

“Liquidity & collateral management – outlook of the secured markets ”

Assembly Meeting of ACI Serbia
Subotica Town City Hall
Sept 20th, 2008

Godfried De Vidts

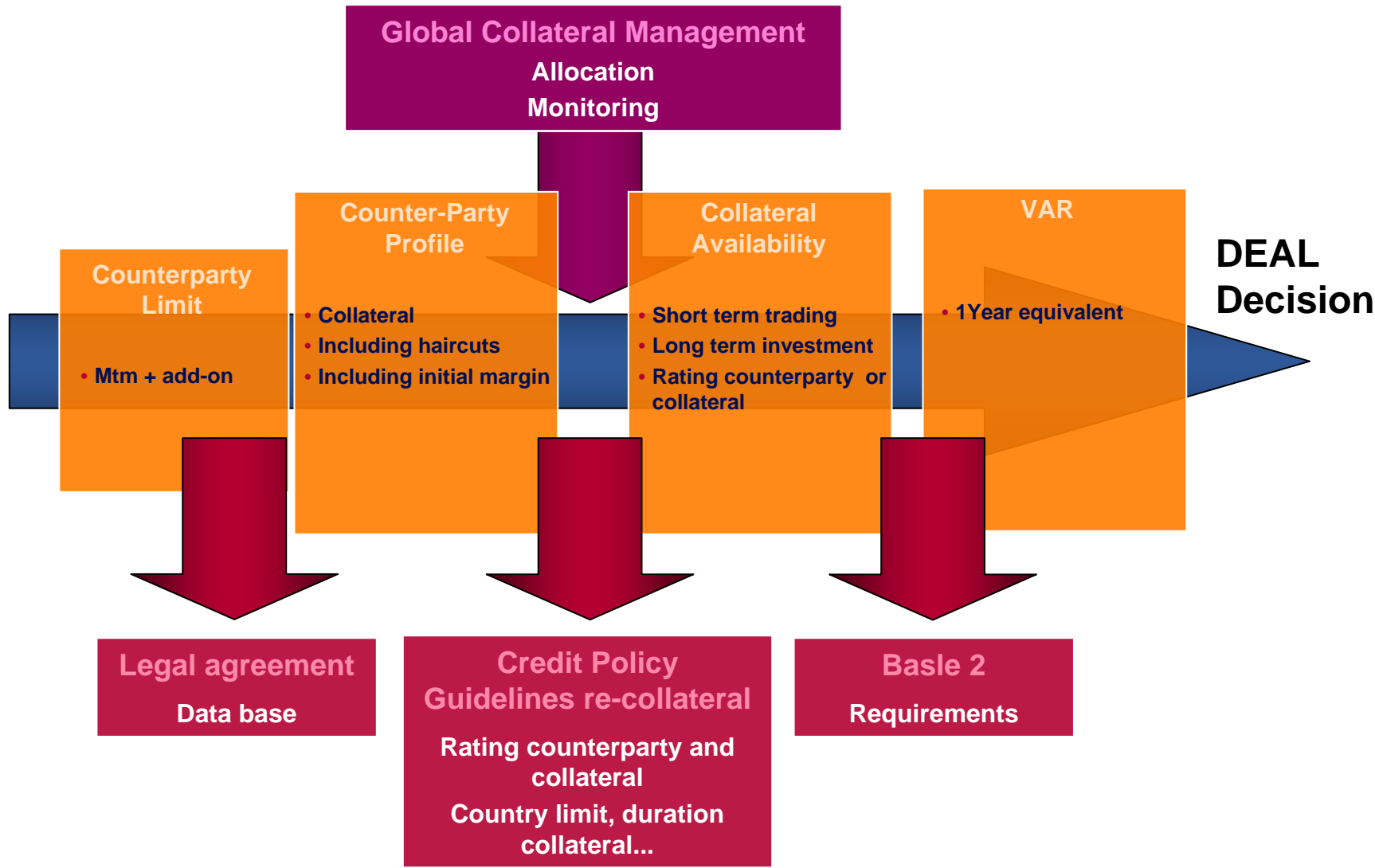
Director of European Affairs



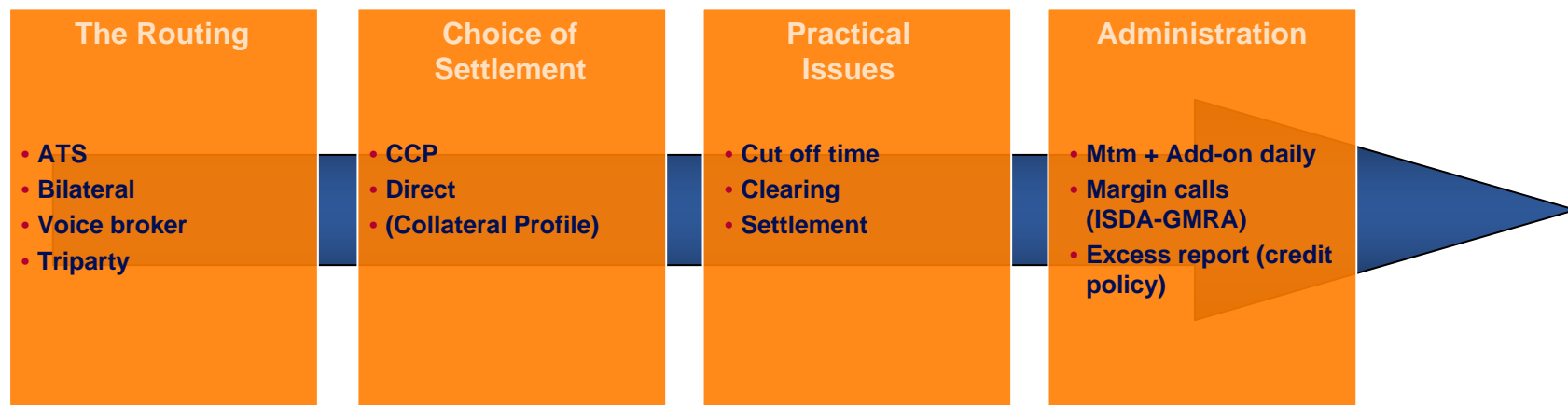
- What does it take to do a trade?
- Liquidity & collateral management
- Electronic trading
- Margin calls (ERC recommendation)
- Central Counterparty (CCP)
- Clearing and settlement , a European debate
- The financing markets – the repo product
- Overview of repo markets
- New market indices

What does it take to do a trade?

The Ultimate Goal – Deal decision Phase 1



The Ultimate Goal – Deal settlement Phase 2



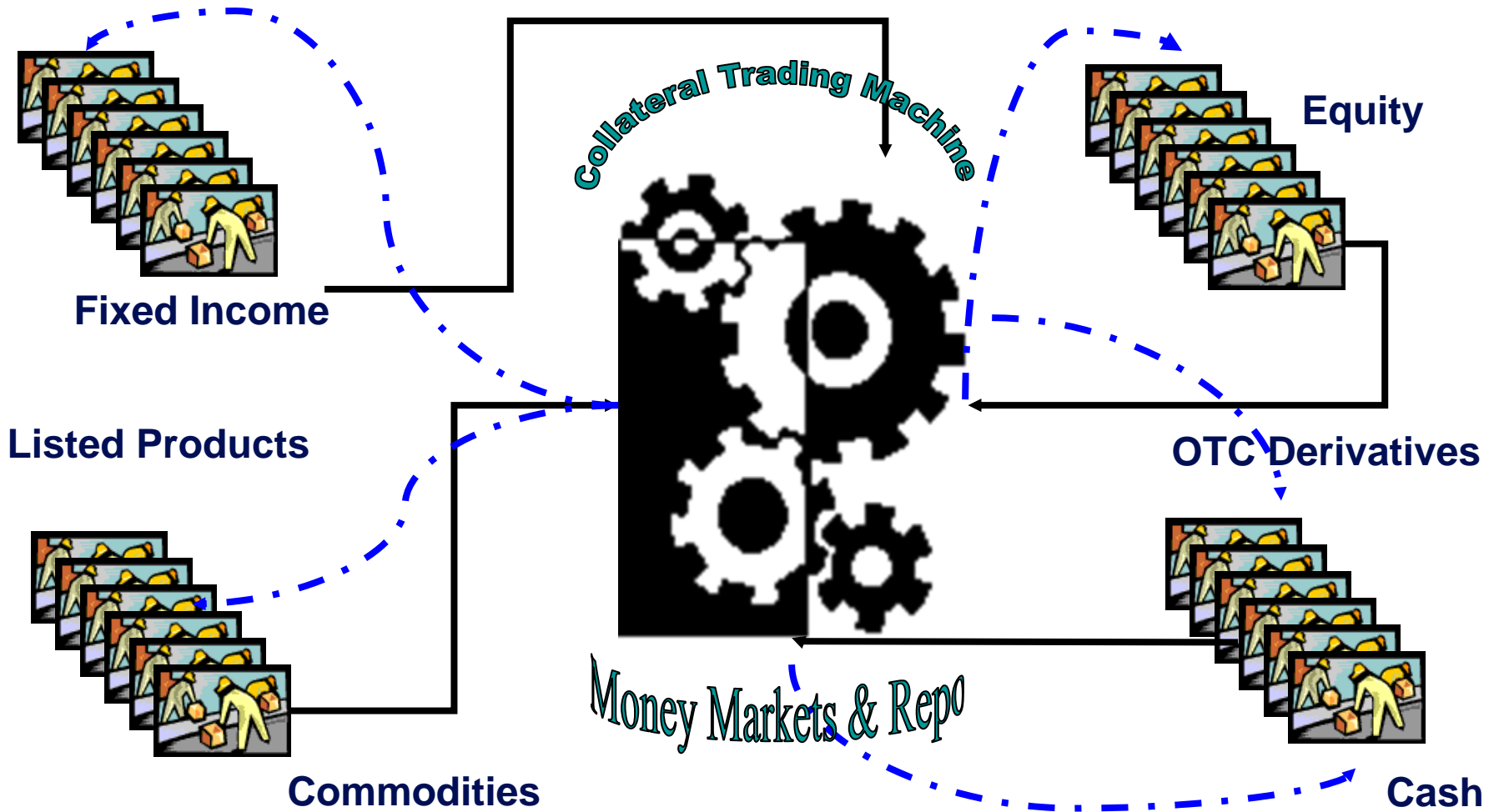
Liquidity & collateral management

Definition of Collateral and Liquidity Management



Collateral and Liquidity Management is defined as the optimal management of credit, collateral, capital and all related execution, pricing, operational, documentation and risk management of a portfolio across **all products, all business units** and **all locations**.

