ISSUE N°3

Newsletter

July 2022

The European Money Markets Institute

A year of great innovations

Dear readers,

At the end of the first half of the year, we have launched several initiatives which I invite you to discover in detail in this third edition of our newsletter. I can already tell you that the coming months will be full of new developments.

First of all, I would like to congratulate Satu Huber on her appointment as the new Chair of The European Money Markets Institute Board of Directors. We are looking forward to working under her direction. I would also like to thank Jean-François Pons for the 8 years he has been overseeing the association as Chair and for the great achievements we have made together such as, among others, the EURIBOR® reform.

The outcome of the second annual review of the Hybrid Methodology for EURIBOR® is a great announcement! We keep on confirming that the benchmark remains robust, resilient, and representative of its underlying market. The analysis we run in 2021 suggests that four non-material adjustments would improve the Hybrid Methodology for EURIBOR®. I invite you to discover them in the article on this subject.

As we are used to do in each edition, we share with you the transparency indicators. This time, we will cover the period from December 2021 to May 2022.

EURIBOR® is entering a new phase of its existence. We are developing EFTERM®, which will become its fallback rate. This is a very important and positive moment for all EURIBOR® users. A Beta EFTERM® is already published weekly since 13 June 2022. We were also pleased to launch a public consultation on the EFTERM® methodology. This takes place from 1 July to 31 August 2022. We will communicate the summary of the stakeholders' feedback and the final methodology for EFTERM® will be available during the fourth quarter of 2022.

We are very pleased to give the floor to Marnix Bruning, Head of Execution Sales at ING. He is glad to share his views on commercial papers and his opinion on recent phenomena and events.

In the last few months and given the positive development of our business, we have grown and we continue to hire new talents. Despite the health crisis, we have evolved into a larger team that is motivated to do its best. The future of EMMI looks bright.

I wish you a pleasant reading and look forward to meeting you back in our next edition.

Kind regards,
Jean-Louis Schirmann
CEO – The European Money Markets Institute

New Chair of the Board of Directors

Goodbye Jean-François, welcome Satu!

The European Money Markets Institute (EMMI) announced the appointment of Satu Huber as its new Board Chair as from 24 July 2022. Jean-François Pons, Board Chair of EMMI since 2014, is serving his last term ending on 23 July 2022. Satu Huber has been selected to succeed Jean-François Pons following EMMI's Board of Directors which took place on 27 June 2022.

Earlier this year, the General Assembly of EMMI approved the appointment to the Board of Directors of Satu Huber as an Independent Member. The duration of her new mandate as Chair is foreseen for four years in alignment with her mandate as a member of the Board of Directors.

Originally member of the EMMI's Board since 2011, Jean-François Pons was appointed as Chair in 2014. He supervised the EURIBOR® reform that led to its authorisation under the Benchmark Regulation (BMR). At the moment, he is associate at Alphalex-Consult. Previously, he was member of the Executive Committee of the European Banking Federation. He had previous positions at the European Commission, including Deputy Director-General at DG Competition.

"Satu's long experience of leadership makes her the ideal person for becoming the new Chair. I am very confident in her success during the coming years. It has also been a great pleasure to serve as Chair, working along-side a bright and devoted Board and Management team. I am deeply grateful to all EMMI's employees for the great achievements over the past years," Jean-François Pons said.

After 12 years at Elo Mutual Pension Insurance Company, Satu Huber left her position as CEO in 2021. Prior to that, she has had a wide range of experience in the private and public sector. Among other things, she worked closely with money and capital markets for most of her long career. Over the past 20 years, she has been appointed to various board member positions. At present, Satu Huber is Board Member of Schibsted AS and Orthex Oyj. She is also part of the Advisory Board of Ermitage-Partners.

"I thank Jean-François for his vision, his passion and for the outstanding work he accomplished by making The European Money Markets Institute possible to grow and to develop its activities. It's a huge honour to take on this role with such an important responsibility. I am looking forward to working with the Board Members, all partners and the extremely talented EMMI staff members," Satu Huber said.

