
A possible market-led initiative to enhance the INFRASTRUCTURE of the interbank money market

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Agenda

Introduction

List of possible initiatives

Focus on the European Interbank Collateralised Market

Next steps

Introduction

Starting point: The EBF report proposals for market-led– initiatives aimed at
“REMEDIYING DYSFUNCTIONAL
INTERBANK MONEY MARKETS”, March 2009

Focus: initiatives limited to interbank money market, in terms of systemic funding liquidity.

It is not a comprehensive report to restore smooth market conditions, it does not address market liquidity, refinancing needs or solvency issues.

Short-term objective: activate market-led initiatives, with the catalyst role of relevant European institutions, and build together a roadmap.

Roadmap: to either revitalise the interbank money market or propose exit strategies for the ECB, when exceptional measures will be removed.

List of possible initiatives suggested in the report

Initiative (1). Short-Term Funding Facility. FED-like facilities: The measures implemented by the New York FED last October to support funding liquidity, with the financial back-up of a single strong treasury, have proven effective.

Initiative (2). European Short-Term Debt certificates swap Such facility could allow banks to swap short-term paper of banks with the same-maturity paper issued by the ECB.

Initiative (3). European Interbank Collateralised Market – focus of today's presentation.

Initiative (4). Enhance market infrastructure for STEP - Recent STEP (temporary) ECB eligibility encourages the establishment of a dedicated platform(s) in order to facilitate the issuance and possibly the trading of short-term securities.

European Interbank Collateralised Market (EICM) -1

It is a positive structural improvement, supposed to increase market resilience. European banks, with the catalyst role of the ECB and the operational support of the Eurosystem national central banks, could promote the set-up of an EICM. In addition to the traditional secured (repo) market, the EICM could entail some form of default risk sharing. This might require further developments in terms of market infrastructure (i.e collateral manager, trading platform and Central Clearing Counterparty-CCP).

Necessary features for counterparty risk:

- good governance and adequate oversight;
- an adequate risk control framework: well capitalised, with initial and variation margins as well as collateralisation;
- public guarantee for the exceptional circumstances (systemic credit risk)?

Necessary features for systemic funding liquidity risk:

- injection of liquidity by the CCP itself through issuance of short-term debt whose default would be shared among participants
- re-use of collateral

EICM pros and cons - 2

Pros	Cons
<ul style="list-style-type: none">• Individual and systemic risk stemming from counterparty risk would be substantially reduced.• higher liquidity also for longer maturities• Trading against a CCP would not generate any increase of risk weighted assets for different maturities.• Trading would be anonymous and any disclosure of participants will be avoided.	<ul style="list-style-type: none">• It is questionable whether banks have sufficient “good” collateral• It does not directly address M/T financing needs.• The operational design and features have to be worked-out. Therefore, it is likely to be very time consuming (magnitude of a few quarters).

EICM pros and cons - 3

Pros	Cons
<ul style="list-style-type: none">• Avoid some of the competitive distortions that arise from the selective granting of state guarantees for individual institutions.• Systemically relevant information would be available to the CCP and its supervisor and to, a lesser degree, to participants.	<ul style="list-style-type: none">• The effectiveness, measured in terms of leverage possibilities, depends on a broad range of participation.• A European scale solution has to cope with the existing differences in the national legal frameworks

EICM: A complex implementation – 4

Different solutions can be implemented in terms of who is going to act as:

- a) collateral manager;
- b) liquidity provider,
- c) trading platform(s)
- d) collateral evaluator

EICM: A complex implementation – 5

The **collateral management function** should be preferably assigned to a private entity, though the operational support of the Eurosystem cannot be ruled out due to current circumstances. Concerning the percentage of collateralisation, different solutions should be investigated. On one hand, it may be argued that 100% collateralisation of a CCP would mainly reduce the need to resort to the ECB credit operations. On the other hand, it might not necessarily create new readily available liquidity to the market participants.

EICM: A complex implementation – 6

Concerning the **liquidity provider**, a possibility to be explored is the injection of liquidity by the CCP itself. The liquidity in demand could be raised by the CCP through issuance of short-term debt. In this regard, an important issue for the Eurosystem is to investigate under what conditions the ECB (and other central banks) could be involved as safe liquidity provider. In addition to its catalyst intervention, the ECB could consider swapping its debt certificates with CCP short-term debt. It appears plausible that, in case of a systemic disruption the facility would receive guaranteed support from the ECB, e.g. in the form of a collateralised credit facility, to bridge any liquidity shortfalls.

EICM: A complex implementation – 7

Regarding the **trading platform(s)**, private initiatives should be preferred.

EICM: A complex implementation – 8

Regarding the **collateral evaluator**, under current market circumstances, a direct operational support of the Eurosystem collateral management seems advisable.

Complementary conditions

- 1) The public guarantee, European dimension, European oversight
- 2) Some form of industry risk sharing

Next steps: a roadmap?

In the short-medium term, the ECMI initiative remains a desirable structural development to be investigated with the catalyst role of the ECB and the operational support of the Eurosystem.

In the long-term, initiative (2) that involves a CCP could be investigated in terms of possible extension of the market infrastructure which are being developed by the Eurosystem (T2S and CCBM2 in particular).