EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

28 April 2014

Money Market Contact Group

Frankfurt am Main, Tuesday, 18 March 2014, 1 p.m. – 5 p.m. CET

Summary of the discussion

1. Update on the current status of regulatory work

Michael Grill (ECB) provided an update on the state of play as regards the Leverage Ratio (LR), the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), as well as on the European Commission proposal on structural measures improving the resilience of EU credit institutions, giving the main elements and issues for discussion.

With regard to the Commission's proposal, members of the Contact Group (MMCG) emphasised a need for more clarity on the definition of trading activities, as this would determine which activities are likely to be reduced. Separation requirements were likely to make trading activities more costly, thus making market-making expensive and forcing banks to reduce or stop market-making, with a potentially negative impact on market liquidity and transparency. The repo market was also likely to be affected. Some members said that while trading in EU sovereign debt was exempt from the separation of trading activities, the proposal put at a disadvantage trading in covered bonds, which were an important instrument for the financing of the economy and were considered a high-quality asset for purposes of the LCR. Furthermore, members called for harmonisation of national initiatives on separation of trading activities, which are under way in a number of euro area countries.

On the regulatory ratios, members noted a possible misalignment between the LCR requirements to hold high-quality liquid assets and the LR, which discourages holding risk-free assets.

With regard to the restricted-use committed liquidity facilities (RCLFs) that were now included in the new provisions of the LCR, the ECB reiterated the point made at the December 2013 meeting of the MMCG that the Eurosystem did not consider offering these facilities at the current stage.

2. Review of the latest market developments

Jan Misch presented the main developments in the euro money market since the last meeting, noting a number of positive developments as reflected in greater convergence of sovereign bond yield and repo market spreads, as well as relatively low levels of implied EURIBOR futures rates at longer maturities, suggesting market confidence in the ECB's forward guidance.

The relative stability of the EONIA since the February maintenance period was the main topic of the group discussion. While some members attributed this to a gradual market readjustment to a lower level of excess liquidity and the effectiveness of the averaging mechanism inherent in the reserve requirements, others were surprised by the stability of EONIA rates and questioned the representativeness of the EONIA as an indicator of money market tensions. Repo market rates were seen by these members as a better market barometer. First, daily trading volumes for overnight repos were estimated to be higher than for unsecured overnight transactions. Second, in view of liquidity and leverage regulations, the unsecured short-term market was likely to become less relevant for bank funding. Banks preferred unsecured funding in longer tenors as reflected in higher issuance of certificates of deposit/commercial paper, which had risen by 10% since September 2013. Market initiatives in the repo market reflected this new market reality: a new futures contract based on the GC Pooling overnight repo index was expected to be launched in second quarter of this year, and work was ongoing on a new repo benchmark, based on repo transactions cleared by central clearing counterparties. Yet it was also noted that EONIA overnight indexed swaps were still used widely for hedging and pricing purposes, indicating that markets do not question the reliability of the EONIA.

Finally, members mentioned that the upcoming quarter-end was seen as a major concern. The usual calendar impact was expected to be aggravated by banks' balance sheet adjustments to meet the LR targets. Looking ahead, tax payment dates in Italy around Easter were expected to result in higher money market volatility.

3. Update on money market developments and short-term funding conditions in selected euro area countries

José Rull and Marco Antonio Bertotti presented recent developments in the Spanish and Italian money markets, noting an on-going improvement in both countries. With regard to Spain, a reduction in market fragmentation was primarily reflected in better longer-term capital market access. Repo markets recorded larger trading volumes and an extension of maturities, even if access to international central clearing counterparties remained expensive for Spanish counterparties.

Despite the ongoing improvements in Italy, the domestic banking system remained fragmented: large banks had better market access, whereas smaller and medium-sized banks faced more difficulties in raising term funding, which may also explain low repayments of the three-year long-term refinancing operations.

4. Improvements in collateral and liquidity management in the euro repo market – a draft report by the ECB and the Ad Hoc Group of the Contact group on euro securities infrastructures (COGESI) on Collateral

Benjamin Hanssens (ECB) and Andreas Biewald presented the main findings and recommendations of a forthcoming report entitled "Euro repo market – improvements for collateral and liquidity management", jointly prepared by the ECB and a working group of market participants. The recommendations were intended to improve the mobilisation of collateral throughout the day and treasury/adjustment operations executed at the end of the day in the euro repo market. The MMCG's discussion focused in particular on the need for market discipline to respect the cut-off times for the end-of-day treasury management activities in the TARGET2-Securities (T2S) system. This would help banks to avoid difficulties in treasury management; a lack of discipline may lead to higher recourse to the central bank standing facilities.

5. Other business:

a. Update on money market reference rates and on the ongoing reform process

Roberto Schiavi informed the MMCG that the ECB/European Banking Federation (EBF) quantitative study of individual unsecured money market transactions data was enhanced with additional analysis based on the MMCG feedback and invited the Contact Group to provide further comments and suggestions. Furthermore, he informed the group about the subsequent steps that would be taken by the EBF on the results of the study, including a broader consultation with the industry and with other EURIBOR reform stakeholders.

MMCG members urged the authorities to move fast with the EURIBOR reform process. Withdrawals from the EURIBOR panel made it more difficult for the remaining banks to stay. Some Contact Group members suggested that contributing to benchmarks should become mandatory at least for the banks that would be soon directly supervised by the ECB. Others suggested that trade repositories' data could be used. In addition, the MMCG argued in favour of a standardised regulatory oversight of the contribution process across all national jurisdictions.

Finally, the members of the MMCG mentioned some technical issues related to the new benchmark submission procedure of EURIBOR-EBF, which may in their view increase operational risk for the contributing banks. An ad-hoc teleconference with EURIBOR-EBF was organised on 24 March to address banks' concerns.

b. Update on the STEP+ initiative

Benjamin Sahel (ECB), who acts as an ECB observer for the STEP+ initiative, reported on the first meeting of STEP+, which took place on 27 January and was hosted by the ECB. The work was organised in three work streams, which were expected to present their findings at the subsequent meeting, taking place on 11 April in Brussels.

A number of MMCG members said that in view of various regulatory initiatives such as the LCR and the LR, which encouraged a reduction of banks' balance sheets and discouraged short-term wholesale funding, the STEP+ initiative's success may benefit from a change in the current regulatory treatment for unsecured paper. Some members noted that greater transparency and a development of the secondary market for STEP securities could make these securities more attractive for a broader set of investors, such as asset managers.

c. Planning of the next meeting

The next MMCG meeting will take place in Madrid on 16 June 2014, starting at 2 p.m., and will be hosted by Santander. The MMCG decided to conduct a survey among MMCG members on banks' internal organisations, i.e. the way they manage their liquidity and how treasury and repo desks interact. The results will be presented at the next MMCG meeting.