Echoes from the euro money markets

Key events closely related to Euribor®

14 April: ECB Governing Council decision

The ECB's Governing Council kept key policy rates unchanged.

In this meeting the ECB upheld its expectations that net asset purchases under the Asset Purchase Programme (APP) should be concluded in the third quarter. Incoming data since their previous meeting reinforced its view.
The ECB will continue to conduct its monetary policy gradually and flexibly.
Inflation increased to 7.5 per cent in March, from 5.9 per cent in February. Energy prices were driven upwards by the war in Ukraine and now stand 45 per cent above their level one year ago.
The downside risks to the growth outlook have also increased substantially and credit standards are expected to tighten further in the coming months.
The war in Ukraine is severely affecting the euro area economy and uncertainty has significantly increased. The calibration of ECB policies will remain data-dependent and reflect the evolving assessment of the economy's outlook. The ECB stands ready to adjust all of the instruments within its mandate, incorporating flexibility if warranted, to ensure that inflation stabilises at two per cent target over the medium term.

9 June: ECB Governing Council decision

The ECB's Governing Council kept key policy rates unchanged but confirmed interest rate hike in July 2022.

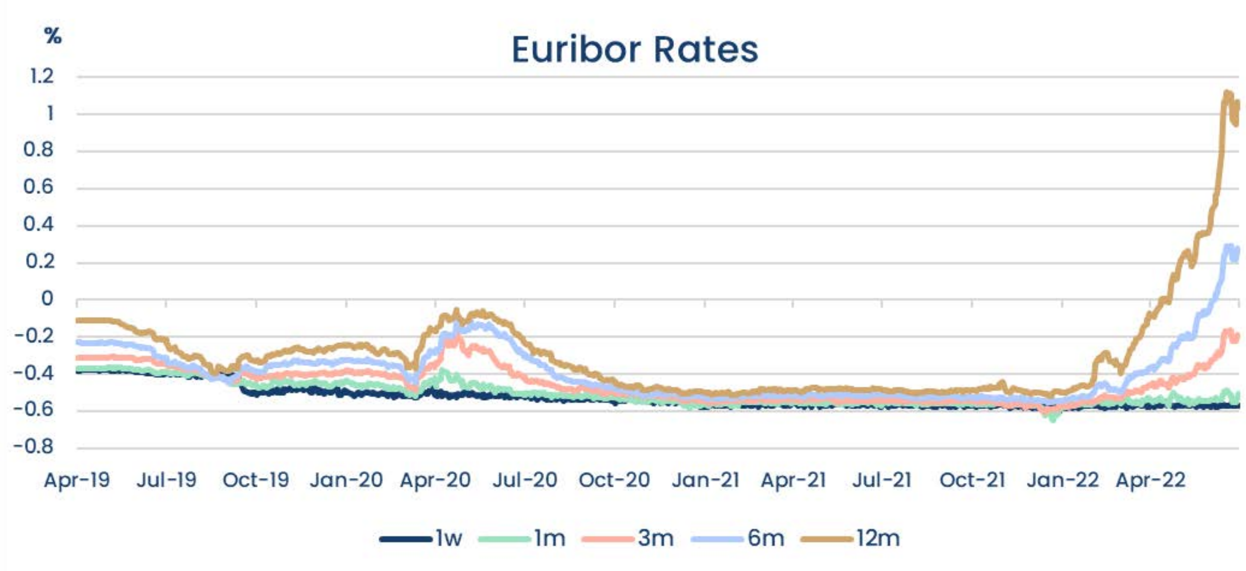
High inflation is a major challenge for the overall economy. The Governing Council aims at inflation to return to its 2% target over the medium term.
In May inflation again rose significantly, mainly because of surging energy and food prices, due to the impact of the war in Ukraine.
Eurosystem staff have revised their baseline inflation projections significantly upwardsto 6.8% in 2022, with a projected decline to 3.5% in 2023 and 2.1% in 2024. Russia's war on Ukraine continues to weigh on the economy in Europe and beyond. It is disrupting trade, leading to shortages of materials, and contributing to high energy and commodity prices.
This outlook is broadly reflected in the Eurosystem staff projections, which foresee annual real GDP growth at 2.8% in 2022, 2.1% in 2023 and 2.1% in 2024.
The Governing Council decided to end net asset purchases under its asset purchase programme (APP) as of 1 July 2022.
The ECB Governing Council intends to reinvest the principal payments from maturing securities purchased under the pandemic emergency purchase programme (PEPP) until at least the end of 2024.
In the event of renewed market fragmentation related to the pandemic, PEPP reinvestments can be adjusted flexibly across time, asset classes and jurisdictions at any time. The Governing Council intends to raise the key ECB interest rates by 25 basis points at its July monetary policy meeting.

