Reserve Management during the Financial Crisis

Alexandre Gautier alexandre.gautier@banque-france.fr
Deputy Director of Market Operations Department

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A changing environment much before the crisis...

- Public sector entities management turned towards cost efficiency
- Eurosystem running favors sharing of skills
- Wider dissemination of market finance knowledge
- Holding of FX reserves by the ECB –partly-removed liquidity constraints for management of NCBs FX reserves
- Low yields environment in the 2000s: (1) motivated introduction of additional spread product and (2) underlined dependency vis-à-vis short term yields

From Reserve Management to Asset Allocation

BdF balance sheet

Financial assets	Bank notes
Monetary policy	Reserve requirements

From Reserve Management to Asset Allocation

BdF balance sheet

Assets		Liabilities	
r% ??	Financial assets	Bank notes	0%
1.5%	Monetary policy	Reserve requirements	1.5%

From Reserve Management to Asset Allocation

r% ??

BdF balance sheet

Financial assets

Bank notes

0%

Additional return

Monetary policy

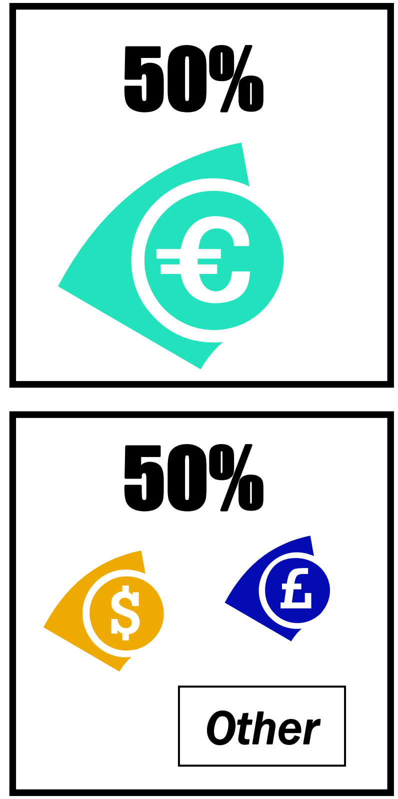
1.5%

Less volatile return

Currency diversification

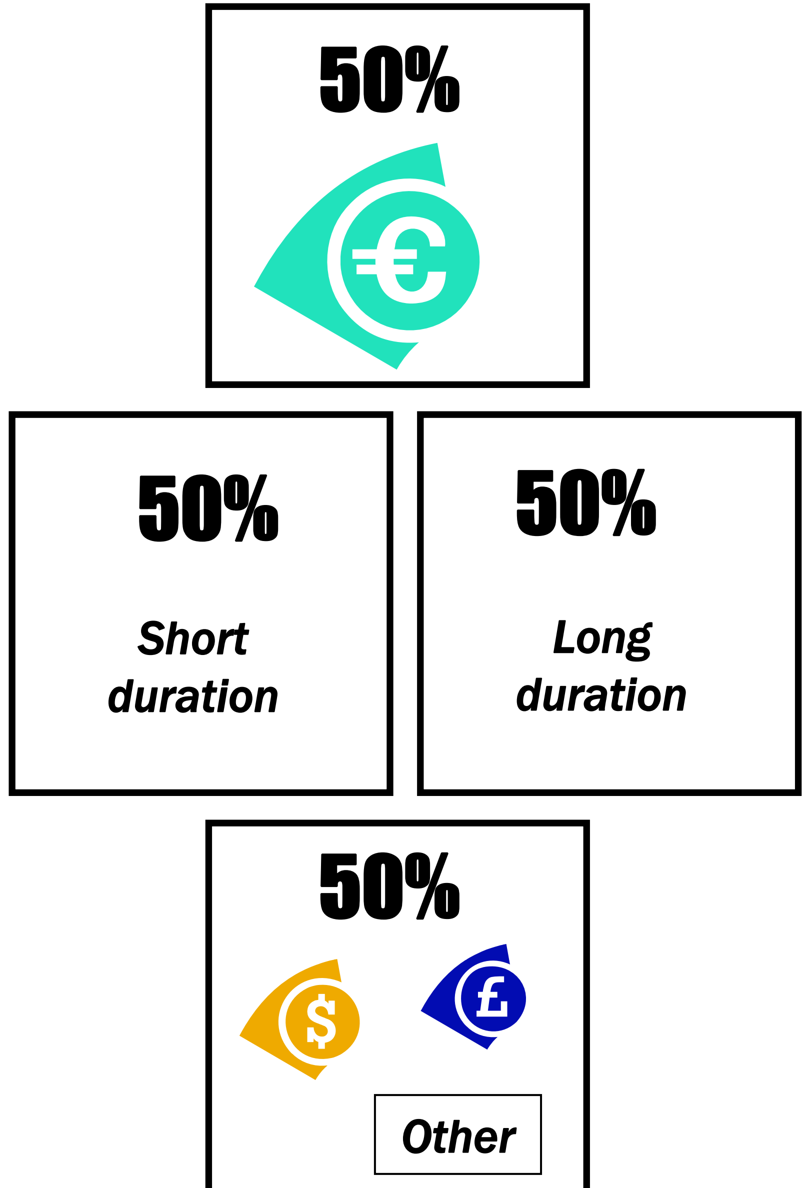
Longer duration portfolios

From Reserve Management to Asset Allocation



≈ 80 GEUR

From Reserve Management to Asset Allocation

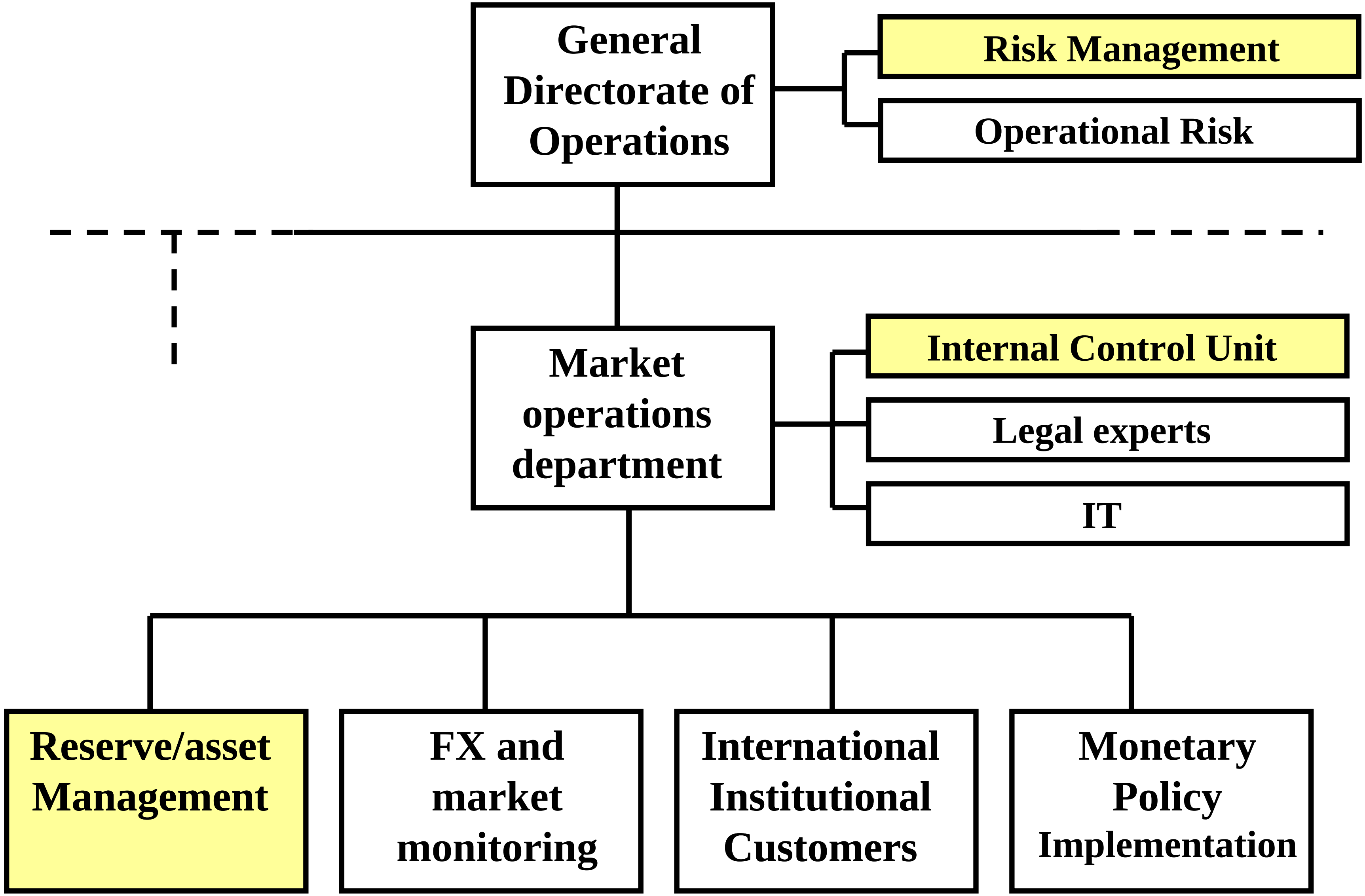


1. Higher concerns about risks

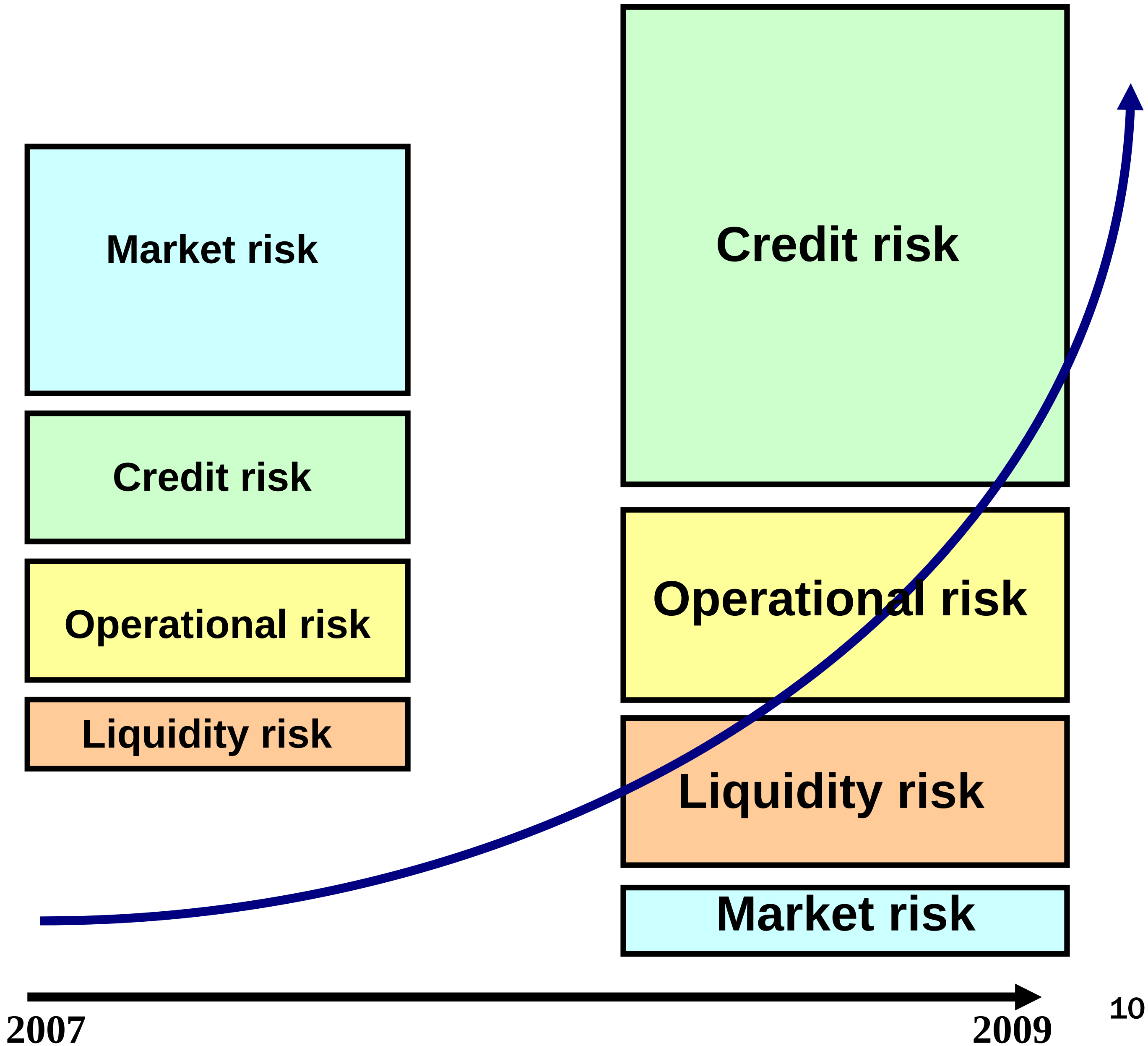
- More staff:
  - ✓ Risk management division
  - ✓ Internal control unit

