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

Money Market Contact Group
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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

- Limited influence on actions: 50%
- Significant influence: 50%

Observation period influencing actions

- 50% to support disclosure and structural changes
- 14% local regulatory restrictions
- 36% it depends on market requirements

reasons for the anticipation of phasing in
Selected findings of the MMCG survey

II) Expected changes in AL management

Key changes expected on assets:
- No shock on HQLA: 8%
- Positive shock on HQLA and negative shock on non-HQLA (replacement effect): 75%
- Use of Non-HQLA as collateral: 17%

Key changes expected on liabilities:
- No material changes - the business is not retail or traditional banking: 17%
- Extension of maturities/strengthening of the retail distribution and stable deposits: 83%
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
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