and not the sovereign issuer) and who all enforcement rights are vested with.[30] A court injunction against the sovereign debtor now risks to have de-facto binding effects on the trustee, compelling him not only to pay, but also to possibly violate his fiduciary duties to the bondholders. It is true that parts of the US Trust Indenture Act and in particular its Section 316(b), which prohibits any reduction in the amounts due a bondholder without that

[26] Bradley and Gulati 2013, p 5; for a brief overview of the historical development cf. Drake 2014, p 144-148.
[27] Finding no or little pricing effects of CACs Petas and Rahman 1999; Becker et al 2003; Weinschelbaum and Wynne 2005; finding a lower cost of capital, especially for below-investment grade bonds Bradley and Gulati 2013; finding little impact on the cost of capital for the highest rated issuers and the lowest rated issuers, but a reduction of the cost of capital for those in the middle range Bardozetti and Dottori 2014.
[28] Gelpern and Gulati 2013; Pistor 2013, p 324.
[29] For an evaluation of the advantages and disadvantages of sovereign vulture funds see Muse-Fisher 2014, p 1684-1685.
[30] Overview at Varottil 2011, p 231.

bondholder's consent, do not apply to sovereigns. However, considering that this precedent created on the basis of the Trust Indenture Act has been followed by New York-law sovereign bond documentation, the trustee's fiduciary duties could serve as safety valves to overcome the deadlock and strike a balance between individual contractual rights and the bondholders' interest in restructuring.[31] In order to actually overcome the impasse, first the true challenge has to be met: this safety valve has to be carefully designed and, in addition, the institutions that will further shape this design have to be designated. Especially the latter question raises the all too well-known alternative between a market solution and regulation that remains to be further explored. The long-lasting debate over default fiduciary duties in the context of business associations as well as the looming threat of political lobbying in the case of regulation pushed by private organizations show that there is no easy solution.[32]

2. Market discipline and financial stability

2.1 The position of central counterparties (CCPs) as intermediaries

This political aspect is one of the key issues of the regulation of the OTC derivatives market and in particular of the mandatory clearing of OTC derivatives via a central counterparty.[33] Contrary to legislators' statements, it is highly contested whether mandatory clearing is in fact an efficient regulatory measure to combat systemic risk. The extensive exchange of arguments pro and con CCPs in the OTC derivatives market shed light on underlying trade-offs to be made resulting from the inherent financial instability of the financial system.[34] The question is not how to eliminate instability, but how to determine and realize the instability's optimal level.

In the case of CCPs this raises particular questions because CCPs do not, by themselves, pose a systemic risk, but because of their position as highly systemically important entities. Again

[31] For the evolution of debt contracts in the shadow of the US Trust Inenture Act see Eichengreen and Mody 2000, p 6-7; for the proposition to bring to bear fiduciary duties to overcome the deadlock see Pustovit 2016, p 65-66.
[32] For the debate over default fiduciary duties cf., e.g., Widener 2013; for the problems of the complex interactions between public legislators and influential transnational private trade associations at the example of the International Swaps and Derivatives Association (ISDA) see Biggins and Scott 2012.
[33] For an overview of central counterparty clearing and its regulatory development see Weber, M 2016, p 81-82; for brief historical background with respect to the US see Kroszner 2006.
[34] Pistor 2013, p 316; for an overview of the arguments cf. Weber 2016, p 82-92.

the problem arises how to design safety valves in order to deal with the interdependencies and interconnectedness of these intermediaries. One well-known legal instrument to address problems of growth and market power resulting from network effects is antitrust law. However, its application to CCPs leads to quite a few challenging questions. First of all, the key determination of whether CCPs have market power may be difficult to make because of the problems of market definition and the scope for market entry. What is more, even in the absence of direct price control it goes without saying that the wide range of regulation governing CCPs, whose assessment has been very controversial, has an impact on their market power.[35] The importance of regulation for market power becomes quite clear considering for example its effect on market access in terms of interoperability.[36] Thus market power depends on governance as provided for by the legislator, hence it is politically determined.

