ACI Money Market & Liquidity Working Group

Meeting on Thursday, February 5, 2015
10:30 hours - 16:00 hours

Venue: **MiCo Congress - Milan**

Attendees:

Jürgen Sklarczyk (chairperson)	Deutsche Bank Frankfurt
Holger Neuhaus	ECB Frankfurt (observer)
Maria Cristina Lege	Intesa San Paolo SpA Milan
Zinia Chatzimpei	National Bank of Greece Athens
Miguel Monzon	BBVA Madrid
Luis Soutullo	Cecabank Madrid
Stefaan van de Mosselaer	BNP Paribas Fortis Brussels
Alberto Covin	UniCredit SpA Milan
Andrea Lanzi	HSBC Dusseldorf

Apologies:

Deborah O'Neill	Bank of Ireland
Jose Carlos Mateus	Montepio Lisbon
Marjo Pesonen	Nordea Bank Finland Helsinki
Frederic Pailloux	Société Générale

Member from France and Austria resigned recently – new member will be appointed by the National ACI.

Minutes:

Juergen Sklarczyk, Chairman of the ACI MMLWG welcomed the participants to the meeting in Milan and thanked Maria Cristina and Alberto for hosting the meeting in Italy during the ACI World Congress 2015.

1. Minutes from last meeting in Paris

Before the minutes were discussed, a more general point has been raised on the use and purpose of each meeting's minutes. It has been agreed from all members that minutes should:

- cover all topics discussed, with no reference to single Member positions (unless explicitly requested),
- refer to other Groups' discussions with a generic and broad approach (not revealing any sensitive detail)
- have in written form explicit take-away, or outcomes, or suggestions at the end of each topic discussed
- make sure that the casual reader can, reading them from top to bottom, achieve a full understanding of the topic discussed
- write the minutes in a formal style (with the purpose of publication on the ACI website), maintaining the actual rule that the hosting country is in charge to write the minutes, in order to minimize the time that each member will dedicate to this activity while distribute the burden.

Under these premises, Paris minutes have been reviewed in light of members' observations and additions, and will therefore be re-distributed in the near future.

Actions requested: Review of Paris meeting minutes

2. Negative rates --- Where do we go from here?

Negative rates are posing new questions to banks; for instance some loan contracts imply now (in particular for CHF) negative rates for the borrowers. This occurrence has far reaching implications (*inter alia* in tax and accounting) that need to be addressed. Some legal advices have explicitly written that a negative loan rate should be avoided, implicitly considering a zero per cent floor to every loan contract; this regardless the fact that a floor to zero is clearly written in the contract. As an example of these far-reaching consequences, it has been observed that accounting standard IAS would not consider efficient the hedging of these claims, as derivative do consider negative rates and do not embed the above mentioned floor. The imbalance in treatment will create a different net present value for assets and liabilities.

Action Requested: members agreed to update the Group during the next meeting on developments involving the legal interpretation of the feasibility to apply negative rates (for loans to SME-households)

ECB's QE – Effects on Liquidity, Rates, LCR, etc.?

As far as the recent ECB actions is concerned (Expanded Asset Purchase Program), members noted the considerations underlying the negative deposit rate and the rationale of the new asset purchase programme. Some members expressed some doubts that the program will be performed with the size and timeline conceived (€ 60 bln a month until September 2016), because of a lack of genuine sellers and relative poor depth of secondary market. Real money accounts would not be keen to sell their assets because of missing of large enough investment alternatives. Banks need to keep their highly liquid bonds in sufficient volume to fulfil their LCR or to use it as collateral to compensate for their derivatives MtM (full EMIR regulation impact starts at the end of 2015).

Given negative rates in CHF and DKK, as well as in EUR, a question has been raised on the possible consequences of very negative deposit and money market rates, e.g. – 3.00%. This would, in the general opinion of the members, cause an increase of banknotes demand from the household; Such occurrence has been evaluated as negative for the banking system.

After recent Swiss National Bank action (namely the breaking of the peg with EUR at 1.20 and the cut in CB Deposit interest rates), and the consequent volatility in many FX markets, it has been observed that EUR future interest rates implied by option pricing (on 3m Euribor), are now skewed toward a higher probability of even lower rates. Taking aside possible occasional option modelling biases, no definitive interpretation has been given for this behaviour.

If the EAPP will succeed in its size, the liquidity in the system will be much larger than at present time. Members observed that - in this case - banks will require more capital as a consequence of the increased monetary base (projection of € 1.160 bln until September 2016); estimations amount to at least € 30 bln up to € 50 bln for the whole banking system, because of the leverage ratio (currently 3% but likely to be around 5% according to some estimates)..

Action Requested: No Action required

3. STEP+ --- An Update

The group has been informed that all the feedbacks received by MMLWG members have been summarized by Alberto and sent to Step+ Secretariat; no answers at the moment but the next step will be the survey distribution. The national ACI will be involved in order to promote a large participation to the survey. At end of February in Spain the local ACI has already scheduled a meeting and - in case the survey will be available - in that occasion the local banks will be informed about the initiative. The group agreed on the proposal to ask to the Survey Group/Step+ Secretariat to publish the result of the survey also in a disaggregated form to allow to better understand the different approach of the different participant to the survey.

