



Highlights of the Eurosystem collateral framework and latest developments in liquidity management



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BANCO DE PORTUGAL
EUROSYSTEM



De Nederlandsche Bank
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Outline

- Basics Eurosystem collateral framework
- Rising demand for collateral
- Collateral trends
- Latest developments (negative deposit rate)



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Role of collateral

General

- Collateral no purpose in itself
- Collateral is a measure to mitigate counterparty risk



Eurosystem:

1. Protection against losses: monetary operations and intra-day credit
2. 'All credit operations should be collateralised' (ESCB Statute, Article 18.1)



“Quote” from a central banker:



“....., but from all others we require collateral.”



10 key principles of the Eurosystem Collateral Framework (ECF) - I



1. Protect the Eurosystem from losses
2. Availability of collateral must be sufficient
3. Broad set of counterparties must have access to facilities
4. Cost-efficient transfer and mobilization conditions
5. Be in accordance with the principle of an open market economy with free competition



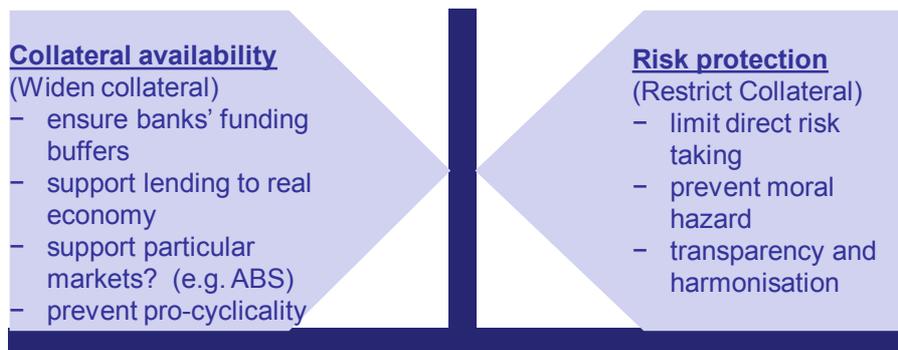
10 key principles of ECF- II

6. Be simple and transparent
7. Flexible to meet future funding/liquidity crises
8. No privileged treatment of public sector securities
9. Market neutrality (=avoid unintended market distortions)
10. Keep the operational burden acceptable



Current topic in the Eurozone

Finding a balance: collateral availability and risk protection



Basics Eurosystem collateral framework

Rule based framework:

- uniform → single list of collateral
- harmonised risk control framework

Discretionary measures:

- When needed for risk protection
- Also on level individual counterparties
- Consistent, transparent and non-discriminatory



The Eurosystem framework: Basics

- All liquidity providing credit operations of the Eurosystem based on **adequate** collateral (no cash)
- **One collateral-list** for monetary policy purposes and intra-day credit, with loss sharing among NCBs
- **Separate** list for non-loss sharing collateral
- **Broad collateral list** consisting of marketable and non-marketable assets
- Lending to **financially sound** counterparties
- Credit provided by Home Central Bank (decentralized)



Broad eurozone collateral framework – examples of eligible assets

Marketable assets (securities)

- Government bonds
- Bank bonds (unsecured)
- Corporate bonds
- Covered bonds
- Asset Backed Securities

Non marketable assets

- Credit claims (bankloans)
- Irish mortgage backed promissory notes

Further broadening during the financial crisis



Risk control framework

Three types of protection:

1. Eligibility of collateral (collateral should be adequate and wide or narrow framework)
2. Risk control measures (examples: haircut, concentration limits)
3. Financial soundness of counterparties (acceptance criteria and balance ratio's)



Risk control collateral framework - instruments

- Limits (uncovered bank bonds)
- Additional valuation mark down in case of theoretical price
- Additional valuation mark down in case of 'own-used' covered bonds
- Daily margining requirements (0.5% margin)