This is why governance infrastructure has had noticeable effects and has received wide attention, as recently illustrated by the European Market Infrastructure Regulation, mandating and implementing equal access in e.g. its Articles 8, 40, 51, and 78.[37] Even though EMIR aims for transparency in the derivatives markets, mitigation of systemic risk and protection against market abuse[38] (e.g. in its Article 7 para. 1 it provides for clearing contracts on a "nondiscriminatory and transparent basis"), the status of market infrastructure institutions as such at the same time raises challenges of its own. The downside of their status is the concentration of systemic risk outside the banking system, effectively turning CCPs into systemically important financial institutions (SIFIs) by regulatory fiat.[39] As a result, applying corporate governance and bank solutions to CCPs as the point of departure for regulatory intervention does not seem to be too far-fetched.[40]

This, of course, cannot eliminate the crucial difference, namely lack of conventional capital on the part of the CCPs, who are also confronted with high and hardly predictable price volatility. Therefore the question of how to limit taxpayer bailout with respect to CCPs has to

[35] Schönenberger and Schmiedel 2005, p 28-31
[36] Lee 2011, p 40-41, 58-60; pointing in the same direction Weber, M 2016, p 86-87.
[37] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories OJ L 201/1.
[38] Consideration 7 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories OJ L 201/1.
[39] Singh (2014).

be addressed by looking for rationales for loss-sharing. One proposition is based on the notion of social responsibility, calling for liability of financial actors that participate in the relevant markets.[41] Another way to arrive at more effective loss-sharing among CCPs, clearing members, and derivative end-users could be to rethink ownership and governance structure of CCPs and to introduce user-ownership.[42] Again, as is the case with all of these solutions, the hierarchy of financial claims results from the legislator's fiat. It may arguably come at a great cost, though, because end-user ownership (and liability) may have severe effects on other financial market actors, such as insurance companies, pension funds etc., so that the actual problem of systemic importance is not overcome, but only emerges at another level. Hence, the issue of bailout is far from resolved. Instead, the need for a loss-absorption mechanism seems to be greater than ever.

2.2 The Design of Contingent Convertible Instruments ('CoCos') as Loss-Absorption Mechanism

On a larger scale, the tension between market discipline and financial stability became particularly clear throughout the global financial crisis in the form of the too-big-to-fail phenomenon.[43] For fear of contagion and material adverse effects on the entire financial system and other sectors, the disciplining effect of insolvency of systemically important financial institutions was eliminated by government bail-out, which imposed significant costs on the taxpayer. In light of LTF this appears as another instance of elasticity of law dependent on the hierarchical status of its beneficiaries within the system.[44] In order to ensure monitoring by shareholders and creditors and to offer alternative loss-absorption mechanisms, the EU Bank Recovery and Resolution Directive provides in its Articles 43 and 44 for the bail-in tool which allows conversion of debt to equity and the writing down of liabilities.[45]

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[40] For similar implications cf. Lee 2010, p 256.
[41] Weber M 2016, p 96-99.
[42] Bank of England 2010, p 56.
[43] Hellwig 2009.
[44] See above 1.2; Pistor 2013, p 320-321.
[45] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance, [2014] OJ L 173/190; for an overview and critical assessment cf. Avgouleas and Goodhart 2014, p 17-27; Biljanovska 2016, p 108-112.

From a policy perspective, this raises the question of whether, in the case of contingent capital, contractual or regulatory enforcement is the more suitable way to implement such a bail-in tool. It is quite apparent that neither solution is without its faults. Especially the design of the trigger highlights the difficulty of both, in the case of contractual enforcement potential liability questions with respect to the exercise of directors' discretion or in the case of regulatory enforcement the well-known risk of regulatory failure.[46] In order to avoid these shortcomings, the regulator paved the way for a loss-absorption mechanism under the minimum capital requirements of Basel III, which may be able to incorporate the strengths of both previously mentioned tools – the contractual and the regulatory enforcement of the bail-in mechanism.[47] Initially the Basel Committee on Banking Supervision favoured an increase in core capital for banks. In Basel III this was not implemented on the basis of common equity only, but other financial instruments may now also absorb losses.[48]

This option offers opportunities, but raises questions at the same time. In order to achieve an optimal level of market discipline and financial stability, the respective financial instruments have to rely on a well-balanced contractual design that has to particularly account for specific dimensions highlighting the trade-off to be made, such as the type of trigger event – whether market-based or based on regulatory discretion, the level of capital to trigger the CoCos, the underlying loss-absorption mechanism – conversion or write down of the debt. A closer look may show that cautious contractual arrangements with resulting gradualism of the loss-absorption mechanism will be better able to achieve the conflicting goals. Only under these circumstances one can be sure that there will be room to take account of change. The danger that the full force of law may bring down the system as suggested by the law and finance paradox according to the LTF framework seems to be lower.[49] Under these conditions contingent capital instruments may serve as safety valves in order to take account of an uncertain future and to bridge the abyss between market discipline and financial stability.