Euro money markets development & Euribor® rates

The 1-week and 1-month Euribor rates remained below the Deposit Facility Rate (-0.50%) during Q2. 3-months and 6-months Euribor rates rose towards the end of the quarter and the 12-months tenor moved strongly and permanently above it, with a rate of 0.839 % on the 6th of July 2022.

The market environment has further changed significantly compared to the previous quarters with respect to demand for liquidity, and especially compared to the peak of the crisis in 2020. All Euribor rates tended upwards. At the extreme, the 12-months Euribor increased by 105 basis points within the second quarter 2022, up to the top of 1.12 per cent- a level last reached in July 2012, while the shorter maturities of Euribor (1-week and 1-month) are almost entirely linked to the ECB refinancing conditions. However, the 1-month interest rate has increased the band of fluctuation from 2 basis points to ca. 10 basis points in the second quarter.

All these strong moves were driven by incoming inflation figures in the euro area, in addition to the ECB signals about potential tightening of monetary policy conditions. Since December, annual inflation figures in the euro area have risen from 4.9% year-over-year to 8.1% year-over-year.



Source: The European Money Markets Institute

Excess liquidity

The level of excess liquidity (sum of banks' reserves in excess of the reserve requirements and net marginal facilities) in the euro area stabilised in the first half of 2022. By 30 June 2022, euro area excess liquidity increased by approximately EUR 2,441 billion compared to end of March 2020 and reached a total volume of EUR 4,352 billon .
However, excess liquidity decreased by approximately EUR 59 billion in the second quarter of 2022 and is expected to further decrease with the end of net asset purchases by the ECB. Targeted longer-term refinancing operations (TLTROs) will have more impact on the excess of liquidity.