Liquidity and collateral management



Electronic trading

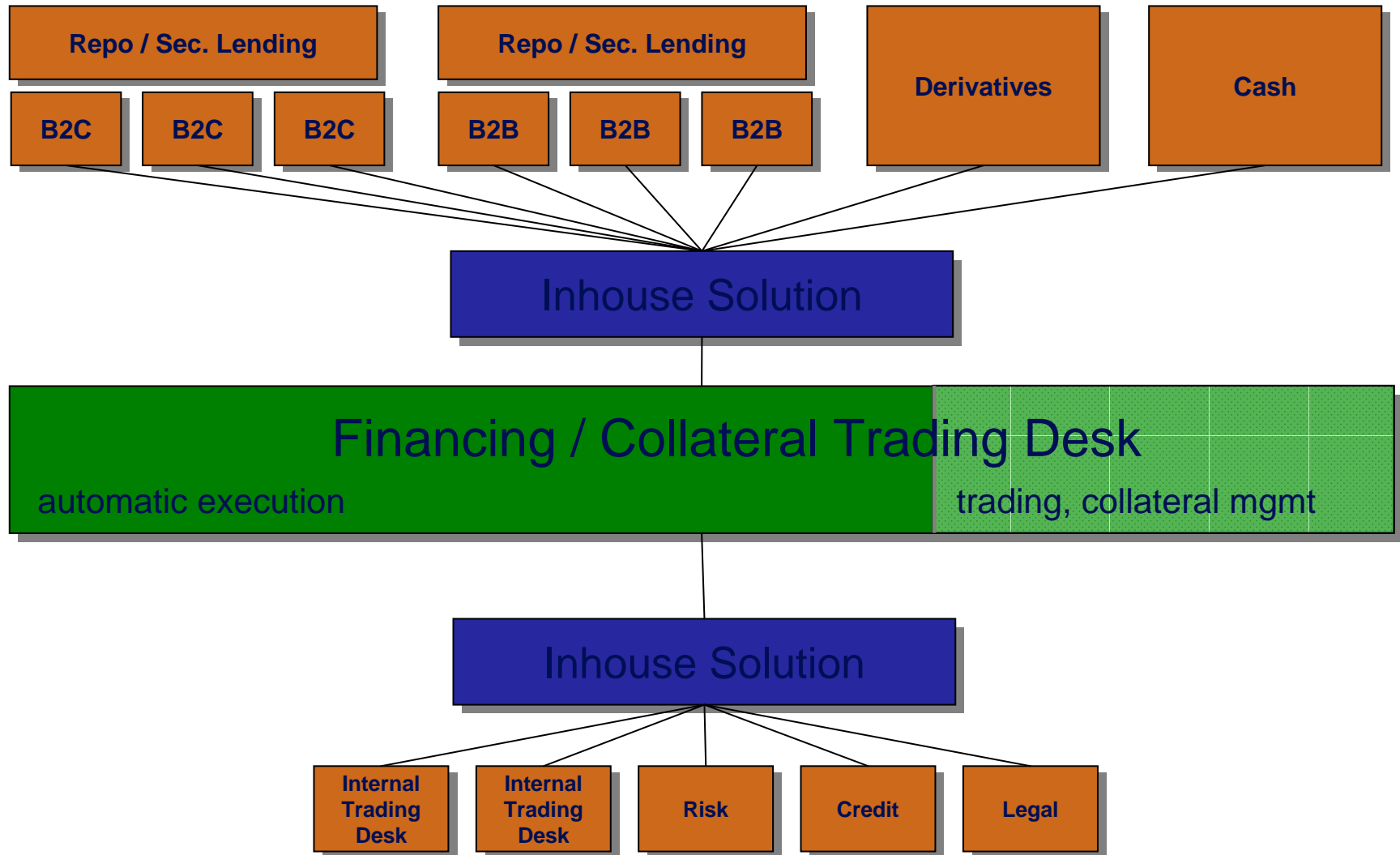
- cash (FX, fixed income)**
- repo & security lending**
- derivatives**

Electronic trading – what was the plan originally?



- increase the trading volume in many products through EBS and Broker Tec (FX, fixed income bonds, repo, security lending, eonia,...)
- increase price transparency
- increase settlement efficiency through STP
- increase customer flows
- reduce transaction costs
- reduce credit risk through netting and CCPs (CLS, LCHClearnet,...)
- develop anonymous trading
- develop a liquid secured Euro money market across the curve (money markets/repo/..)
- move away from unsecured money market products (Basle 2)
- create liquid collateral markets for various asset classes

Vision for Electronic Trading in the Future



Broker Tec trading system

Repo

- Euro Govt Bonds & Bills
- UK Gilts
- Supra, Sovs, Agencies
- US Treasuries
- Scandinavia
- Credit Repo / E.M.
- GC and Specials

EGB

- Euro Deliverable & Non-deliverable Basis
- Euro Cash
- Switches / Swaps
- Pfandbriefe & Supras
- Inflation and Breakeven's

UST's

- Actives/Off the runs
- Agencies
- Tips
- Canada Govt Bonds
- Bills
- Mortgages

Gilts

- Basis
- Gilt cash
- Switches

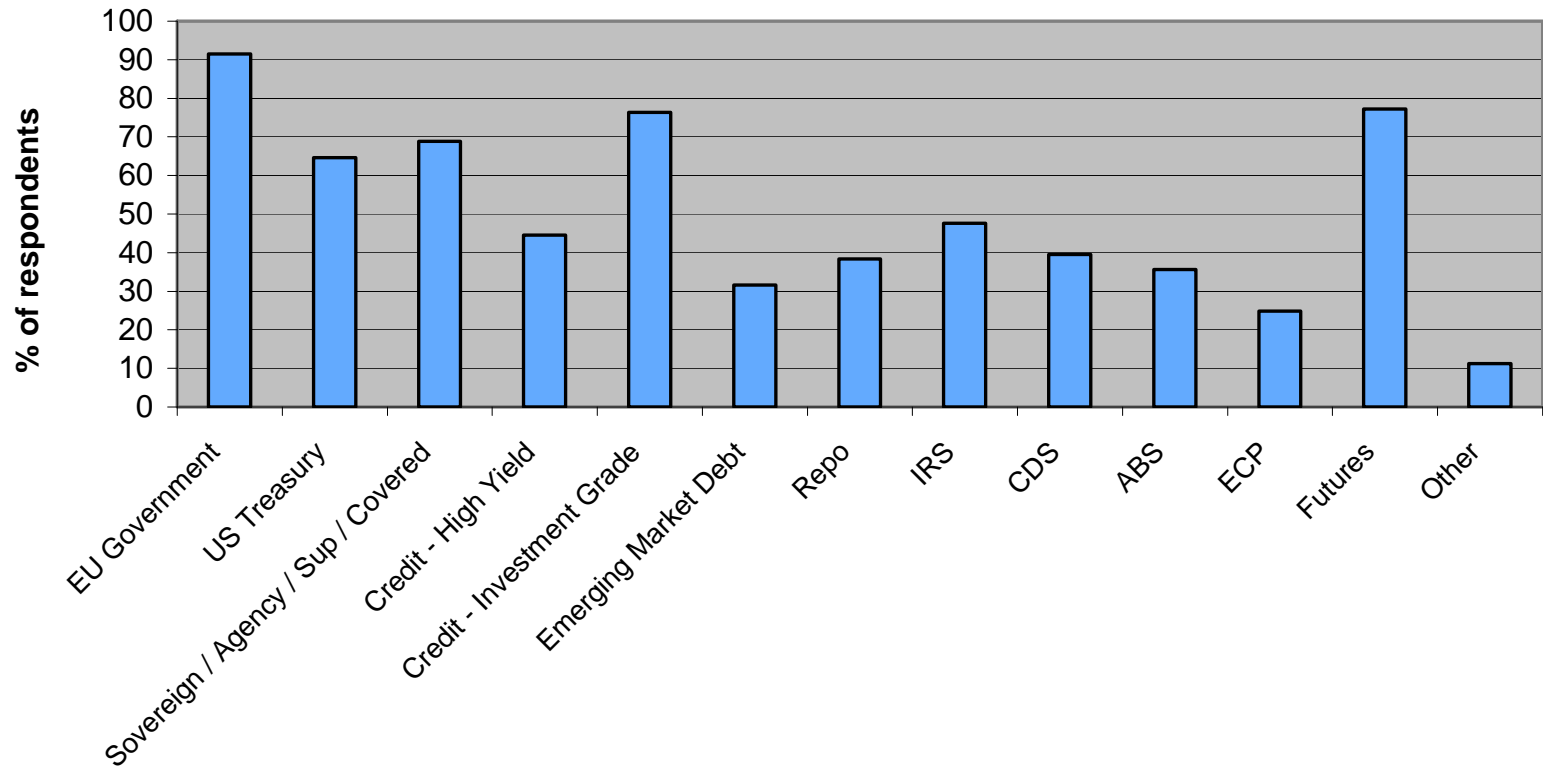
Eurobonds & CDS

- Bank Capital
- \$ + € Sov's
- Industrials
- Auto's & Telecoms
- Euro Financials
- CDS Corporates
- CDS Financials
- I-Traxx
- CDS Tranches & Options

The future...?



