THE ROLE OF NON-BANKS IN THE EURO MONEY-MARKETS AND ITS EFFECTS ON LIQUIDITY

PRESENTATION TO THE ECB MONEY MARKET CONTACT GROUP

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INTRODUCTION

The growing importance of non-bank market participants in the euro area money-markets poses the question of the impact on liquidity in times of increased volatility or liquidity shortages.

Beyond aspects of liquidity and pricing, what is the relevance of the non-bank sector to the real economy financing and its capacity to absorb external shocks?

TOPICS EXPLORED IN THIS PRESENTATION

- Cyclicality
- Liquidity models & transformation
- Stress-testing
- Leverage
- Concentration
- Interconnection
Since the global crisis and especially since the inception of the ECB QE, assets under management in the asset management industry have grown steadily and stand now at their highest.

Short-term money-market funds are widely used by investors to manage liquidity and as alternatives to cash accounts held in banks.
PART OF NON-BANKS IS GROWING IN SPITE OF DECLINING RETURNS

- As of February 2021, returns on EUR prime /LVNAV Money-Market Funds stand below the ECB Deposit Facility Rate

<table>
<thead>
<tr>
<th>EUR PRIME/LVNAV MMFs</th>
<th>Assets</th>
<th>Yield</th>
<th>7 Day</th>
<th>30 Day</th>
<th>Agency Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Accum</td>
<td>Dist</td>
<td>Total</td>
<td>Change</td>
<td>Change %</td>
</tr>
<tr>
<td>Amundi Money Market Fund-Short Term (EUR)</td>
<td>-</td>
<td>-</td>
<td>35,881</td>
<td>-2.347</td>
<td>-6%</td>
</tr>
<tr>
<td>BlackRock ICS-Instit Euro Liq Fund</td>
<td>35,881</td>
<td>-</td>
<td>-</td>
<td>-2.347</td>
<td>-6%</td>
</tr>
<tr>
<td>Deutsche Managed Euro Fund</td>
<td>8,962</td>
<td>-</td>
<td>8,962</td>
<td>-128</td>
<td>-1%</td>
</tr>
<tr>
<td>Fidelity Instl Liquidity Fund-Euro</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Goldman Sachs Euro Liq Resv Fund</td>
<td>12,457</td>
<td>-</td>
<td>12,457</td>
<td>-217</td>
<td>-2%</td>
</tr>
<tr>
<td>HSBC Euro Liquidity Fund</td>
<td>9,152</td>
<td>-</td>
<td>9,152</td>
<td>90</td>
<td>1%</td>
</tr>
<tr>
<td>Invesco Euro Liquidity Portfolio</td>
<td>1,036</td>
<td>-</td>
<td>1,036</td>
<td>9</td>
<td>1%</td>
</tr>
<tr>
<td>JPM EUR Liquidity LVNAV</td>
<td>15,792</td>
<td>-</td>
<td>15,792</td>
<td>-314</td>
<td>-2%</td>
</tr>
<tr>
<td>LGIM Euro Liquidity Fund</td>
<td>1,261</td>
<td>-</td>
<td>1,261</td>
<td>20</td>
<td>2%</td>
</tr>
<tr>
<td>Morgan Stanley-Euro Liquidity</td>
<td>9,613</td>
<td>-</td>
<td>9,613</td>
<td>224</td>
<td>2%</td>
</tr>
<tr>
<td>State Street EUR Liquidity LVNAV Fund</td>
<td>6,361</td>
<td>-</td>
<td>6,361</td>
<td>-45</td>
<td>-1%</td>
</tr>
<tr>
<td>UBS (III) Select Money Market Fund-EUR</td>
<td>1,328</td>
<td>-</td>
<td>1,328</td>
<td>133</td>
<td>11%</td>
</tr>
</tbody>
</table>

Total/Net: 101,843

Maximum: 11%
Median: -0.58
Minimum: -0.58
Range: 0.04 to 0.67

Source IMMFA
During the Covid crisis in March 2020, Autonomous Factors increased as a consequence to the increase of the Eurozone excess liquidity, albeit at a slower pace.

The Autonomous Factors may reduce liquidity available in money-markets...

...and increase volatility all the more so as Government deposits are very sensitive to price and do not deal below the ECB DFR.
▪ MMFs are widely used by Corporates to manage and invest their excess short-term liquidity

▪ The Covid crisis in March 2020 affected corporate liquidity and confidence: massive withdrawals from MMFs triggered a freeze on term money-markets as asset managers sought to maintain or even increase liquidity buffers and refrained from investing in financial or non-financial short-term paper

▪ Liquidity was retrieved after the implementation of PEPP & CSPP

▪ Corporate firms withdraw liquidity from funds as programs mature in 2021

Source Bloomberg: Amundi Cash Corporate Fund
REPO SEGMENT SHOCK PROOF BUT HIGHLY CYCLICAL

- Euro secured funding market maintains volumes and prices during the COVID crisis...

- …but remains highly sensitive to regulatory constraints.

- A sector with high volumes, tight margins and costly in terms of leverage ratio.

Source Bloomberg: Repo Fund Rate Volumes (left charts) and Yield (right charts)
INCREASED INTERCONNECTION AND DEPENDENCIES

- During the Covid crisis Corporates drew on bank committed lines and withdrew cash from Money-Market Funds
- MMFs recovered liquidity by selling bank short-term paper
- Banks regulatory ratios were degraded, confidence was shaken
- EUR term unsecured market segment froze completely
- ECB had to step in to restore market confidence and functioning

Central Banks

Governments
Banks
Money-Market Funds
Corporates
Pension & Insurance Funds
Investment Funds
HIGHER RISKS TO MARKET STABILITY?

- Risks migrated from banks to non-banks and from a highly regulated environment to a less watched sector

- Transformation of liquidity from short to long term relies on modeling and stress-testing

- Behavioral models and stress testing scenarios can show inefficiencies (redemptions during the Covid crisis in March 2020 surpassed needs defined by models)

- Liquid assets can be subject to market stress when used as a substitute to less-liquid ones: as Equity markets collapsed last March, Euro government securities were pledged in lieu of Equity securities in a chain of settlement fails

- Investment in illiquid and long-term assets funded on short-term maturities relies on confidence and low volatility
CENTRAL BANK RESPONSE TO THE NON-BANKS ROLE

- To what extent is the development of the non-bank sector relevant to the financing of the real economy?
- Is this sector able to absorb exogenous shocks?
- Can there be any further significant increase in the role of non-banks in the Euro money-markets without an adjustment in regulation and Central Bank monetary policy?