- More reports:
  - ✓ Balance between precision and « flooding »
  - ✓ Balance between speed and reliability

- Shorter reporting line:
  - ✓ More directs contact with very top management
  - ✓ 2 ways contacts


General Directorate of Operations
Risk Management
Operational Risk
Market operations department
Internal Control Unit
Legal experts
IT
Reserve/asset Management
FX and market monitoring
International Institutional Customers
Monetary Policy Implementation

2. New ranking of risks



Credit risk

- Credit risk exposure (1):
  - Reduction of the number of counterparties
  - Business concentrated on local banks
- Credit risk exposure (2):
  - NO downsizing of portfolios driven by credit risk reduction
- Credit risk exposure (3):
  - -Traditionally strict approach in terms of issuer: eurozone/G10 sovereigns, selected AAA issuers
  - Addittion of some Government guaranteed.

Credit risk

- Credit risk methdology/principles questioned:
  - Counterparty selection based on ratings reconsidered: CDS, spread, financial statements analysis
  - Diversification principle ‘disregarded’

Operational risk

- Comprehensive review of operational vulnerabilities:
  - Cancelled transactions
  - Concentration of transactions
  - Procedures
  - BO reconciliation
  - IT system resilience

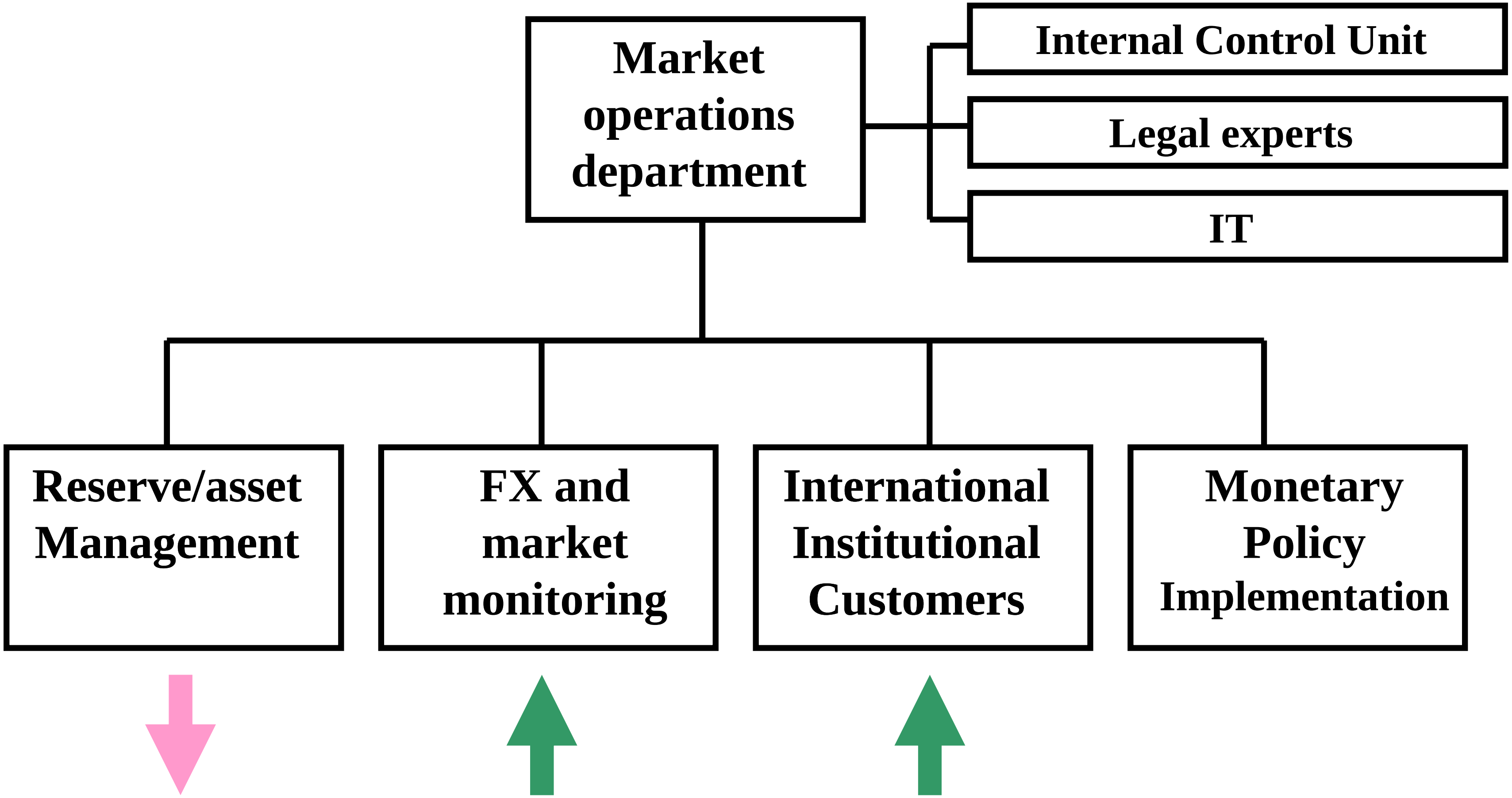
- More and more frequent controls/audits

- Post-Lehman ‘trauma’: much higher legal concerns
  - Review of all master agreements
  - Review of close-out procedures
  - Focus on written confirmation

Liquidity risk

- Not a major risk but...
  - Portfolios composed of very liquid assets but some surprises..
  - New monitoring of positions size vs market outstanding amount
  - Simulation of positions liquidation
- Reserve considered as potential/additional liquidity provider for market participants
- Volumes:
  - Lower volumes for reserve mangement
  - Higher for other market activities

Liquidity risk: volumes ?



