Liquidity standards:
- selected findings of the MMCG survey
- topical issues

Money Market Contact Group

Frankfurt, 5 September 2011

Background on MMCG survey

Why is liquidity regulation of interest for central bank market operations?

Central bank market operations play key role as liquidity source for banks under stress in a systemic liquidity crisis – but regulatory perspective is that undue reliance on central banks should be avoided => policy issues

- "Distance to fire sales"
- HQLA set versus central bank eligible collateral
- ELA / unconventional liquidity provision / regular liquidity provision….

Impact of LCR on bank behaviour in central bank operations

- Demand for long term operations;
- Special behaviour on reporting days = EONIA spike?
- Use of non-HQLA collateral to keep HQLA non-encumbered
- Use of non-HQLA to deposit with CB
- Change of interest rate structures (instrument, term structure) => operational target; transmission mechanism

Impact on markets and banking in general

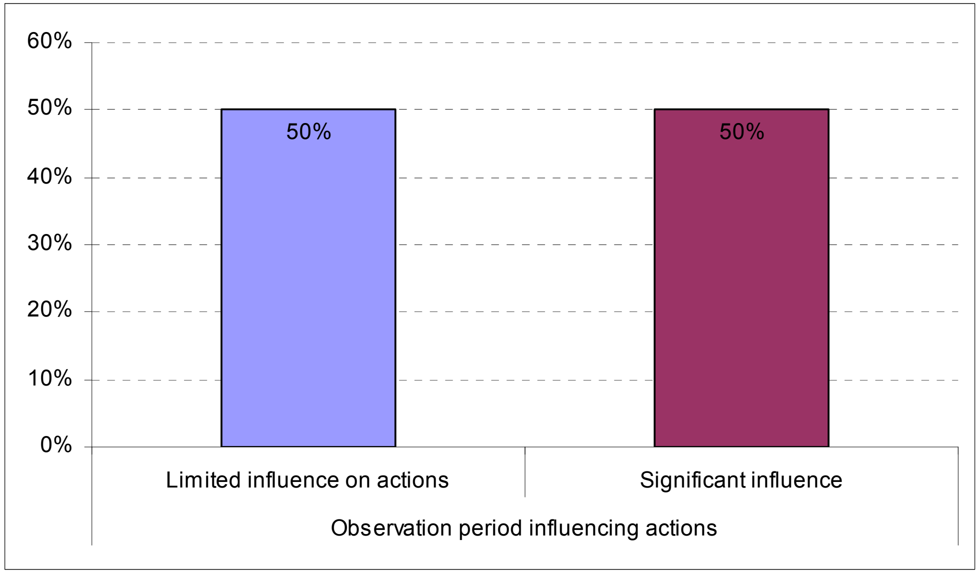
What should CB do:

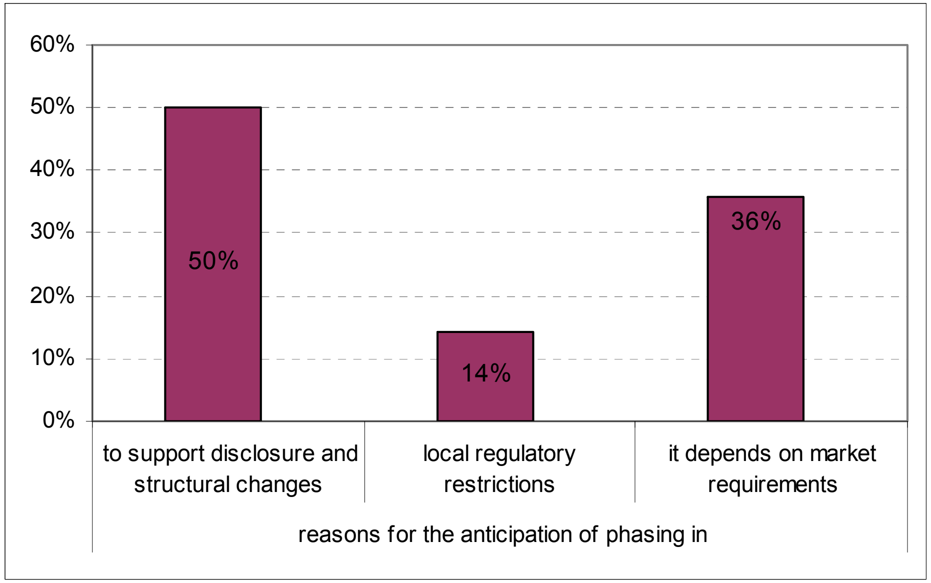
- to keep mon pol implementation effective?
- facilitate or not LCR achievement? Level playing field issues