Products traded (electronically or otherwise) by Buy-side



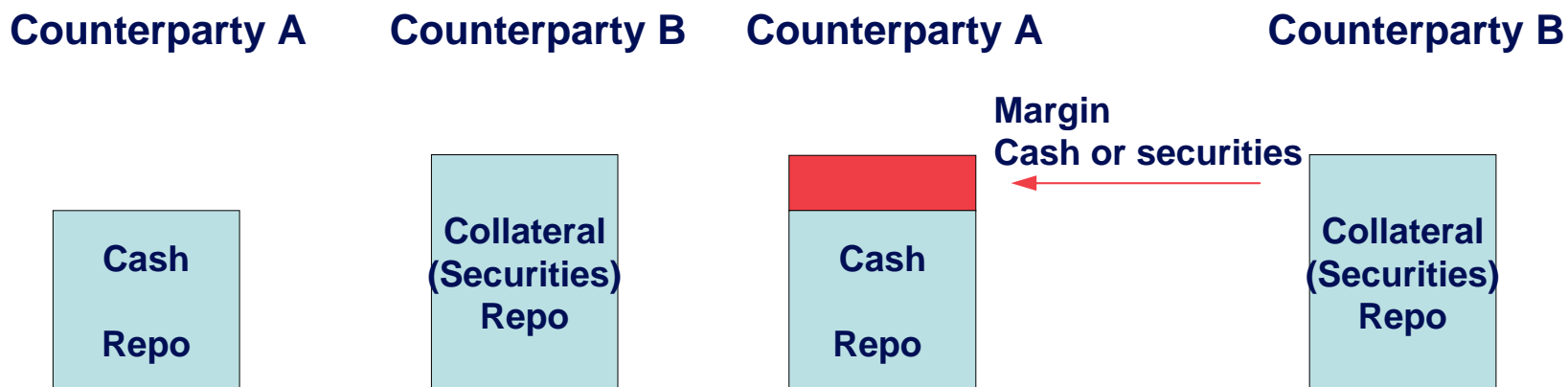
Margin calls

(ERC recommendations)

Margining: what does this mean ?



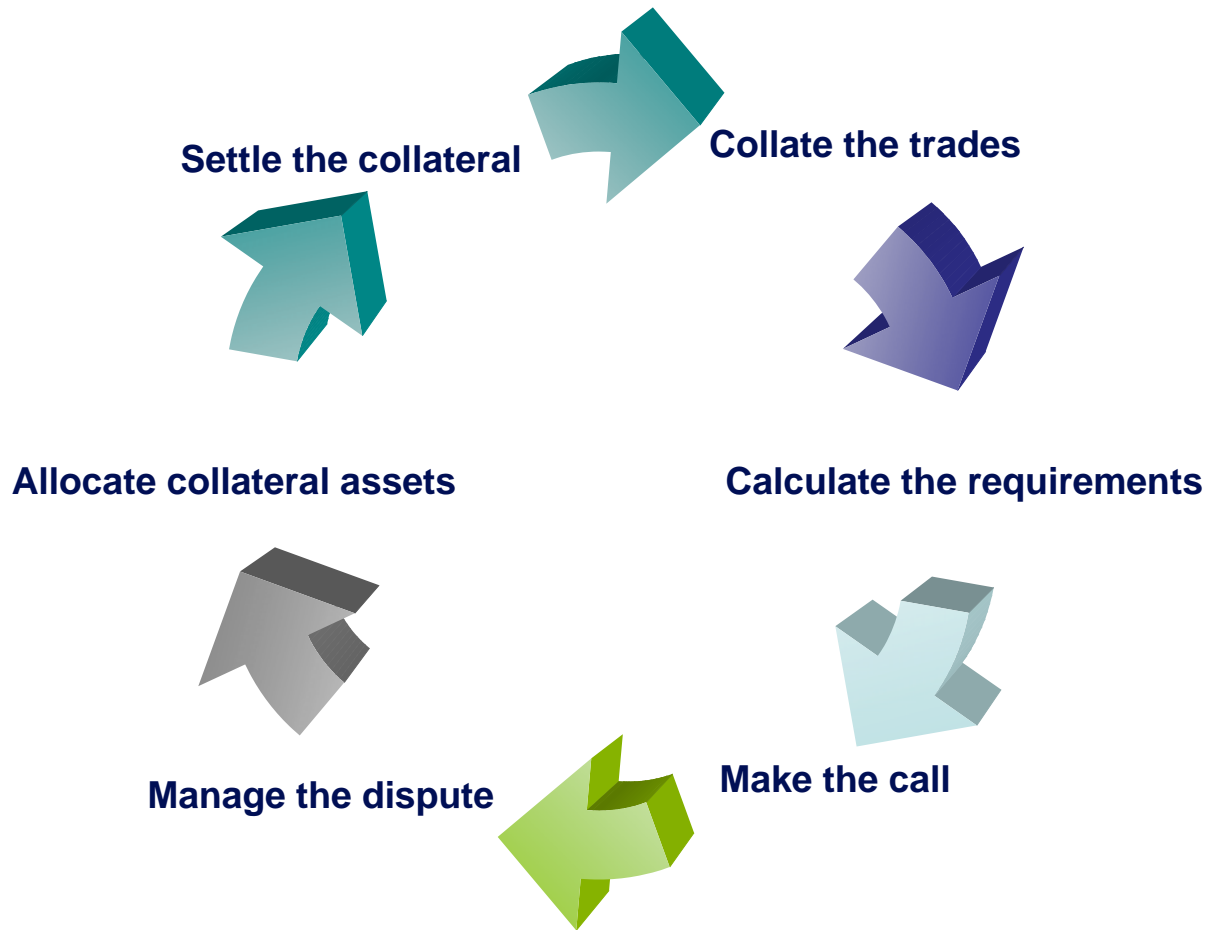
- **What?**
Generally, the amount of cash or collateral which must be transferred when there is a change in the value of collateral.
- **Why?**
In order to bring the ratio between the values of cash and collateral back to that required under the repo agreement.