Market risk

• Marked to market losses/valuation volatilty due to widening of spreads:

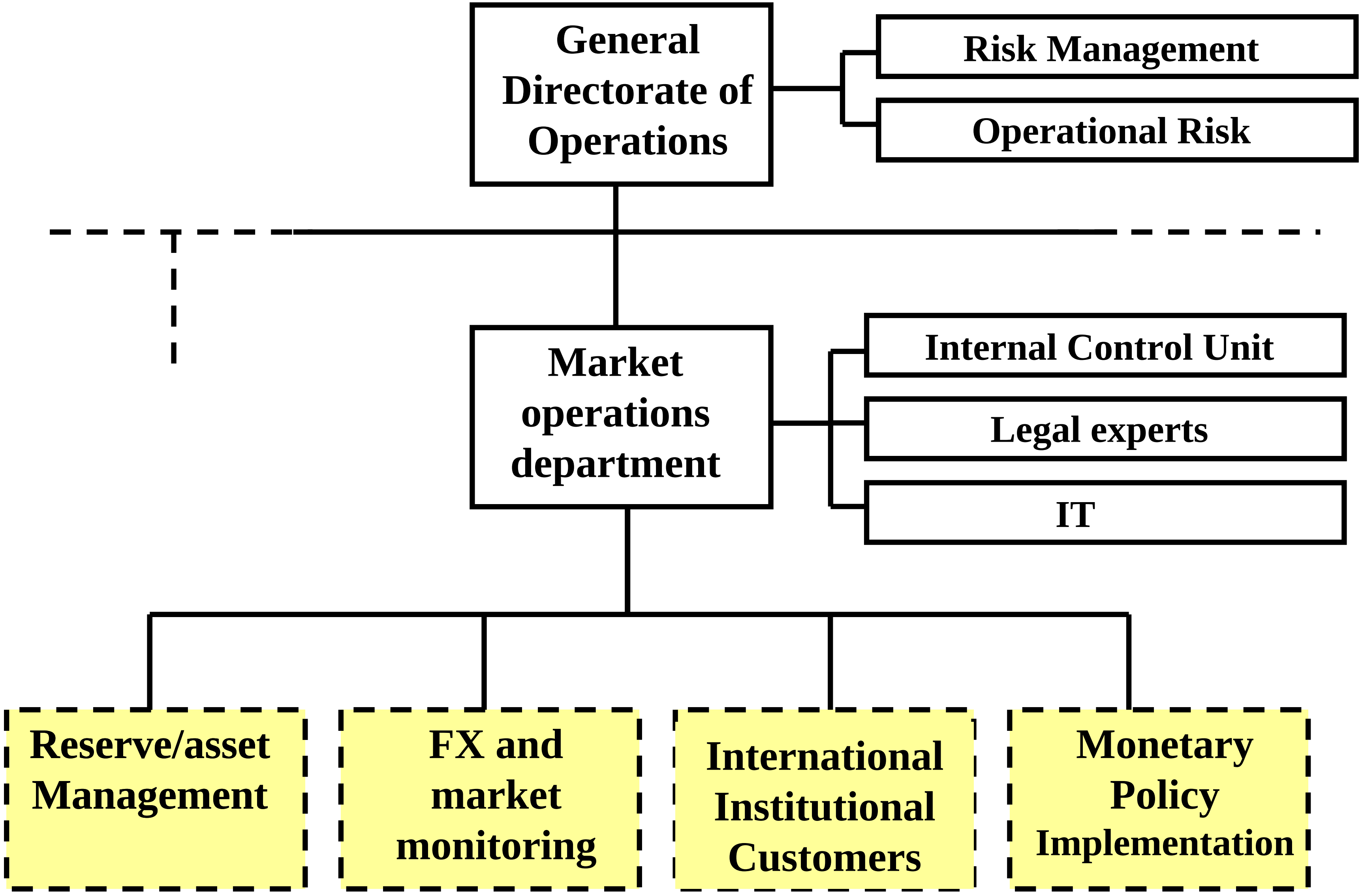
- No liquidation of positions
- Opportunities of investments: Dexma or KfW

• (Slight) reduction of currency exposure:

- To avoid marked to market losses
- As rates declined worldwide: carry does not compensate adequately FX risk

3. More collective/transverse work

- Within Banque de France:
  - Within Market operations department
  - With other departments
- With other institutions:
  - ECB and other Central Banks
  - Public Authorities
- With market participants:
  - TC sometimes daily
  - Physical meetings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Thank you for your attention…