Can the interaction be improved by fine tuning the Basle III / the CRDIV?

Selected findings of the MMCG survey

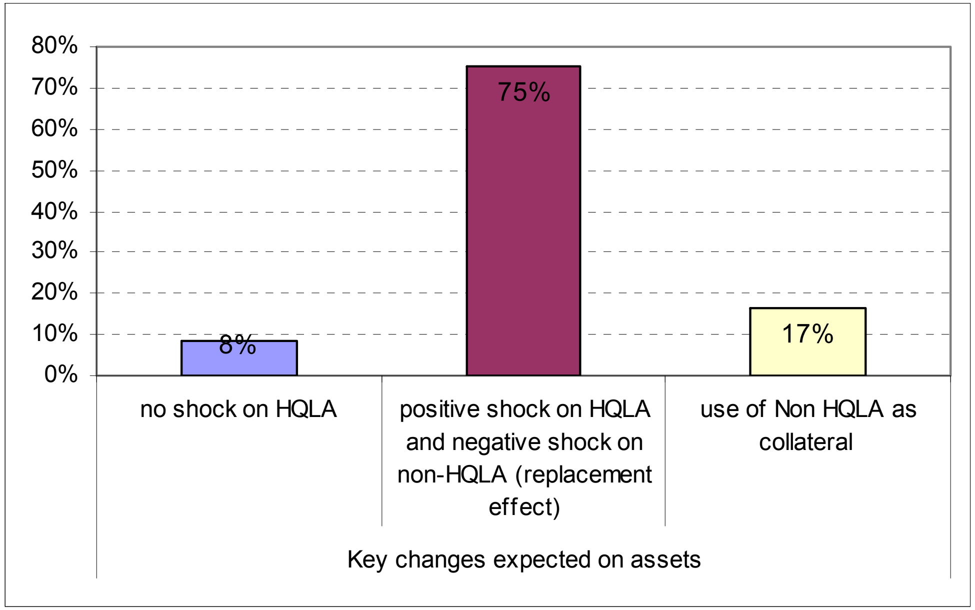
1) Phasing the liquidity standards in

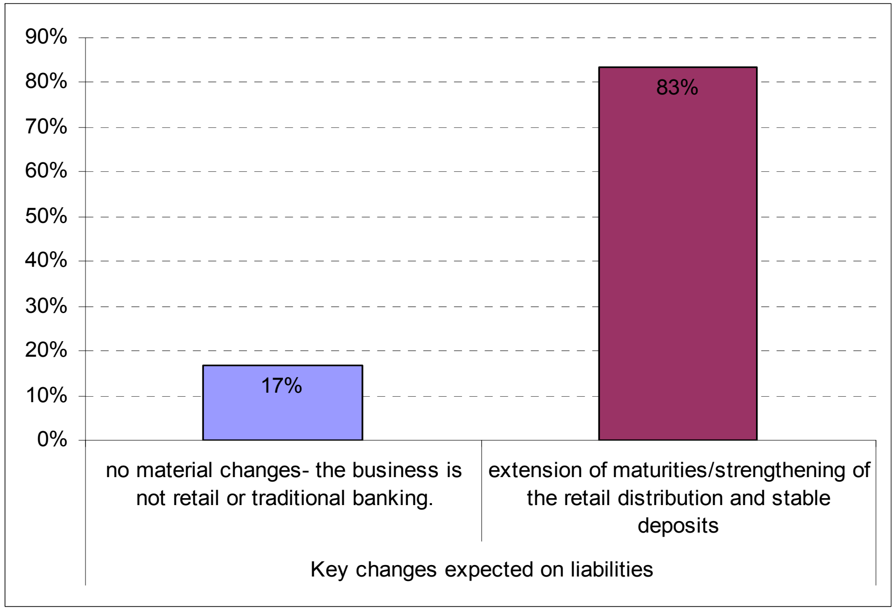