- Discretionary measures





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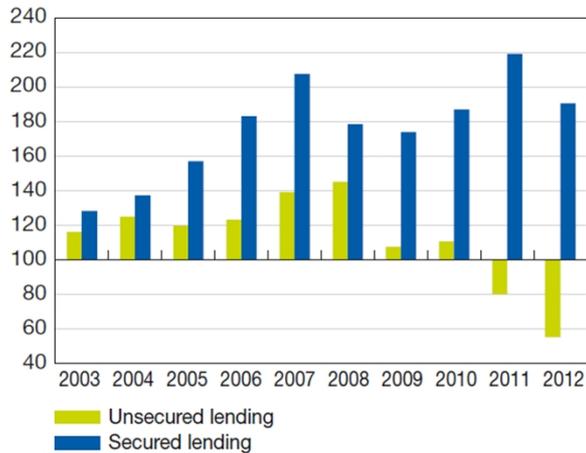
General developments – more demand for collateral

- Collapse unsecured money market, more demand for secured lending
- The need for high quality collateral is growing, regulators impose capital and liquidity ratio's on banks (Basel3: B3-LCR and B3-NSFR)
- Collateral needed for derivatives transactions, for securities lending, for repo-market and ECB refinancing operations.



Average daily turnover in secured and unsecured cash lending

(Index: 2002 = 100)



- Collapse unsecured money market
- Collateral needed for secured lending

Note: The panel comprised 105 credit institutions.
Source: ECB.



Collateral management at DNB

DNB **used** to operate a single multi purpose pool of pledged collateral for ESCB services:

- Intraday credit in TARGET
- Monetary policy operations

And for various DNB services like:

- Freezings for Clearing house margins
- Banknote consignments
- Other purposes



Collateral Management at DNB

- In 2013 the Single collateral pool was separated
- Now: Monetary pool for ESCB services
and
Second pool for DNB services
- Reason: Risk mitigation for DNB
In joint pool: DNB claims junior to ESCB claims



Outline



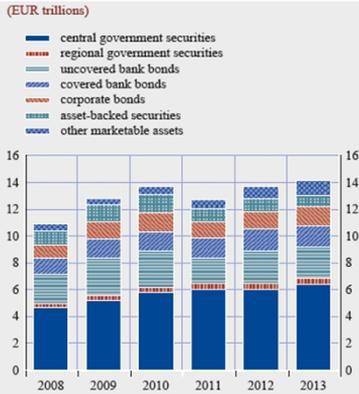
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Sufficiency of collateral

Available in 2013: +/- EUR 14,200 bln

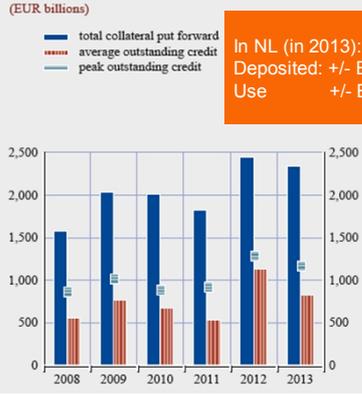
Chart 33 Eligible marketable assets



Source: ECB.
Notes: Nominal amounts; averages of end-of-month data. The data shown in this chart are published on a quarterly basis on the ECB's website.

Deposited in 2013:
+/- EUR 2,350 bln
Use: +/- EUR 830 bln

Chart 34 Collateral put forward in Eurosystem credit operations and outstanding credit in monetary policy operations