Source: Bloomberg, ECB

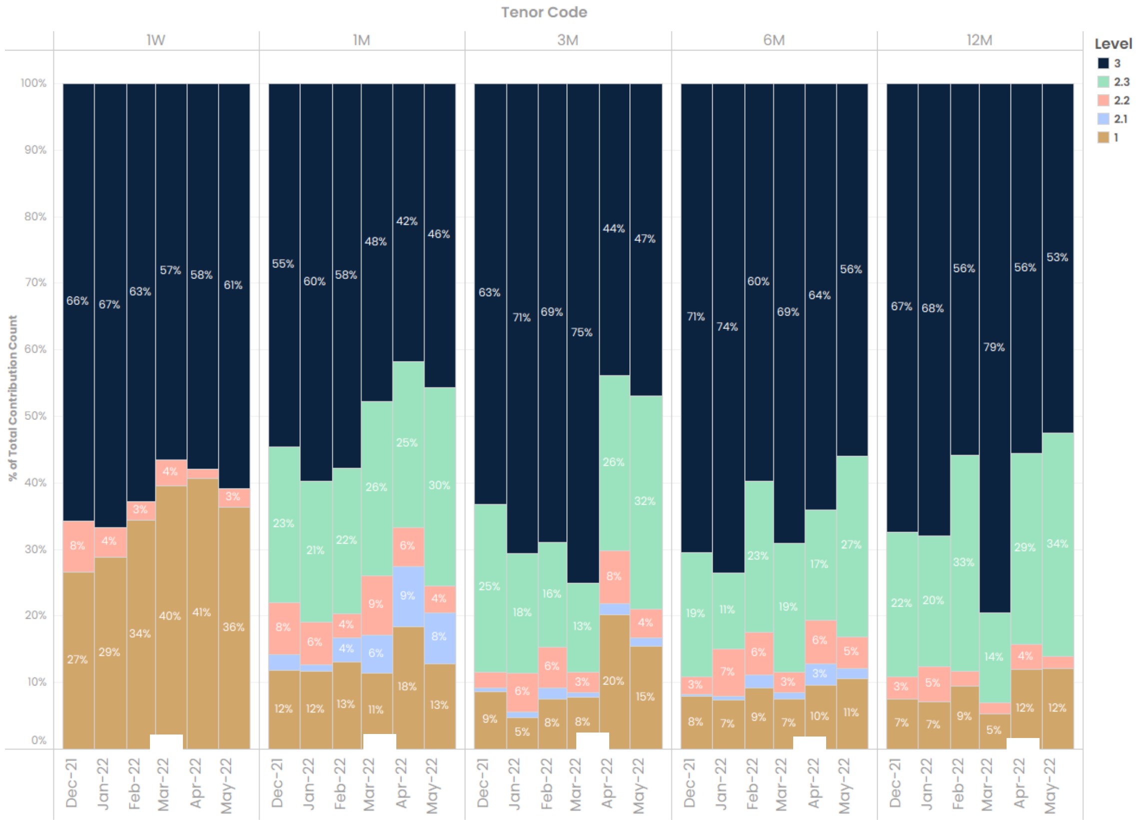
Euribor® Transparency Indicators Continuous improvement for Euribor®

Euribor® Transparency Indicators for the period December 2021 – May 2022

Use of each level of the Hybrid Methodology, broken down by tenor and date

The share of Level 3 contributions decreased between March and May compared to previous months.
The decrease was due to two main factors:

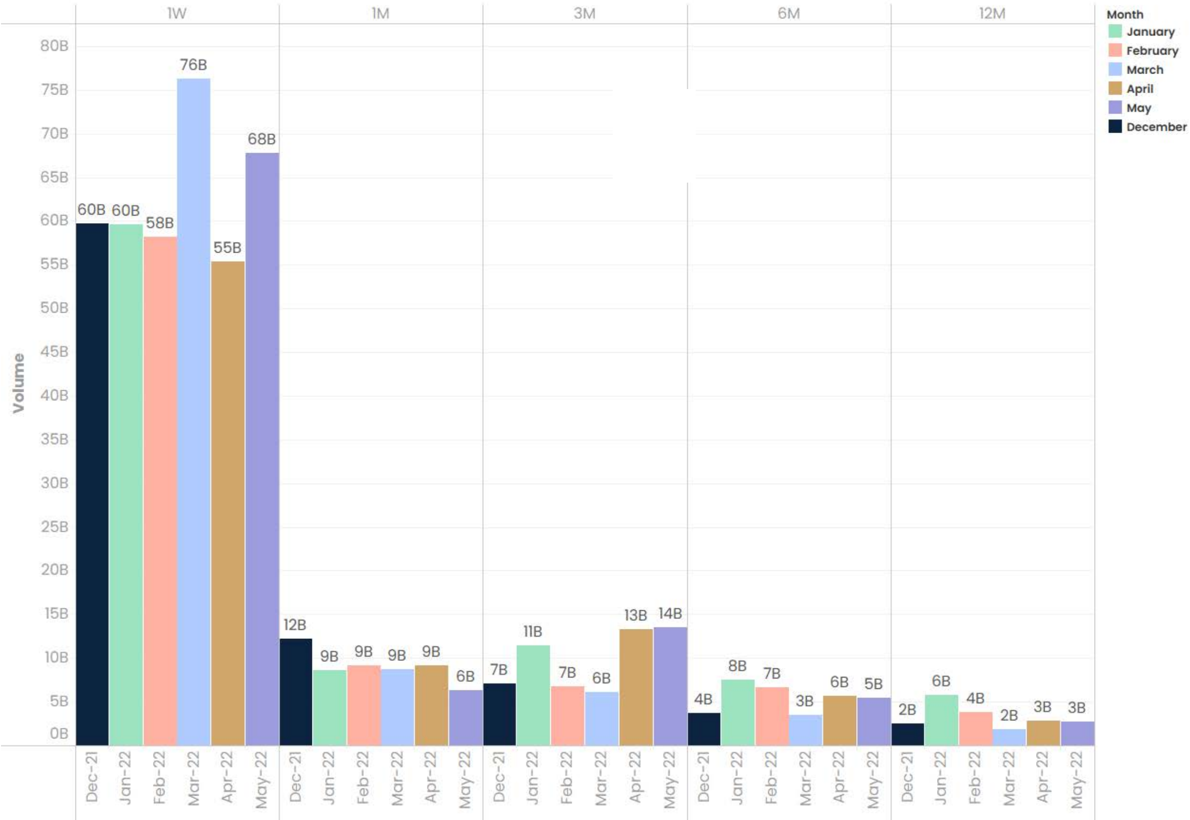
- An increase of Level 1 transactions across all maturities compared to previous months.
- Consequently, more previous days' transactions could be used for Level 2.3 (see chart below).



