



E U R O P E A N C E N T R A L B A N K

DG MARKET OPERATIONS

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Money Market Contact Group

Frankfurt, Wednesday 20 September 2006, 16:00 – 19:00

SUMMARY OF THE DISCUSSION

1. Latest developments regarding the eligibility of credit claims

Helmut Wacket (ECB) introduced the item, which had been postponed from the May meeting, and provided a presentation.

The main points of the presentation were:

- Credit claims will become eligible as collateral throughout the euro area from 1 January 2007.
- National specificities will exist in a transition period and a unified regime throughout the euro area will apply only as of 1 January 2012.
- Credit claims are different from marketable assets, and this has a number of organisational consequences. Moreover, they have a legal dimension, with legal requirements varying from country to country.
- As the Eurosystem does not accept credit risk below a minimum threshold of “single A”, a Eurosystem Credit Assessment Framework (ECAAF) will be established to ensure compliance with this requirement. Under this framework, there will be four potential credit assessment sources.
- There is no ranking of the different credit assessment sources. The framework will make sure that these 4 sources are comparable, for example by having a common definition of “default”.
- Procedures for using credit claims as collateral will be implemented according to the national legal and operational environment, but a further harmonisation of the handling procedure is envisaged in the intermediate period.

The subsequent discussion mainly centred around the potential use of credit claims by the banks in the euro area. The feedback from participants was quite diverse. The following five points summarise the main findings:

- It seems unlikely that there will be a very substantial use of credit claims right at the beginning of 2007.
- Many banks will use credit claims only after their internal ratings based models will have been approved by the local regulators, which in many cases will probably not be the case by the end of this year. While interim solutions will be used by some banks, this will probably not be the case for all of them.
- Over the medium term, it is however expected that, on average, credit claims will account for a large share in the collateral provided to the Eurosystem.

- The use of credit claims is likely to be quite variegated among banks, depending in particular on the nature of their business.
- The extent of the use of credit claims will also depend on individual banks' balance sheet structures; on national legal requirements and on the level of automation offered by NCBs.

2. Round up on market developments during the last few months

The Secretary provided a short introduction to the latest developments in the money markets. He focussed on three main issues: first, the development of interest rate expectations following the ECB rate hikes on 8 June and 3 August; second, the low level of implied volatilities on money market rates; and, third, the ECB's liquidity management since the last meeting of the MMCG.

The subsequent discussion revealed that banks more or less unanimously expect the ECB to increase interest rates two more times in 2006 and rates to reach 3.50 percent by the end of the year.

As regards the low volatility, members' main explanations were: first, the rather high predictability of the future ECB policy; and second, a continued interest of various types of investors, in particular hedge funds, to sell volatility as a way to generate some additional income.

Concerning the ECB's liquidity management over the last several months, market participants generally expressed their satisfaction with the ECB's strategy to allot EUR +2 billion in all tenders of the reserve maintenance period. This strategy had indeed contributed to a narrowing of the spread between the minimum bid rate on the one hand and the tender rates and the Eonia rate on the other hand. They also generally welcomed the ECB's decision to reduce the excess allotment to only EUR +1 billion since the start of the current maintenance period, given that the spreads had indeed decreased markedly, whereas the risk of a potential underbidding in the last tender of the maintenance period seemed to have increased.

Looking ahead, some members stressed that even with the current EUR +1 billion allotment strategy there seems to be some risk of underbidding for the last tender of the maintenance period, other members deemed instead the risk of underbidding as limited.

There were also, echoing previous discussions, some diverging views about the impact of the ECB's collateral policy on short-term money market spreads: while some members argued that the recent decline in spreads showed that this issue was no longer topical, others were of the view that the issue still deserved the group's attention. At the end, it was agreed that a deeper analysis of the subject could be a possible topic for the 2007 work program.

3. Initial assessment of the development of the STEP initiative

Before giving the floor to Franck Hebeisen (Société Générale), the Chairman recalled that the STEP initiative was actually "conceived" within the Money Market Contact Group even if it was later developed by the ACI and the FBE. He also recalled the Eurosystem's involvement in the initiative, as

- the Governing Council approved the Eurosystem's assistance to the STEP Secretariat for the management of the STEP label and the production of STEP statistics at its meeting on 6 April 2006.
- on 14 September, the Governing Council decided that the STEP market will be accepted as a non-regulated market for collateral purposes in Eurosystem credit operations, as soon as the STEP statistics on yields are published on the ECB's website.

Franck started his presentation by saying that the STEP initiative aims at fostering the integration of the European markets for short-term securities. With the signing of the STEP Market Convention on 9 June 2006, STEP has come to life and the STEP Secretariat has already

published on its website the information memoranda of the first 11 STEP-labelled issuance programmes. More applications for the STEP label seem to be in the pipeline.

Franck illustrated the composition of the STEP Market Committee and the compilation of the STEP statistics and also briefly mentioned the labelling cycle and the eligibility criteria for STEP Security Settlement Systems.

The feedback in the subsequent discussion was generally positive, although there still seem to be some fiscal obstacles that prevent banks from making use of the STEP market in some countries. Franck expects a significant growth of the market in spring next year, as at that time many French issuers traditionally update the documentation of the short-term paper programs.

The Chairman thanked Franck for his very interesting presentation and it was agreed that the presentation would be published on the group's website.

4. Other items

- The Secretary recalled the Chairman's letter to the ECB Directorate General Payment Systems and Market Infrastructures in which a number of settlement-related issues had been raised. He then presented the reply letter, which was recently received and some overview tables that were compiled on the basis of input received from the euro area NCBs. The tables revealed that there had been several recent improvements and that further steps were planned. He recalled, however, that the Eurosystem is a decentralised system in which different legal environments sometimes require different national approaches. In the context of this item it was generally agreed that it would be useful to deepen the co-operation between the MMCG and the Contact Group on Euro Securities Infrastructure (COGESI).
- The Secretary presented the group's public website, which should be further enriched by a photograph of the group, and provided some initial acceptance statistics.
- The Secretary of the Operations Managers Group, Annemieke Bax, presented the tentative agenda for next year's Global Operations Managers Conference and asked the Members for their feedback.
- The Chairman informed about some initial ideas of the ECB as regards the work program for 2007 and asked Members for their input ahead of the next meeting. Moreover, Members were asked for their feedback on the suggested meeting dates for next year.
- The next meeting will be on 23 November 2006 in Frankfurt from 13:00 to 16:00 CET.

The following agenda items were tentatively agreed:

- Regular review of recent market developments
- Preliminary findings of the ECB Money Market Study
- Presentation on TARGET II Securities
- Visit by the President of the ECB