

DG MARKET OPERATIONS

## Money Market Contact Group

Frankfurt, Wednesday 15 December 2010, 13:00 – 16:00

# SUMMARY OF THE DISCUSSION

## 1. Update on the CCBM2 and T2S projects

Fiona van Echelpoel and Helmut Wacket (both ECB) provided an overview of the latest developments of the Collateral Central Bank Management (CCBM2) and Target2-Securities (T2S) projects.

Following a general introduction, Fiona provided a status update on the CCBM2 project, which will facilitate collateral management in the Eurosystem and is currently scheduled to go live in two waves in 2013. Thereafter she presented some features in more detail and outlined the main changes that the CCBM2 project will bring. Regarding the latter, she put particular emphasis on i) the harmonised procedure for domestic and cross-border collateral mobilisation; ii) the removal of the repatriation requirement; and iii) the incorporation of cross border triparty collateral management services. She also referred to the fact that EUR-denominated out-collateral would again become eligible.

Helmut then continued with a status update for the T2S project, which will facilitate a borderless securities settlement in Europe and is scheduled to go live in 2014. He also provided an overview of the cost structure, where the DvP price has recently been fixed at 15 cent per instruction. He finished his presentation by stressing the benefits that T2S will bring for the markets, namely to i) facilitate easier access to foreign markets, thus fostering competition in Europe's post-trade industry; ii) reduce settlement cost due to significant economies of scale; iii) reduce collateral and liquidity needs by means of single collateral and liquidity pools; iv) trigger back-office cost savings because of further (technical, legal and regulatory) harmonisation; and v) promote a Single Market for financial services through the harmonisation of clearing and settlement in Europe.

In the following discussion, members welcomed the Eurosystem's initiatives in the securities settlement field. Some mentioned, however, that a full harmonisation of the euro area securities markets would still not be achieved, as differences would, for example, remain in the field of national tax provisions. Members were eager to know, if the new systems would provide features that could contribute to a more efficient (re-)use of collateral and Helmut explained that T2S will incorporate sophisticated features (e.g. optimisation) that should indeed reduce banks' collateral needs.

Regarding the participation of non-euro currencies to T2S, Helmut informed that so far Denmark, Sweden and Norway have indicated an interest to have their currencies participate in T2S. Negotiations with these and other non-euro area central banks are ongoing to elaborate a contract to include their national currencies. These should be concluded by September 2011 in order for those currencies to be included at the go-live date in September 2014.

There was also a short discussion on the transparency of asset prices in the CCBM2 triparty collateral management services, which led members to ask the ECB to re-consider its currently negative stance on the dissemination of price data for eligible assets.

Finally Francesco mentioned that the COGESI was about to establish a working group exclusively focussing on the CCBM2 project and that members of the MMCG would be welcome to join this working group in case of interest (to be expressed to the Secretary).

## **2. Presentation of the findings of the latest ICMA repo market survey**

After the Chairman had expressed his gratitude for Johan Evenepoel's (Dexia) continued willingness to present the findings of the ICMA repo market surveys, Johan summed-up the main results of the June 2010 survey, which had been published in September.

A key development was that the total value of repo contracts outstanding reached a new record level at EUR 6,979 billion. A comparison of the aggregate returns from a constant sample of institutions showed growth rates of almost 30% over the last six months and of 43% since June 2009.

Johan mentioned, however, that the results of the survey needed careful interpretation, as there was an increasing divergence in the sizes of individual repo books and a growing concentration of the market among the major players, with the top 10 survey participants now accounting for 69% of total turnover. In addition, he stressed that a number of the most significant developments in the survey data (i.e. the significant increases in USD-denominated transactions; the increased use of "other OECD" collateral and the rise in "forward start" transactions) were driven only by a small sample of the survey and should thus be interpreted with some care.

Regarding the usage of certain types of collateral, it was interesting to observe a continued increase in the share of AAA-rated collateral (mainly at the expense of AA and A collateral) and a general shift back into government bonds (EU and others), the share of which reached 44.1% from 40.7%.

The subsequent discussion revealed that several members were surprised by the new record volume of repo transactions, which seemed to be somewhat at odds with the still ongoing de-leveraging process in the banking industry. Others were however less surprised, arguing that the repo market turnover had benefited from the increasing trend to shift previously unsecured business into the repo market. One member mentioned that the rising volumes need to be interpreted together with the increased concentration of the repo business, which might be a reflection of banks' different stages within the balance sheet adjustment process (i.e. the strongest banks that have more or less completed their adjustment process might already expand their business again and thus increase their market share).