Action Requested: No immediate action requested, yet the group will ask the STEP+ Secretariat to make public the cross sections of the survey responses.

4. Benchmark Regulation and Euribor+

On February 4, EU Member States reached an agreement on a common position under the lead of the Latvian Presidency. This text - also known as “Council general approach”- will reflect the Council’s position vis-à-vis negotiations with the EU Parliament. It has been observed that

i. rather than to ESMA, the supervision of critical benchmarks rests with the national competent authority of the administrator;

ii. although with some improvements in respect to the Commission’s proposal, the definition of critical benchmarks mostly depends on the value of the referenced financial instruments and contracts regardless of whether the benchmark is of significant importance for being used to reference financial instruments across the EU

iii. non-transaction based data are admitted upon the condition that transaction-based data are not available regardless of whether or not they are more appropriate to represent a certain market.

EMMI, the administrator of EONIA and Euribor, has planned a series of workshops and meetings with stakeholders (next one will be on February 10^{th}) in order to present a path for the enhancement and improvement of Euribor. These improvements are made in order to comply with IOSCO Principles and FSB Reform of Benchmarks. A migration toward submissions informed or directly fed by real transactions data are going to be implemented in the near future, possible leveraging on the efforts that banks will need make in order to comply to recent Money Market Statistical Regulation.

Action Requested: No Action required

5. Regulation on Money Market Funds and mandatory Buy-ins → Effects on Repo Markets?

Mandatory buy-ins: the group shortly discussed that the provision for mandatory buy-ins under CSD Regulation is likely to have a significant impact on liquidity and pricing in the European fixed-income markets, both for outright cash transactions and the repo market. The Regulation in fact provides that buy-ins must be executed against failing securities transactions (4 or 7 days depending on the liquidity of the collateral). ICMA and the Repo Council have pushed the market participants to send their comments to a survey no later than Jan 30th; the results are expected in the second part of February.

MMF: the participants commented the last evolutions of MMF regulation in France, especially taking into consideration to the possibility for asset managers to develop their internal rating models in order to avoid in the future to refer only to external Rating Agencies (and specifically include this analysis/investment in their prospectuses). This alternative could be interesting for issuers that at the moment have been penalized by the downgrading of their Countries (typically rated below A2); in the next few months the most important investors will evaluate the costs/benefits trade-off to develop internal models. A large share of them already embeds an active credit risk management department, especially in France which is the most important market in Europe through the very developed MMF industry and the French CD Programmes. The scenario for CP and CD is not optimistic for financial and corporates issuers also for other reasons; the recent decision of one of the biggest US asset manager (it plans to convert its largest money funds into an only-Government assets one) after the restrictions imposed by Regulators may diminish the ability to raise funds in the unsecured markets for US corporates and Financials, or may cause an increase of their cost.

Action Requested: No Action required

6. Electronic Trading Platforms – What happens in extreme volatile markets?

The recent events in Switzerland have shown that the orders execution (especially stop loss orders) in a volatile market represent an important issue. The group discussed about the responsibilities, the need for supervision, transparency and explicit principles governing conduct and used in best practice for order execution (for instance First in - First out criteria for orders drove to different results compared with a random execution criteria – the activity of high frequency traders has in fact had an impact on the rules in recent years). It has been also observed that some larger player may have a dominating effect when considering the order of the trades to be performed, because of their higher negotiating power.

Action Requested: No Action required

7. Markets --- Developments (e.g. new Greek government), Issues, and Problems

8. Miscellaneous

Infraday Liquidity Monitoring: the Groups took into considerations two elements:

(1) the new request coming from the centrals bank for a monthly comment related to management of the intraday liquidity risk (i.e. contingent presence of a negative net liquidity position at some point intraday, etc.) and

(2) the request coming from Basel III for an intraday monitoring tool set up that have been postponed

No new deadline has been communicated and the common view of the group, taking into consideration the importance of the use of the collateral pooling also from ECB / National Central Banks' perspective, is that the most coherent solutions could be to comment under a qualitative point of view some numerical evidence that have not been requested yet, so not all banks have defined the set-up of the intra-day reporting.

MMSR: this issues, already mentioned during the discussion related to transaction based benchmarks has just been recapped at the end of the meeting to underline that the final instructions are expected in March. They would be applied for the reporting starting in 2016 unless banks had last "fatal flaw" concerns or required clarifications. Some members expressed their expectations that the data based that banks will set up for MMSR could be the same one that will be necessary for the benchmark contributions, to reduce costs and efforts.

Trading and Hedging Books : the segregation of the different books, the treatment under a PL/Accrual point of view, the implication for the business models of the banks are very important issues, raised at the beginning from Volcker Rule / Liikanen. The item is considered important by the group and during the next meeting there is the intention to go more in deep in the analysis

MMLWG Governance: Appointment of MMLWG Co-Chairman is in stand-by as developments within ACI International are in place.

Next meeting: is scheduled in 18th June 2015 and will take place in Paris, hosted by ACI; the following one will be in Dusseldorf hosted by HSBC in October

Action Requested: during the next meeting Trading/hedging issue will be discussed more in depth