Source: The European Money Markets Institute | Timeframe: 12/2021 – 05/2022

Aggregate notional volumes of transactions used in the determination of Euribor® (Level 1 and Level 2.2[1])

Aggregate notional volumes have increased during the observed period.



Source: The European Money Markets Institute | Timeframe: 12/2021 – 05/2022

[1] For Level 2.2, only the portion of the overall volume of the transaction that is attributed to a particular tenor is considered

Counterparty sectors'[2] share of volume used in the determination of Euribor®
(Level 1 and Level 2.2), broken down by tenor

Source: *The European Money Markets Institute* | *Timeframe*: *12/2021 – 05/2022*

The public sector still has a dominant share in the one-week band. While on the longer end of the curve, other Financial Intermediaries were most active.

[2] The counterparty classification is based on the definitions of the European System of Accounts (ESA 2010) as follows: Deposit-Taking Corporations except the Central Bank: S.122; Other Financial Intermediaries: S.123 – S.127; Insurance Corporations and Pension Funds: S.128, S.129; Official Sector Institutions: S.121, S.13 (more information can be found here).

Let’s meet with EFTERM®

A coming fallback rate for EURIBOR®

In June 2022, The European Money Markets Institute (EMMI) started to publish a beta version of its first EURIBOR fallback rate. This forward-looking term rate, **EFTERM®**, is based on available market data on Overnight Indexed Swaps that reference the European Central Bank's Euro Short Term Rate (€STR). EFTERM® is designed to measure the average expected €STR rates over the standard EURIBOR® tenors 1 week, 1 month, 3 months, 6 months and 12 months. Once live, EFTERM® will help EURIBOR® users to comply with their obligations under the EU Benchmarks Regulation, which requires supervised entities to nominate an alternative benchmark, where feasible and appropriate, for the event the benchmark they use materially changes or ceases to exist.

So the coming EFTERM represents very good news for EURIBOR® users. The Euro Risk Free Rates Working Group has recommended a forward-looking term rate as a fallback for EURIBOR® for certain asset classes. Going forward, EMMI will assess the development of additional fallback rates to address further recommendations by the Working Group and to facilitate regulatory compliance for its EURIBOR® users.

The European Money Markets Institute has appointed ICE Benchmark Administration Limited[1] as the calculation agent for EFTERM®. For the calculation of EFTERM®, it applies a waterfall methodology, which currently uses dealer-to-client bid and offer prices and volumes obtained from Tradeweb’s global institutional trading platform or end-of-day settlement prices for ICE® 1 month €STR futures contracts. Tradeable bid and offer prices and volumes from regulated electronic trading venues will also be used in the waterfall when available. The European Money Markets Institute publishes sample calculations (Beta EFTERM® Rates) on its website for an initial testing period. The sample file is updated every Monday with the daily calculations from the previous week.