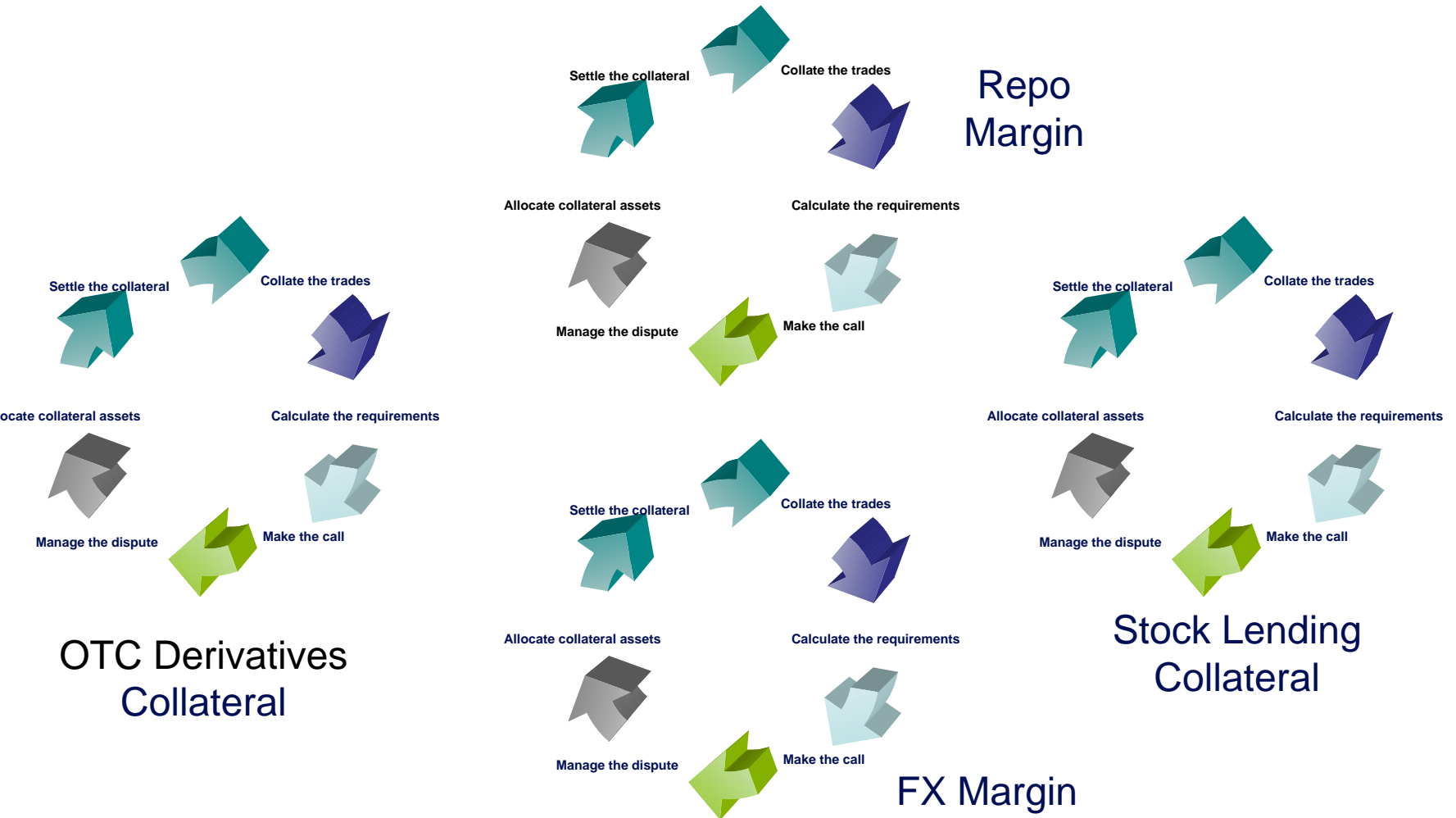
Trends in Collateral Management



Repo
Margin



Trends in Collateral Management



Central Counterparty (CCP)

Initial trade:



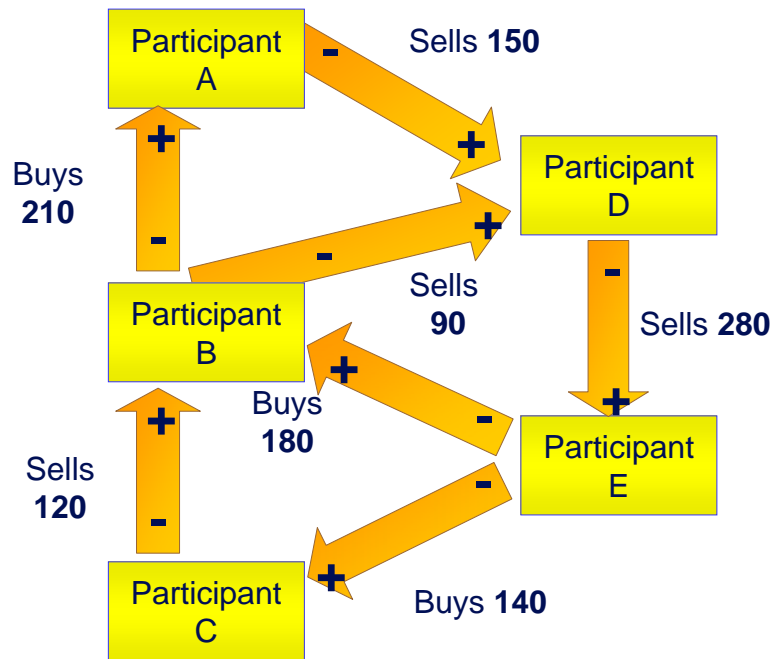
Novates:



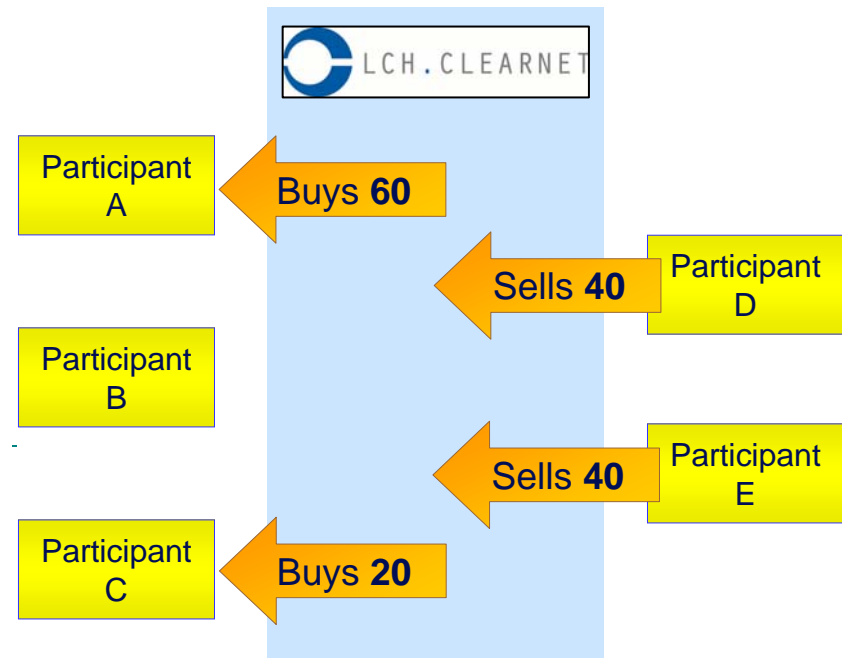
- Immediate commitment, at the point of execution
- Principal to principal relationship
- Final commitment is with the Clearing Member

Multilateral Netting

Bilateral relationships



Multilateral netting



Advantages include :

- Reduction of the number of instructions sent on for settlement
- Reduction of the costs of the member's back-office processes
- Collateral optimisation: reduction of the risk exposure for open positions
- Netting ratios (number of instructions): Cash market up to 95% efficiency

Why a Central Counterparty in Fixed Income ?



- Capital and Operational Efficiency
 - Maximises netting effect and facilitates **balance-sheet netting**
 - Maximises **usage of collateral** and frees up credit lines
 - Operational risks and back office costs are **reduced** through single counterparty
- Optimal Risk Management
 - A **financial guarantee** of transaction settlement
 - A **single** risk relationship
 - Daily **marking-to-market** providing risk management
- Related Benefits
 - **Net settlement** reducing costs and risks
 - Enables electronic **trading anonymity**
 - Members can also **trade bilaterally but clear centrally** through post trade confirmation systems

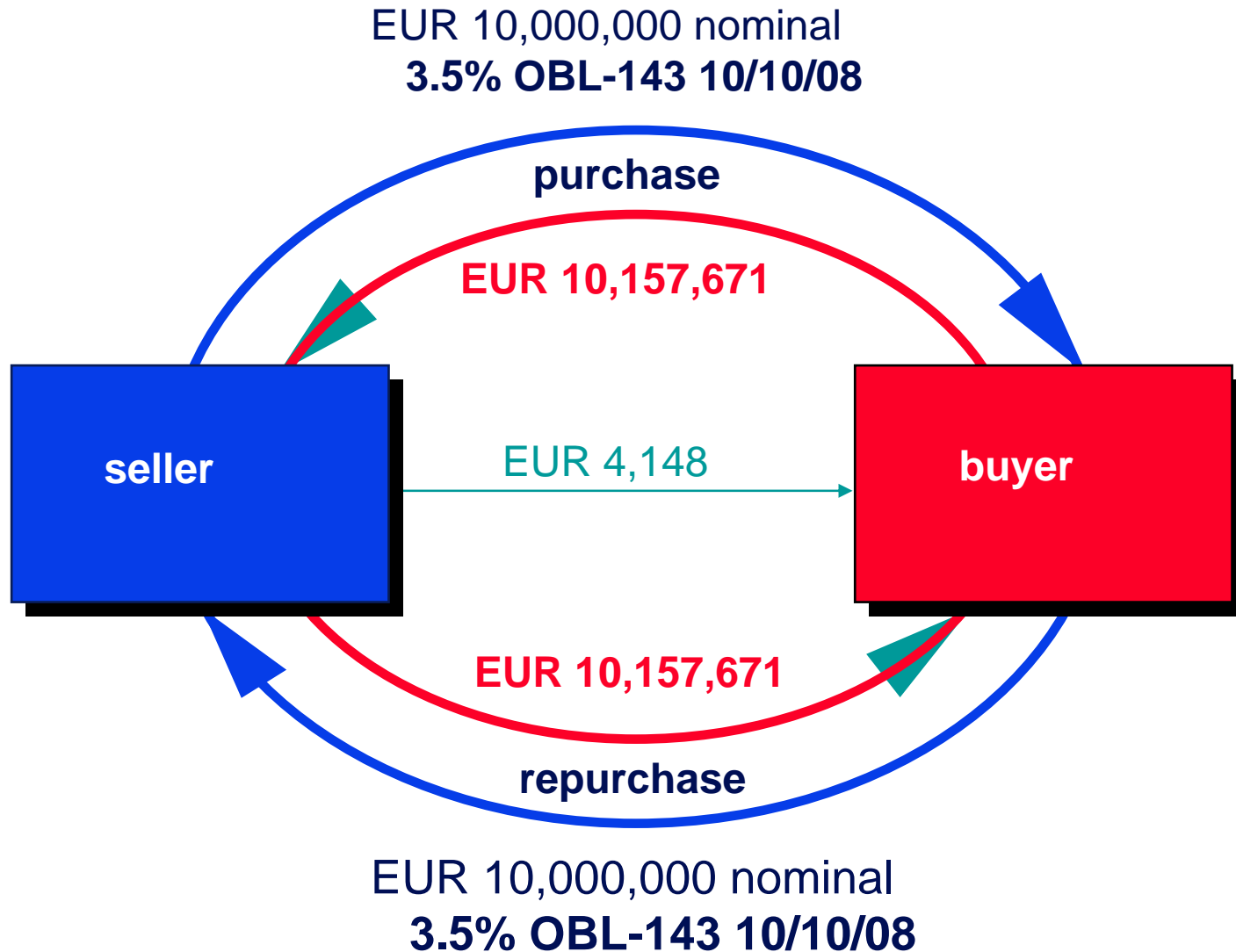
**Clearing and settlement -
a very wide European debate**

- Giovannini working group – work on government bonds and repo markets at launch new currency
- Resulted in discovery of Clearing and Settlement issues – the Giovannini reports I & II with list of 15 barriers
- Commission used the 1st report and other work to adopt a communication regarding clearing and settlement to the Council and the European Parliament 28 May 2002
- Creation of Cesame group – end of mandate July 2008
- Start of new working group Cesame 2
- Code of conduct for equities – analysis for FI & derivatives
- ESCB/CESR recommendations for CI & Settl
- ECB T2S & CCBM2 projects

The financing markets

The repo product

The Repo Market



GRAB

Corp RRRA

Enter <1><GO> to send screen via <MESSAGE> System.