2.3. The impact of Basel III on competition in the banking sector

[46] Bates and Gleeson 2011, p 269-270.
[47] 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 Text with EEA relevance [2013] OJ L 176/1.
[48] For details cf. Biljanovska 2016, p 119-121.
[49] For the law finance paradox cf. Pistor 2013, p 323.

Basel III has also been targeted against procyclical effects at macro level, in addition to allowing contingent capital instruments as loss-absorption mechanisms. For this purpose, it has strengthened capital conservation on the basis of higher standards regarding quality and quantity of minimum capital requirements for banks and by introducing a countercyclical buffer that imposes an additional time-varying capital requirement of 0-2.5% of risk weighted assets (RWA).[50]

There is empirical evidence that Basel III has an impact on competition in the banking sector.[51] As a result of Basel II the larger banks opted for model-based regulation and implemented an extensive risk management system, whereas small banks remained under the standard approach and were then required to hold relatively higher capital charges for their asset positions. With the increase in complexity in Basel III has come an increase in this competitive effect, possibly further strengthening the competitive advantage of larger banks and leading to further consolidation in the banking sector to the detriment of small and medium-sized financial institutions.[52] From the perspective of LTF, it could could be concluded that this is evidence of the legal construction of finance, which, however, differs from the exemplary way in which law constructs financial markets as has been shown above at the example of asset-backed securities.[53] In this latter case, it is the legal construction drafted by market participants that constructs finance and not the regulator that constructs finance.[54] In contrast, Basel III is based on legislative action. Its "constructive" effect with respect to financial markets results from its incentive effect on bank behavior, but is not an integral component of the financial market by itself.

3. Conclusion

This tour d'horizon of contracts in financial markets has highlighted the explanatory power of the Legal Theory of Finance in various respects. Structured finance products, securitisation techniques and resulting private money creation are cases in point to show that financial markets are legally constructed and do not exist independently of law, such as contracts,

[50] For details of the related regulatory framework in Basel III cf. Amorello 2016, p 151-153.
[51] Behn/Haselmann/Vig (2014); Behn/Haselmann/Wachtel (2014).
[52] For details cf. Amorello 2016, p 155-164.
[53] For this approach see Amorello 2016, p 153-155.
[54] Pistor 2013, p 317-318.

private and public rules governing them. The pari passu clauses and their application then show the differential application of these legal rules according to the hierarchical status of the respective market participant and reveal the resulting danger of deadlock of sovereign debt restructuring. At the same time, the latter may create a need for a safety valve in order to eliminate the possibility of holdout litigation. Two legal instruments to achieve this could be CACs or fiduciary duties of the trustee towards the bondholders. This need for safety valves can also be framed as the need to resolve the tension between market discipline and financial stability, which lies at the heart of the law finance paradox. This trade-off has proved to be relevant for the regulation of the OTC derivatives market and the related question of effective loss-sharing among CCPS, clearing members, and derivative end-users. Apart from the concept of ownership, which may have to be rethought for this purpose, this issue raises the question about another loss-absorption mechanism. The same holds true for the conceptualisation of the minimum capital requirements of Basel III that allow financial instruments other than common eequity to absorb losses. It goes without saying that these instruments have to be designed as cautious contractual arrangements with corresponding gradualism of the loss-absorption mechanism so that the safety valves will be able to function. In addition to this dimension, Basel III is characterized by a resulting effect on competition in the banking sector. This regulation has been strongly shaping financial markets by creating corresponding incentives. Legal construction in this case results from behavior instigated by law, but not immediately from law itself. Regulation in this case only provides the framework for legal construction, so that law in finance can unfold.

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