The Beta EFTERM® Rates are for information and illustration purposes only. They should facilitate EURIBOR® users to evaluate the suitability of the Beta EFTERM® Rates as a fallback in their own use cases. The European Money Markets Institute has launched a public consultation to collect such feedback.

From 1 July to 31 August 2022, all interested parties have the opportunity to respond to the questions that are published on the EMMI website. The draft methodology is based on the recommendations issued by the Euro Risk Free Rate Working Group and it is detailed in the consultation paper.

This consultation represents a major milestone in the development of EFTERM®. The summary of the stakeholders' feedback and the final methodology for EFTERM® will be available during the fourth quarter of 2022.

[1] ICE Benchmark Administration Limited (IBA) is EMMI's calculation agent for Efterm®. Input data for Efterm® is provided “as is” by data providers. IBA, data providers and its and their affiliates owe no duty of care to users or recipients of Efterm® and will not be liable to users or recipients of Efterm® in relation to Efterm® or the input data in any way whatsoever, whether under tort, contract, misrepresentation, restitution, breach of statutory duty, or otherwise under any applicable law save for any liability which by law may not be excluded. None of IBA, any data providers, or any of its or their affiliates make any claim, prediction, warranty, or representation whatsoever, express or implied, in relation to Efterm®, the input data, or the appropriateness, suitability, or fitness of Efterm® or the input data for any particular purpose to which it might be put and all warranties and representations of any kind, express or implied, are excluded.

Outcome of the second annual review of the Hybrid Methodology for EURIBOR®

Four changes as four beneficial recalibrations

The outcome of the second annual review of the Hybrid Methodology for EURIBOR® was communicated end June. The review aimed at confirming that the benchmark remains robust, resilient, and representative of its underlying market on the one hand, and at identifying any potential for further beneficial recalibrations, on the other hand.

The analysis run by the European Money Markets Institute in 2021 suggests that four non-material adjustments would improve the Hybrid Methodology for EURIBOR®, namely:

- Enlarging the 12-months maturity window of Level 1 by 15 days
- Using the previous 5-days banks' contributions to calculate the SAF used to determine Level 2.1
- Using the previous banks' contributions to calculate the adjustment used to determine Level 2.2
- Qualifying a Level 2.2 rate as eligible if the original volume of the trade is higher than EUR 10 million

In close collaboration with the Panel Banks, these favourable amendments to the Hybrid Methodology for EURIBOR® will be implemented as of October 2022.

The European Money Markets Institute performed the second annual review of the Hybrid Methodology for EURIBOR® with a twofold objective: confirming that the benchmark remains robust, resilient, and representative of its underlying market on the one hand, and identifying any potential for further beneficial recalibrations, on the other hand.

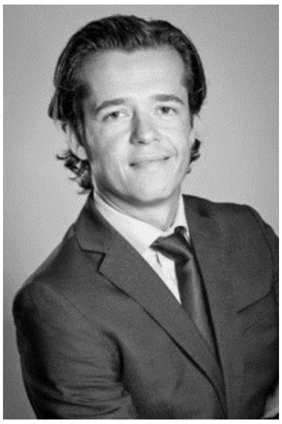
Further scenarios were also considered and analysed, based on the data gathered from the Panel Banks in the period May-October 2021. These scenarios entailed changes in the volume threshold for individual transactions, the inclusion of the counterparty sector with non-financial corporates and, finally, other amendments to certain maturity buckets. However, the European Money Market Institute did not see additional merit in implementing further changes.