Selected findings of the MMCG survey

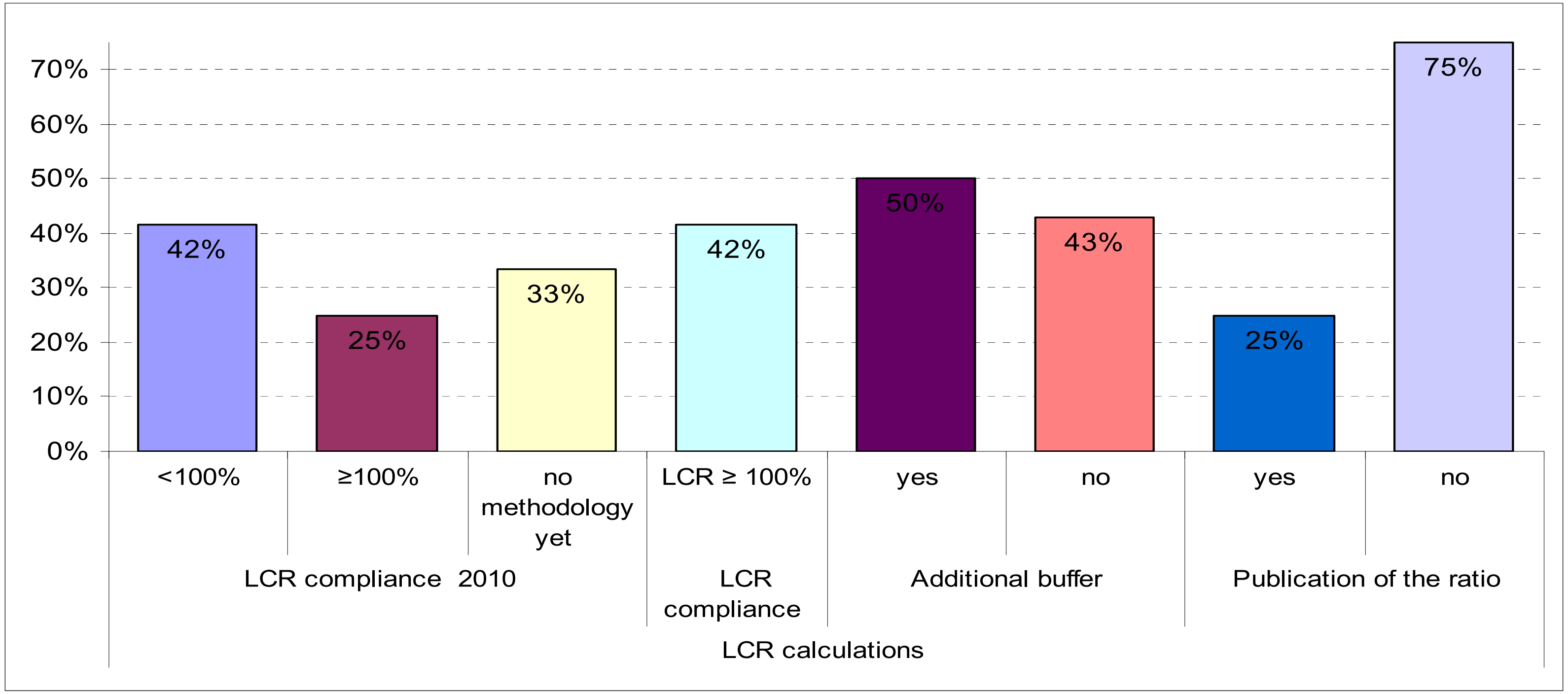
II) Expected changes in AL management





Selected findings of the MMCG survey

III) LCR calculations



Additional buffers refers to a surplus over the minimum level of compliance of the LCR.