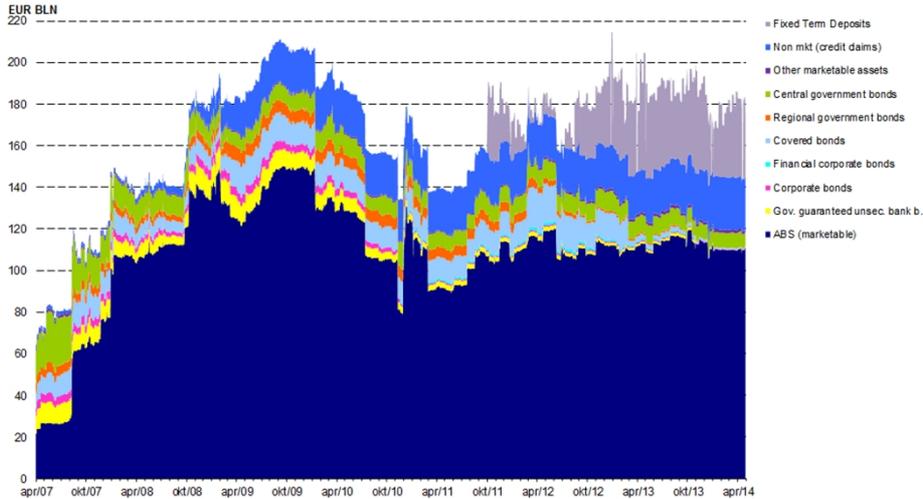
Source: ECB.
Notes: "Collateral put forward" refers to assets deposited as collateral in countries operating a pooling system and assets used as collateral in countries operating an earmarking system. Collateral value after valuation and haircuts; averages of end-of-month data. The data shown in this chart are published on a quarterly basis on the ECB's website.

In NL (in 2013):
Deposited: +/- EUR 189 bln
Use +/- EUR 16.5 bln



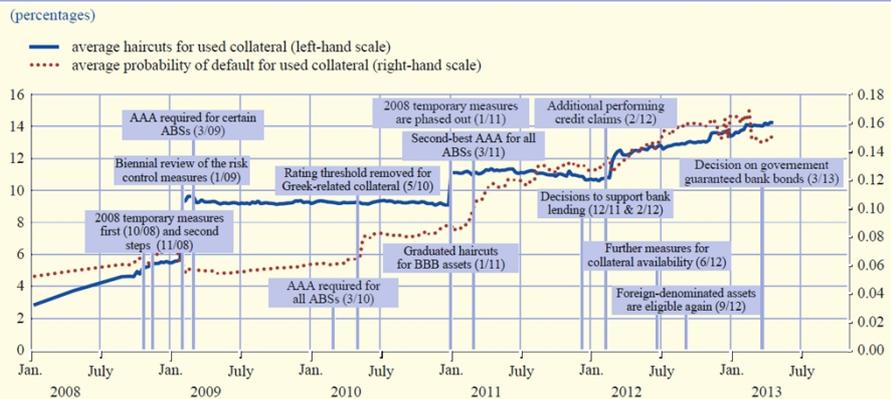
NL collateral pool – asset types 2007 - 2014

Value of the deposited collateral by assettype



Effects crisis on complexity – example haircuts

Chart A Average haircuts applied to the collateral used by counterparties in Eurosystem monetary policy operations (weighted by the amount of collateral used, after valuation and before the application of haircuts)¹



Effects crisis – complex framework

Broadening framework and approach (additional) risks:

- Since 2007 – abundance of crisis measures
- Since 2010 new risk management committee (E-RMC) -> new risk policy

After incidents more attention on data compliance

- 40.000 eligible assets, daily update through NCBs
- Public incidents (2012 – ES, FR)
- More data checks -> every quarter -> as of 2013 'data quality compliance network'

Continuous update regulations and more monitoring

- 4x per annum update DNB contracts with banks (before: 1x per annum)

Complex collateral framework

- Actions to reduce complexity ...but already new rules/regulations in preparation....
- New measures are introduced too fastneed to use temporary ICT solutions and legacy ICT systems ->release calendar ICT overloaded
- Regulations and Manuals not up-to-date and not aligned -> overview missing
- Complete Revision of Regulations/Manuals has been taken up (after 15Y)



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Latest developments

- Why new monetary policy measures?
 - Euro area faces two problem:
 - ✓ Very low inflation outlook
 - ✓ Weak lending to businesses
- Price stability: Inflation below but close to 2% medium term
- Outlook: below target for extended period of time
gradual rise to 1.5% by end 2016