Regarding the significant increase in the USD-denominated business, some members made the point that this might be linked to USD liquidity providers' perceived increased reluctance to provide USD cash on an unsecured basis (or through the purchase of CPs/CDs). This might have caused the borrowers to increasingly rely on secured USD funding sources.

The discussion also touched upon the margining practice of CCPs. Being fully aware of CCPs' need to constantly maintain a credit risk profile that is beyond any doubt, some members nevertheless viewed the most recent experience in this field somewhat critically. They argued that sharp increases of margin requirements in times of stress would have pro-cyclical effects, thus increasing volatility and might therefore have de-stabilising effects for the whole market.

## **3. Review of the recent market developments**

As usual the Secretary provided an update on the money market developments since the last MMCG meeting. The main points of his presentation were: i) a short background look at equity and credit markets (where the financial sector underperformed significantly); ii) a review of money market indicators, with some displaying some signs of stress (e.g. FX swaps, certain repo markets), while others (e.g. deposit-OIS spreads) remain in recent ranges; iii) a review of the development of outstanding tender volumes / the use of the standing facilities / the link between level of excess liquidity and Eonia level; iv) information on the development of the Securities Markets Programme, including the related 1-week liquidity absorbing operations; and v) a summary of the main ECB announcements since September 2010.

In the discussion it became apparent that members generally had a rather cautious assessment of the overall functioning of the euro money market, as the current environment remained rather challenging. Several mentioned that they welcomed the Governing Council's decision of 2 December to postpone further steps in the ECB's gradual exit from non-standard measures and to keep the modalities of the refinancing operations in Q1/2011 unchanged compared to the current quarter.

Concerning the apparent tensions in the FX swaps market, which the Secretary had mentioned in his presentation, several members confirmed that it had recently become more difficult to raise USD liquidity. Some explained this observation by a more cautious attitude of traditional USD liquidity providers (e.g. US money market funds) triggered by concerns related to the perceived sovereign risk in some euro area countries. In this context, several members stressed the usefulness of the ECB's weekly USD providing operations, which served as an important support even though the actual use of this facility was very small, given that it is priced as a back-stop facility.

The Chairman asked whether it would be a fair assessment that the euro money market is currently polarised, in the sense that there seems to be an overall trend for lower demand for excess liquidity, which is, however, in contrast with the significant funding challenges for banks in jurisdictions facing particular difficulties. This assessment was generally shared and several members expressed the view that they would not expect this polarisation to disappear anytime soon. Some members argued that the Eurosystem should consider excluding banks with a persistent (over-) reliance on central bank funding from the regular operations as these banks' reliance made it very difficult for the ECB to resume its gradual exit strategy in the coming quarters.

Reacting to these remarks Paul made the point that it was quite difficult for the ECB to make a distinction between so-called persistent bidders and banks which made normal regular use of the ECB operations. After all, the banking system of the euro area is operating in a liquidity deficit, so that in aggregate banks have to rely on Eurosystem funding – and it would not be in the ECB's interest to introduce some kind of stigma into the participation in the regular monetary policy operations.

In the same context several members supported an idea according to which the Eurosystem could offer collateral switches, i.e. a facility in which counterparties could switch, against a fee, ECB eligible collateral into top quality collateral, which they could then use to fund themselves in the private repo market.

Other interesting points that came up in the discussion were: i) the recent higher volatility of Eonia rates was generally not seen as problematic; ii) there were some concerns about so-called pools of liquidity (i.e. barriers that would hamper the liquidity flow within cross-border institutions) even within the euro area; and iii) the de-leveraging process is quite challenging for institutions facing rating downgrades, as they tend to lose funding sources quicker than they can shed assets. With regard to the latter point Francesco remarked that this seemed to be a typical case where central bank operations could help filling the funding gap (provided of course that this would be viewed and understood as a temporary support and not as a permanent solution).

#### **4. Other items**

After the Chairman had invited members to take note of the tentative meeting dates for 2011 there was a discussion about the work programme for 2011, a draft of which had been circulated prior to the meeting. The group came up with several further proposals: i) the idea to conduct a survey on liquidity regulations' impact on banks' internal organisations; ii) an analysis of liquidity regulations' potential impact on demand for and collateralisation of Eurosystem operations; iii) a closer look at the trends in the CP/CD markets; and iv) an analysis of the market impact of CCPs margining decisions. Based on this (and potential further) input the Secretary will finalise the work programme which would then also be published on the group's website.

Francesco mentioned that the next meeting is scheduled for Monday, 14 March 2011 from 13:00 to 16.00. The following potential topics were identified: The regular review of recent market developments; the proposed survey on liquidity regulations' impact on banks' internal organisations; and a review of the recent trends in the developments of autonomous liquidity factors.