"Just like in the case of the first annual review, this second one doesn't mean a new Hybrid Methodology at all as only four specific parameters will be fine-tuned. These changes should not increase resources for panel banks, since they are only mild adjustments to eligibility criteria and formulaic approach of Level 1 and Level 2, which are calculated internally by EMMI," said Jean-Louis Schirmann, CEO of the European Money Markets Institute.

The combination of these four methodological 'upgrades' will serve the representativeness of the benchmark, without inducing unwanted volatility or inflicting unnecessary material changes. They will have a positive effect on EURIBOR® by improving its robustness and making it even more resistant to undue fixing influence. They will also induce an increase in the share of Level 1 and Level 2 contributions, a decrease in the share of Level 3 submissions and, lastly, an enhancement of the benchmark's responsiveness to market events.

Source: The European Money Markets Institute

The STEP Label: the success story goes on



For 16 years, the STEP[1] label has been one of the best practices for European commercial paper issuers. What is the reason for this success? How is this label perceived? How can it evolve in the current economic and geo-political context? We are pleased to have the opinion of Marnix Bruning, Head of Execution/Flow Sales at ING.

The STEP label has become very popular since its introduction in 2006. How do you explain this phenomenon?

Marnix Bruning: The success of STEP is based on 2 pillars, first and foremost through the creation of a transparent and more standardized market and secondly STEP becoming an accepted non regulated market supported the initiative. Having potential European Central Bank (ECB) eligibility triggered a massive increase of STEP programmes during the financial crisis. The basis of the success however sits in its transparency and standardization. Transparency is important for the investor community, having readily available information on issuer outstandings and documentation has proven to be important. On the other hand, standardization is making lives easier for the issuer community and having a STEP label ensures the documentation ticks all the boxes and stays up to date. For a dealer, the combination of all these aspects is an important key.

We are noticing an increase in issuers from the non-financial corporation sector. What is your opinion on this?

The reason for this is two-fold, we simply see more new programmes being launched in the non-financial segment compared to the financial segment. There are several ways to understand this and for a large part this is regulatory driven. Bottom line is that banks have become less dependent on short-term liquidity, hence there is less needs to launch CP programmes at these banks. Another reason is that Corporates like standardization and they see STEP as a quality stamp when launching their ~~a~~ commercial paper (CP) programmes.

"Transparency is important for the investor community, having readily available information on issuer outstandings and documentation has proven to be important." - Marnix Burning

The war in Ukraine started in February and inflation is rising globally. What impact can these elements have on short-term commercial papers?

As the ECB confronts persistently high inflation, the expectations of tighter monetary policy go hand in hand with widening pressure for market spreads in general. To the degree that this is related to more systemic risk of "fragmentation" stemming from the

[1] Short-Term European Paper

sovereign bond markets, the ECB is attempting to keep this widening orderly by promising tools to tackle the issue now that net asset purchases come to an end. The evolving communication surrounding these tools has added to the volatility in spreads, though it appears the ECB is regaining the upper hand.

CP markets have been relatively untouched by the Ukraine war as exposure to the region in general has been limited. What also helped was that on the back of the tail of the Covid pandemic and rising interest rate environment, Money Market Funds kept high liquidity buffers which meant limited selling pressure and liquidity in the market was able to absorb buyback requests. In money markets more specifically, the spot 3 months Euribor/€STR spread has been subject to widening with ECB rate hike expectations on the rise, though also subject to greater volatility as the hawkish shift taking place within the ECB continues. However, while the general direction is in all likelihood towards wider spreads, market hike expectations also work towards capping at least near term widening pressure as early TLTRO (targeted longer-term refinancing operations) repayments are kept at bay. This was evidenced by banks announcing to repay only €74bn at the end of June.

Looking beyond that near term effect, the ECB's desire to normalise policies means that that once TLTROs reach final maturity, they will unlikely be replaced by new operations. This could for instance trigger increased EU bank CP issuance to replace TLTRO funding. That said, excess reserves in the system will still remain on historically elevated levels even after TLTROs mature.

STEP Initiative
Evolution of outstanding amounts (Billion € - left axis) and the number of programmes (right axis)