EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 4 March 2013

Money Market Contact Group

Frankfurt, Monday, 10 December 2012, 13:00-16:00 CET

SUMMARY OF THE DISCUSSION

1. Recent developments in the loan repo market

Franck Carminati (HSBC) and Godfried De Vidts (ICMA-European Repo Council) presented the currently on-going market initiatives in the loan repo market. The first initiative is based on securitisation of the ECB eligible credit claims, which could be subsequently used as collateral both in market and central bank repo operations. The second initiative, led by ICMA, foresees development of a loan repo market operating via clearing systems without securitisation. It would be initially focused on syndicated loans but bilateral loans could also be included at a later stage. Despite some progress made on this initiative already, several hurdles still need to be overcome, such as differences across national legal frameworks, work to be done on standardisation of loans and on developing an operational framework.

Kentaro Tamura (ECB) presented an overview of the syndicate loan market in the euro area and sought MMCG feedback on possible impediments on the usage of syndicated loans either in private market transactions or for the submission to the Eurosystem as collateral. The use of syndicated loans as collateral in the Eurosystem operations was found to be very low compared to the size of this market. The MMCG attributed a low utilisation of these loans in the Eurosystem operations to the fact that: (i) most syndicated loans were governed by the UK law, (ii) are often governed by more than two laws and (iii) are often cross-currency, all of which make them non-eligible as collateral.

The Chairman noted that the ECB encourages these market initiatives aimed at mobilisation of collateral if these help to revitalise the interbank market and to facilitate refinancing of these assets in the market. The ECB has a strong interest in functioning money and capital markets to ensure (a) that it does not need to play an extensive interbank intermediation function, and (b) a smooth monetary policy transmission.

2. Asset encumbrance. A follow-up on the MMCG survey on Bank funding patterns and demand for high-quality collateral assets (in relation to work of the Basel Committee on the Global Financial System)

Pontus Aberg (ECB) reviewed the main findings of the survey conducted in July 2012 and provided a status update on the work of the Basel Committee on the Global Financial System (CGFS).

The MMCG survey showed that in general a shortage of collateral was not seen as an imminent problem, however with an increased regulatory demand for collateralised transactions, this may become an issue. Some banks in the euro area might be facing higher asset encumbrance due to their covered bonds issuance and a greater reliance on repo markets. However higher asset encumbrance did not necessarily reflect a scarcity of collateral.

3. Update on money market benchmarks and their future

Holger Neuhaus (ECB) provided an overview of the Eurosystem's response to the European Commission consultation and Jaana Sulin (Nordea) presented the EBF response to the same consultation.

Several MMCG members mentioned that various suggestions on improved internal governance procedures, which were mentioned in the above responses, were being proactively implemented in banks, at times with significant costs implications in terms of human resources and IT infrastructure.

The ECB encouraged banks to stay on the panels and to support the transitional reform process on the money market benchmarks as an important element of common market infrastructure.

4. Market initiatives to revive the unsecured interbank market

Marco Bertotti (Intesa Sanpaolo) and Mirco Brisighelli (UniCredit) introduced a new market initiative aimed at supporting the unsecured money market in the euro area. Unsecured interbank market trading volumes were seen adversely affected by a number of existing or forthcoming regulatory changes, which in turn affected activity and credit lines in the unsecured interbank market. However, the unsecured interbank market was deemed important as a buffer against funding shocks affecting banks. Therefore, the impairment of the unsecured money market led banks, everything else equal, to be significantly more constrained in their funding. This was also seen detrimental to the credit provision by banks to the real economy. Finally, robust unsecured trading volumes were seen helpful in ensuring credible unsecured money market benchmarks.

The presenters provided an overview of the initiative launched by the Financial Markets Association in Italy, suggesting a number of requirements which would contribute to the revival of the unsecured money market, such as (i) a lower capital absorption for interbank lending; (ii) adjusting liquidity rules for money market funds with regard to WAL and WAM requirements; (iii) more neutral treatment of interbank loans in the LCR buffer; (iv) non-punitive, harmonised fiscal treatment of interbank loans across all countries and (v) eligibility of interbank loan/paper for central bank operations at least under a backstop/contingency scenario.

The Chairman indicated that most of the above proposals were in the domain of regulatory bodies and noted that banks' short-term unsecured paper (STEP) was already eligible as collateral for the Eurosystem operations. However, the ECB reiterated its interest in the revival of the unsecured money market and would carefully consider banks' concerns.

5. Review of the latest market developments

Julija Jakovicka (ECB) provided a brief update on the money market developments since last MMCG meeting. Looking forward two important factors were the forthcoming 3-year LTRO repayments and an increased probability of a rate cut, which was reflected in a downward move in the EONIA forward curve.

With regard to market expectations of a rate cut, the MMCG reiterated its concerns with regard to the negative deposit rates expressed at the previous meeting in September. In addition, several MMCG members stressed operational difficulties of operating with negative deposit facility and with negative money market rates.

6. Other items

The MMCG Chairman mentioned that the next MMG meeting is scheduled for Monday, 18 March.

The following potential topics were identified for a group discussion: (i) a regular review of recent market developments; (ii) a presentation on the results of the quarterly money market survey results for Q3 and Q4 activity by mid-January. Other suggestions for discussion items can be put forward via the MMCG Secretariat.

MMCG draft work programme for 2013 would be sent to the MMCG for possible suggestions in written form. The Chairman informed about the internal organisational changes within DG-M and about the establishment of the new Bond Market Contact Group. MMCG members noted that market issues with regard to the repo market should remain on the work programme of the MMCG.