New monetary policy measures

- As from June 11, 2014:
 - Negative interest rate Deposit facility and for excess reserves (-0.10%)
 - ✓ Lowering Main refinancing rate to 0.15%
 - ✓ Lowering Marginal lending rate to 0.40%
- Continue Fixed rate Full allotment in tenders at least till December 2016
- Suspension sterilising operations stemming from SMP
- Introduction of T-LTRO's
- Intensify preparation for outright purchases of ABS



Negative deposit facility rate

- Does not only impact banks
- But also other account holders at NCB's
e.g. central banks outside euro area
 - Remuneration of cash holdings (limited)
'Eonia -/- 0.10%' but not lower than DFR
 - Excess balances 'DFR -/- 0.15%'
 - NCB's can also invest these funds in the market

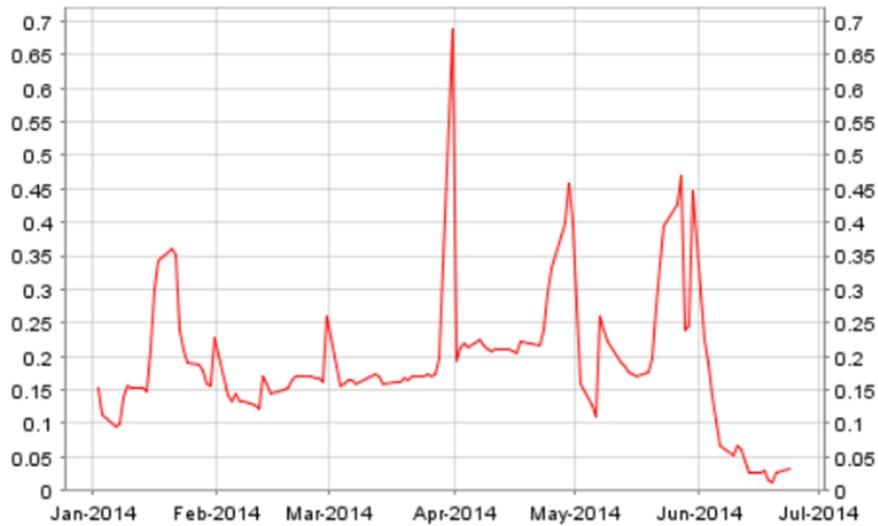


Negative deposit facility rate

- Surplus liquidity drives EONIA to 0 or even lower
- Banks will quote more often negative rates
-
-



EONIA in 2014 (till June 23)



Daily liquidity conditions (EUR millions)

Reserve maintenance period:	11/06/2014 to 08/07/2014
Average reserve requirements:	104,428
Figures as at	23/06/2014
Average current acc. holdings in the MP:	207,685
Current account holdings:	214,373
Use of the marginal lending facility:	11
Use of the deposit facility:	25,142
Net liquidity effect from Autonomous Factors and SMP (*):	374,814

(*) SMP = Securities Market Programme

MRO's and LTRO's

In line with forward guidance and to maintain high degree of monetary accommodation and to contain volatility in money markets:

**Fixed rate and full allotment at least till
December 2016**



Suspension of sterilising operations

- In 2010 Eurosystem started with Securities Markets program (SMP)
- Aim: to dampen the Sovereign debt crisis
- However: To avoid inflation liquidity was sterilised by auctioning 1-week fixed term deposits (June 13 eur 163 bn)
- Suspension adds liquidity, but at same time lower MRO amounts.



Introduction of T-LTRO's

- 'T' stands for Targetted:
to support bank lending to house-holds and non-financial corporations
- Mature in September 2018
- Fixed rate over life-time (0.25%)
- Maximum of 7% of outstanding loans to relevant sector on April 30 2014.
- Total amount Eur 400 billion
- Many details still to be decided



Intensify preparations for outright purchases of ABS

- Purchasing simple and transparent Asset Backed securities
- Underlying assets must be claims against euro area non-financial private sector

Goal: enhance monetary policy transmission mechanism



Negative side effects monetary easing

- Abundant liquidity and low rates may reduce incentive for structural adjustments and reforms
- Induce investors in excessive risk taking: risk for new bubbles
- Therefore: new liquidity support is temporary



Thank you for listening!



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