REPO/REVERSE REPO ANALYSIS

BUNDESBL-143 OBL 3 1/2 08 #143 101.4900/101.5400 (3.10/3.09) BGN @11:50

CUSIP: ED1687745

| | | | |
|---|-------------------------------------|-------------|---|
| SETTLEMENT DATE | 10/18/04 | RATE (360) | 2.1000% |
| <small><SETTLEMENT PRICE></small> | <small><MARKET PRICE></small> | COLLATERAL: | 100.0000% OF MONEY |
| PRICE | 101.500000 | 101.500000 | Y/N, HOLD COLLATERAL PERCENT CONSTANT? Y |
| YIELD | 3.0931565 | 3.0931565 | Y/N, BUMP ALL DATES FOR WEEKENDS/HOLIDAYS? Y |
| ACCRUED | 0.0767123 | 0.0767123 | |
| FOR 8 DAYS. | | | |
| TOTAL | 101.5767123 | 101.576712 | ROUNDING 1 1 = NOT ROUNDED 2 = ROUND TO NEAREST 1/ 8 |

| | | | | |
|---|----------|------|------------------|-------------|
| FACE AMT M | 10000 | <OR> | SETTLEMENT MONEY | 10157671.23 |
| <OR> To solve for PRICE: Enter NUMBER of BONDS, SETTLEMENT MONEY & COLLATERAL | | | | |
| TERMINATION DATE | 10/25/04 | <OR> | TERM (IN DAYS) | ? |
| ACCRUED 0.143836 FOR 15 DAYS. | | | | |

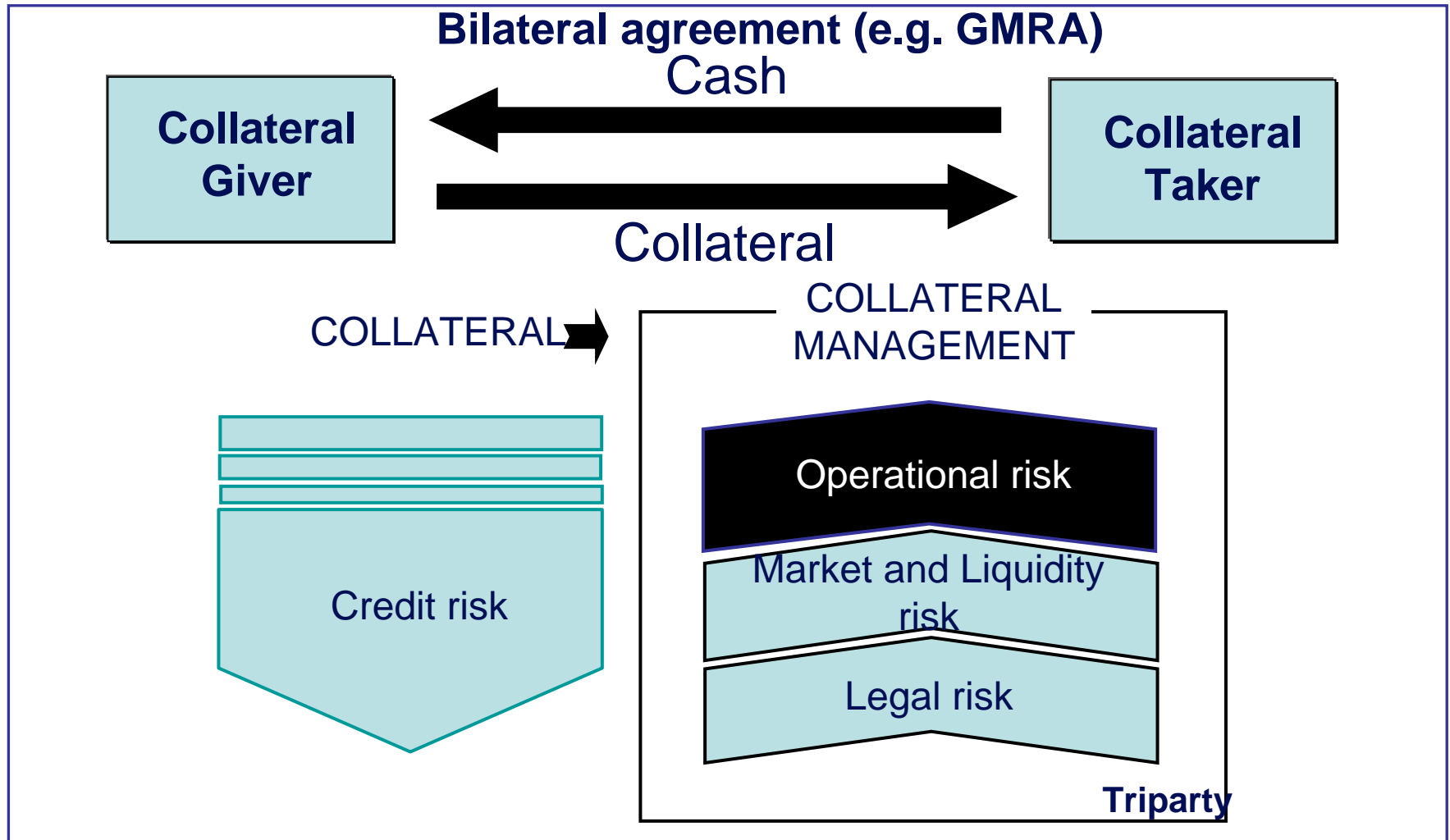
MONEY AT TERMINATION

| | |
|-------------------|---------------|
| WIRED AMOUNT | 10,157,671.23 |
| REPO INTEREST | 4,147.72 |
| TERMINATION MONEY | 10,161,818.95 |

NOTES:

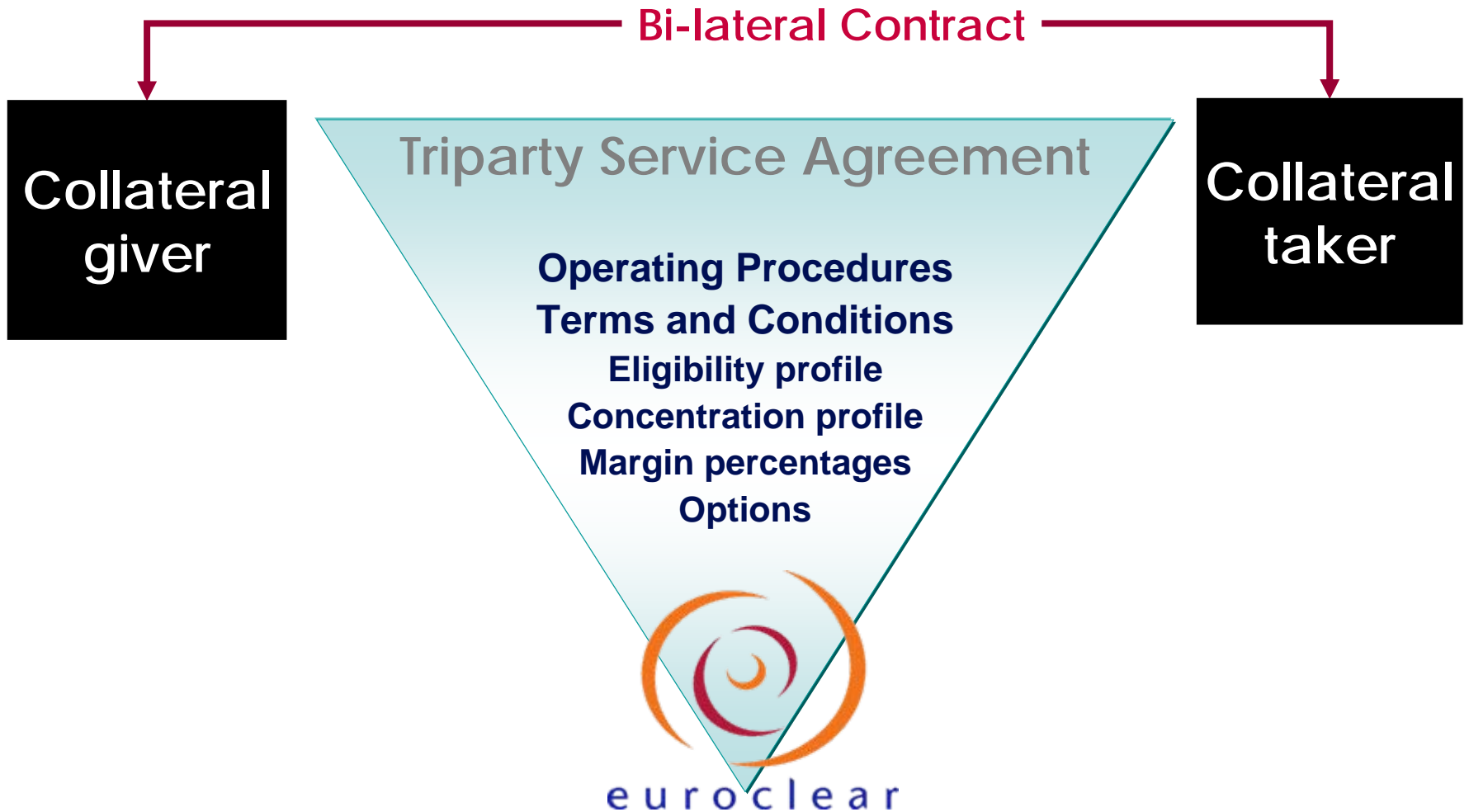
Collateral management: a challenge

A repo transaction

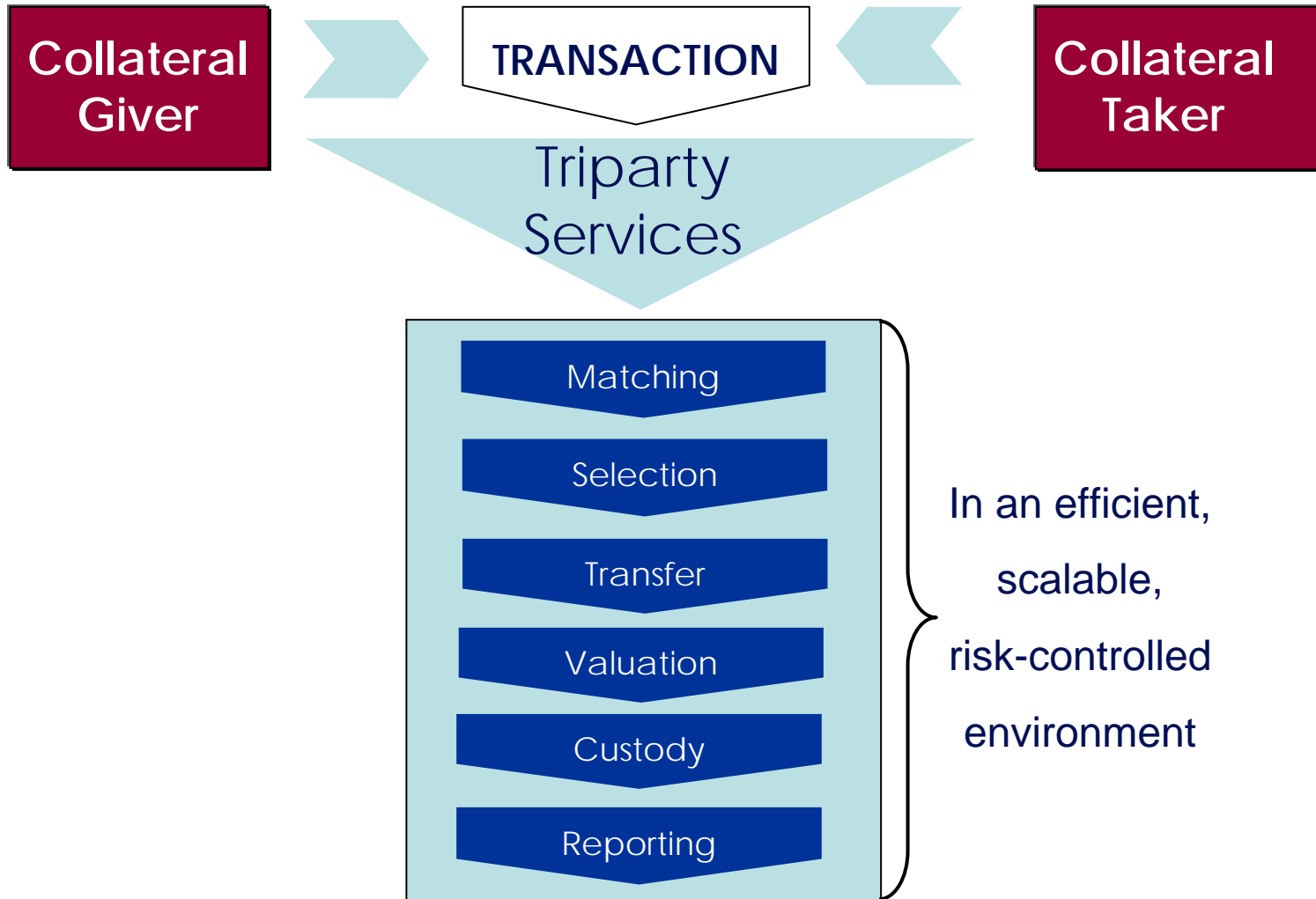


Collateral management: a challenge

Mitigating legal, market and liquidity risks



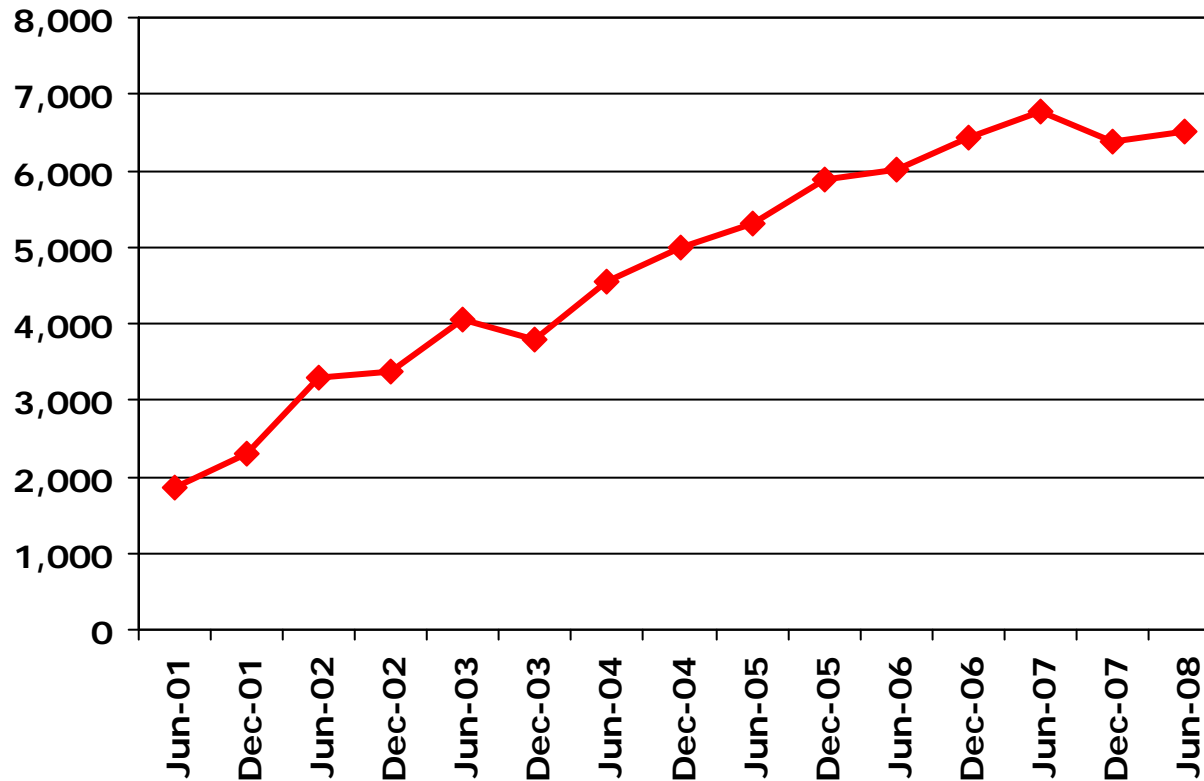
Collateral management: a challenge mitigating operational risk