One bank considers it is a premature issue that will depend on market expectations. Given severity of underlying assumptions within LCR, they would expect firms to run fairly tightly to the ratios.

Selected findings of the MMCG survey

IV) Expected impact on markets

Securities markets

HQLA: decrease in yields and increase in volume held by banks.

non HQLA: increase in yields & reduction in volumes held by banks,

Increasing concentration risk, gvt bubble and distortion

Credit markets

Tiering

Yields up and volume, duration down

Repo/reverse repo, interbank, wholesale funding and derivatives down

Duration of loans shorter and stable deposits targeted

Cost increase

Bank funding

More difficult to raise funds (issuance of uncovered bonds), enough retail funding to fill the gap?

Increased competition, liquidity premium up

Increased demand for term wholesale funding

Increased demand, decreased supply for maturity higher than 1 month,

Product innovation

Selected findings of the MMCG survey

IV) Expected impact on markets

Unsecured money markets

Steeper curve and lower volumes (maturity segmentation)

Calendar effects→ anomalies and kinks along the yield curve

Wider bid-offer spreads, marginal increase of ST liquidity risk (as liabilities concentrated into preferred maturities)

FRA-OIS up

Unsecured interbank deposit down and Central Bank as a broker

Secured money markets

More difficult to raise funds (issuance of uncovered bonds), enough retail funding to fill the gap?

Increased competition, liquidity premium up

Increased demand for term wholesale funding

Increased demand, decreased supply for maturity higher than 1 month,

Product innovation

Currency swap

No major effect expected

Selected findings of the MMCG survey

V) Expected impact on central bank operations

Collateral use

Some : More systematic use on non-eligible assets

Repo illiquid collateral as contingency

Standing facilities

Mixed views:

In excess liquidity, move from FTO to DF

Difficult to estimate

An alternative to interbank

No change

Could increase for instance owing to tiering

Reserve requirements

Mixed views:

Further move towards uneven path

Front-loading

But also no change

Refinancing operations

More demand for LTRO

Move from short term to maturities above 1 month a natural trend

Greater volatility in the recourse to central bank funding

Key issues arising with regard to liquidity regulation, financial stability and central bank operations

Very important : Uncertainty and level playing field

- Is there sufficient stable/long-term funding in the market to cover all liquidity requirements?
- Final impact to the real economy (pricing of loans and deposits and overall volumes) as banks will need to adjust their business models and balance sheets.
- how the central banks will be able to carry out their monetary policy targets in light of the upcoming regulatory changes.
- LCR eligible assets definition.
- Level playing field globally / consistency in the implementation across nations (risks due to early implementation).

Important: Systemic risk and disclosure requirement

- Systemic risk (high concentration in reduced number of assets and disclosure requirements). Narrow eligibility of liquid collateral will increase concentration risks and cliff effects.
- Disclosure requirements: definition of LCR implies volatility in the ratio values across time which is difficult to understand by the market. Significant changes in the ratio value may cause unjustified alarm.

Remaining issues

- One market for HQLA and another one for other assets. Impact on securities, credit and interbank markets.
- Complex interaction between the various new regulations such as liquidity, repricing of products and credit risks from a liquidity point of view, impact of NSFR expected to lead to significant squeeze on credit availability and increase in price.

Follow up on the central bank side

- Provide input to relevant fora working on Basle III liquidity risk framework; consultation on CRDIV
- Monitor closely bank behaviour and adjust operations such as to maintain effectiveness of monetary policy implementation
- Achieve a better international understanding on key policy and level playing field issues