Overview of repo markets

European Repo Council

15th European repo market survey

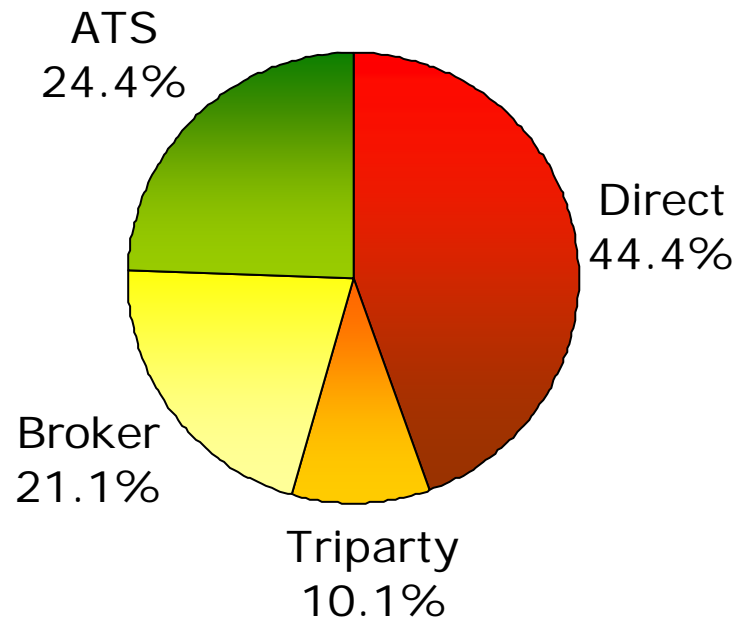


European Repo Council

15th European repo market survey



Counterparty analysis

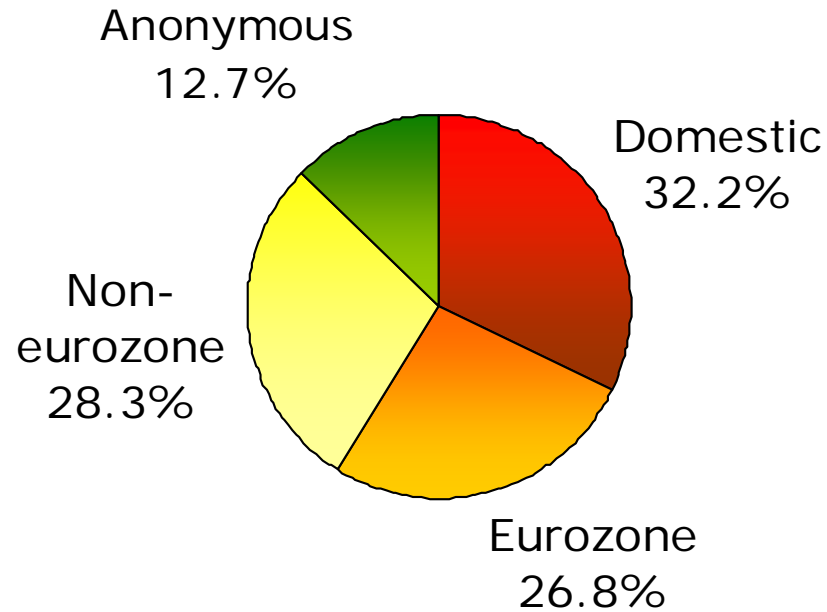


European Repo Council

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Geographical analysis

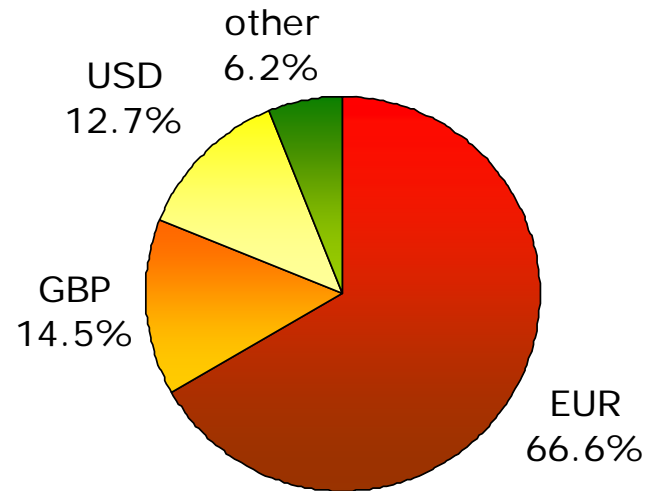


European Repo Council

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Currency analysis

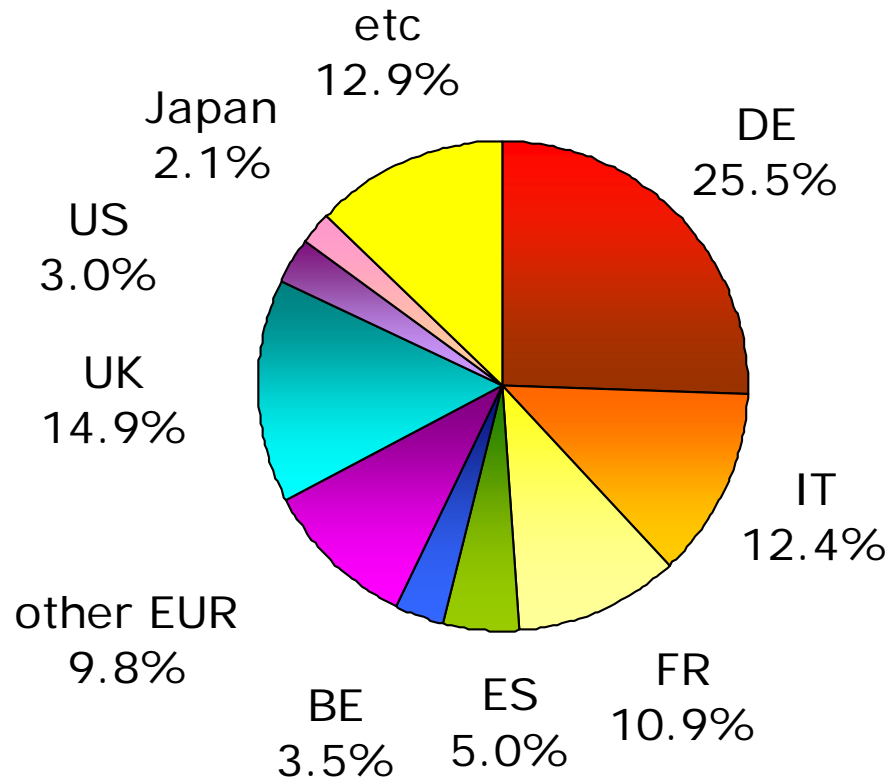


European Repo Council

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Collateral analysis

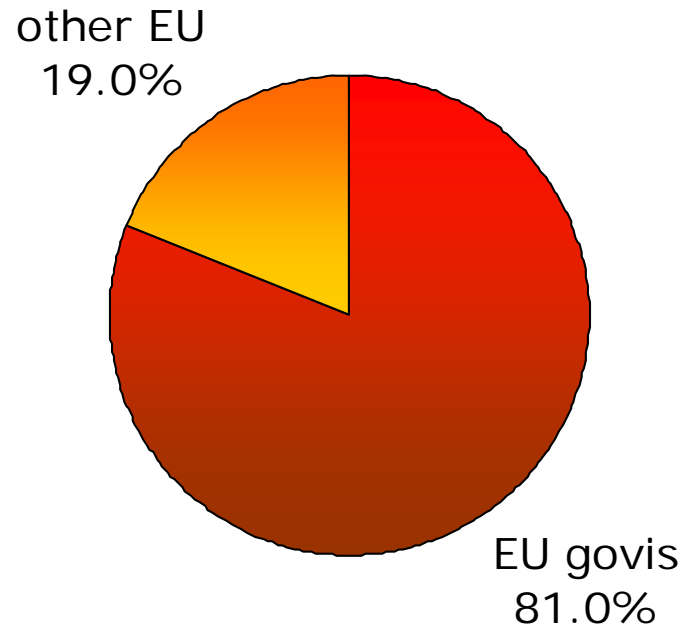


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Collateral analysis

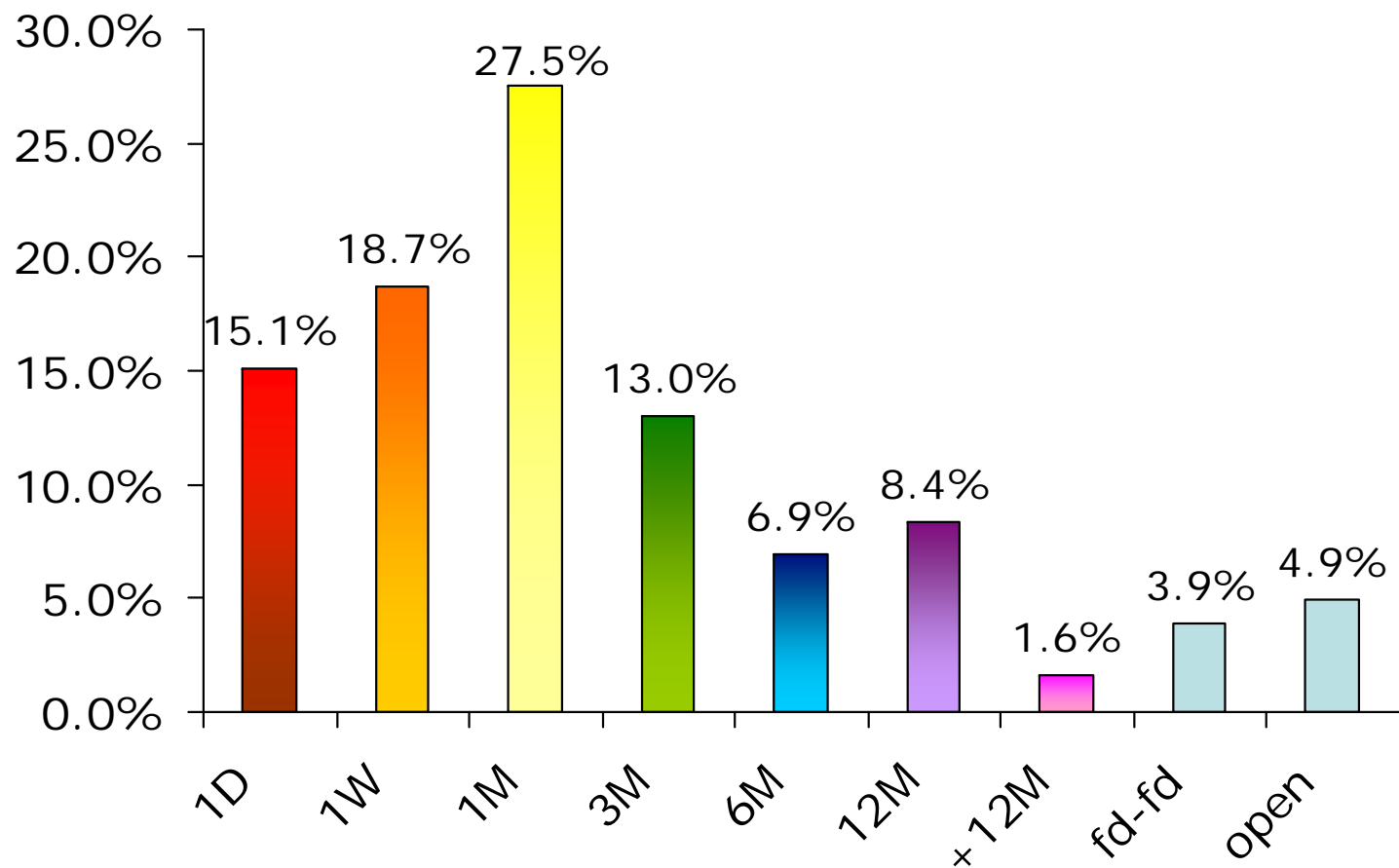


European Repo Council

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Maturity analysis

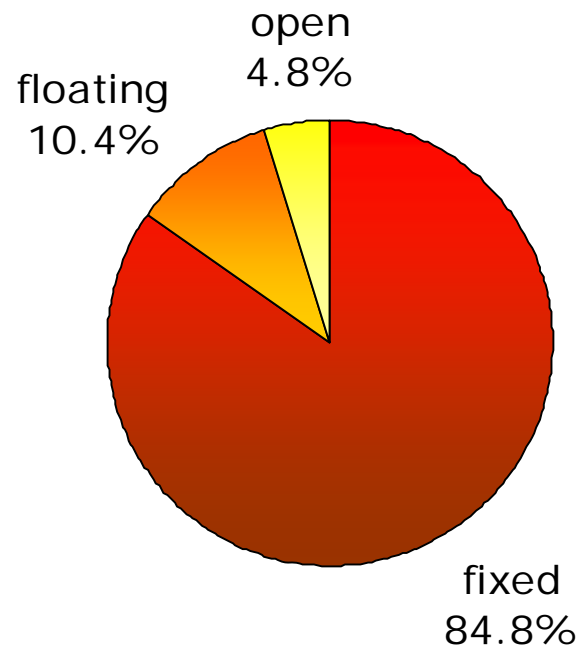


European Repo Council

15th European repo market survey



Rate analysis



New market indices

- Euribor & Libor
- Eurepo
- Eonia Swap index
- STEP

- **EURIBOR® and EONIA®**
- **The money market reference rates for the euro.**
- Since the 1st of January 1999, Europe has a new currency, the euro. To date, 12 countries of the European Union have adopted the euro.

A new financial market has emerged following the introduction of the euro. This new financial market has its own benchmarks.

The benchmarks for the money and capital markets in the euro zone are [Euribor®](#) and **Eonia®**.

Euribor® (Euro Interbank Offered Rate) is the rate at which euro interbank term deposits within the euro zone are offered by one prime bank to another prime bank.

Eonia® (Euro OverNight Index Average) is an effective overnight rate computed as a weighted average of all overnight unsecured lending transactions in the interbank market, initiated within the euro area by the contributing panel banks.

- **"The growing repo market is still somewhat less integrated than the unsecured segment which is fully integrated, but integration progresses. The creation of the EUREPO index - the benchmark for secured money market transactions in the euro area - three years ago was an important market initiative for promoting the repo market's integration. Anecdotal evidence collected via market survey from counterparties active in the repo market suggests that the share of euro area cross-border transactions increased further to around 30% in December 2004." (ECB's President Trichet, New York, 19 April 2005).**

Since the introduction of the Euro, the European repo markets have developed significantly, with more and more emphasis on cross border financing trades. This has led to an increasingly homogenous Euro-denominated General Collateral ('GC') market.

The market is now ready for a representative benchmark.

The benchmark for secured money market transactions in the Euro zone will be **Eurepo**.

Eurepo is the rate at which one prime bank offers funds in euro to another prime bank if in exchange the former receives from the latter Eurepo GC as collateral.

- EONIA SWAP INDEX is the new derivatives market reference rate for the Euro sponsored by EURIBOR FBE. EONIA SWAP INDEX is the average rate at which, at 16:30 Brussels time, a representative panel of prime banks provide daily quotes, rounded to three decimal places, that each Panel Bank believes is the Mid Market rate of EONIA swap quotations between prime banks. It is quoted on an actual/360 day basis.
- An "EONIA swap" is an interest rate swap transaction, where one party agrees to receive/pay a fixed rate to another party, against paying/receiving a floating rate named EONIA. An [information brochure](#) is available.

History & Goal of the STEP Initiative



- Promoting the development of the short term paper market in Europe
- Achieving European integration through convergence of existing markets
- Market defined standard features and best practices Euribor, ACI, EACT (European Association of Corporate Treasurers), ICMA (International Capital market Association), investors,...
- A tool to foster convergence towards the STEP label
- Institutional sponsors: ECB/ESCB, European Banking Federation and ACI



EUROPEAN CENTRAL BANK



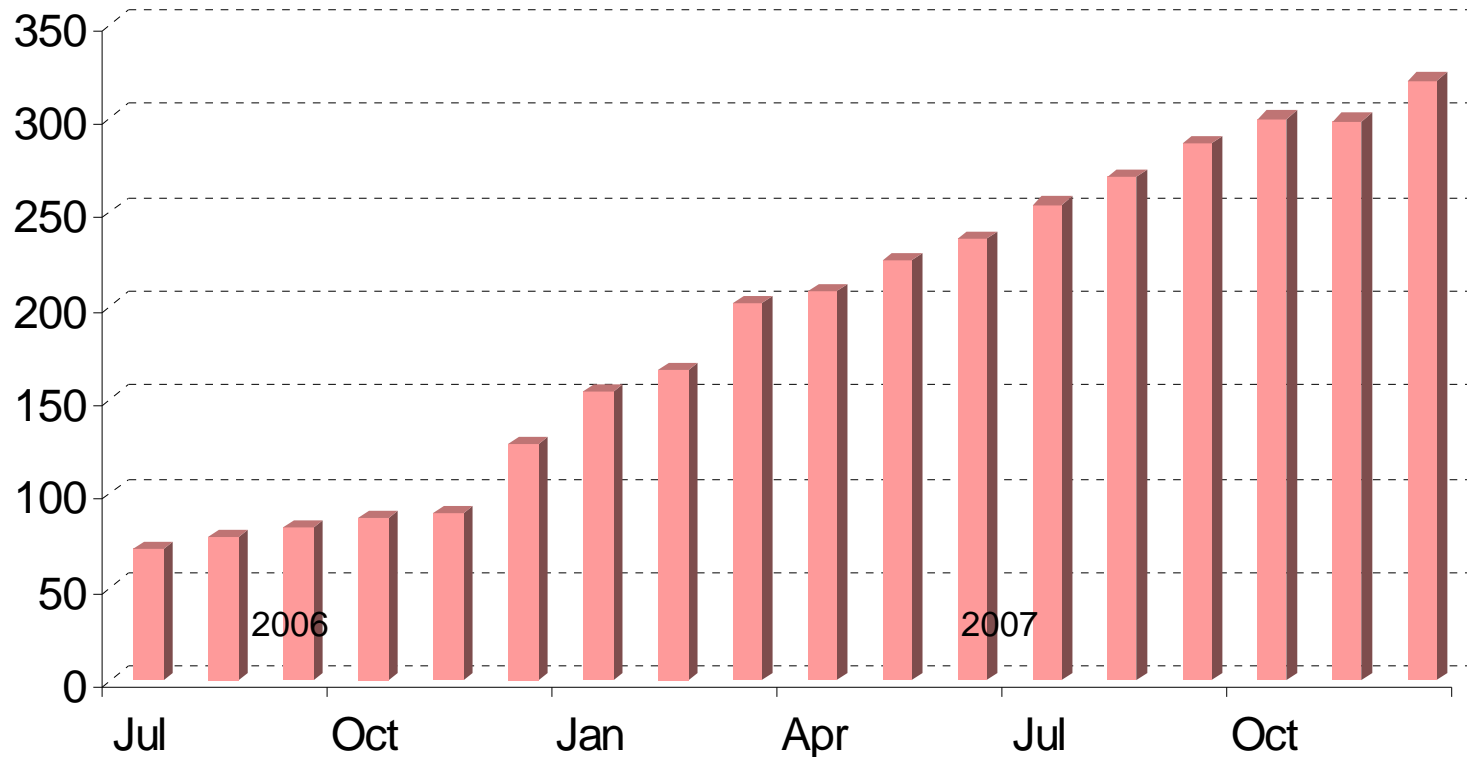
STEP Market Convention: description and main features



- Introduction & two chapters
- Code of Conduct
- Involvement of ESCB
- Application Form
- STEP Standard Information Memorandum
- Declaration of adherence of the Issuer to the Market Convention
- Statistical Requirements for Eligible Data Providers
- Selection of STEP - Compliant Securities Settlement Systems

STEP Statistics: outstanding issues

July 2006 – December 2007 (€320 Bn)



- End 2007: € 320 Bn (compared to € 264 Bn using CP Ware)

Contact details

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