EMMEC Meeting - Summary

Meeting title	EMMEC meeting
Date and time	24 September 19.00 – 25 September 2024 16.30 CET
Location	Hybrid: Salon 'Prestige' at Rousegaertchen Building, 16, rue Ste Zithe, 11160 Luxembourgand via Teams
Attendees	EMMEC Members F. PAILLOUX -Chair- (Société Générale) for ACI France – physical P. LE VEZIEL (Credit Agricole SA & Crédit Agricole CIB) for ACI France – physical L. BRANDTNER (Raiffeisenlandesbank Oberösterreich) for TMA Austria - physical R. BRUNNER (Erste Group Bank AG) for TMA Austria - virtual H. WESTERMANN (Commerzbank) for AEFMA Germany – virtual F. SPAHN (DZ Bank) for AEFMA Germany - physical M.C. LEGE (Intesa SanPaolo SpA) for Assiom Forex Italy - virtual S. CIMINO (UniCredit) for Assiom Forex Italy - virtual M. GALLI (Banco BPM) for Assiom Forex Italy - physical M. POLFER(BCEE - Banque et Caisse d'Épargne de l'Etat, Luxembourg) for LFMA Luxembourg - physical C. HUSS (Union Bancaire Privée) for LFMA Luxembourg - physical F. BESET (Rabobank) - physical L. BARRIGON (Banco Santander SA) for ACI Spain - virtual J. LARDINOIS (Belfius Bank) for ACI Belgium - physical C. WICHMANN (Danske Bank) for ACI Denmark - virtual T. KOEFOED (Danske Bank) for ACI Denmark – virtual K. WINDING LARSEN for ACI FMA – physical O. HUBERT (Nataxis) for ACI France – physical B. LAIN SAN MARTIN for ACI Spain - virtual Guest speakers CHRISTOPH RIEGER – Commerzbank PASCAL LAUFFER – Onbrane CHARLES-ENGUERRAND COSTE - ECB Observers J. JACKOVICKA – ECB H. WACKET – ECB F. HEBEISEN - ACI France R. CAPPARELLI – EMMI B. DENECKER - EMMI

	EMMEC Secretariat R. CAPPARELLI – EMMI B. DENECKER - EMMI
Agenda items	**Speaking points**
Introduction	EMMEC members were reminded of competition law, confidentiality and conflicts of interest.
Item 1	<u>Members roundtable</u> Entering a New Phase of Monetary Policy Members noted that we are entering a new phase of monetary policy, marked by increased market volatility and uncertainty. There is a significant amount of speculation about how the markets will evolve, especially with new PMI data expected in Europe. Current trends indicate a drop in rates, but positive economic data could reverse this trend, pushing rates higher. While the market seems capable of managing this volatility under current conditions, external shocks could complicate matters. European Central Bank (ECB) Rate Cuts and Projections Some members expect the ECB to hold off on further rate cuts until December, aligning with the release of their macroeconomic projections. The wait-and-see approach reflects the broader uncertainty in the economy and the potential for geopolitical factors to influence decisions. The US Federal Reserve, in comparison, is seen as slightly behind the curve. Although a 50 bps cut has occurred, this is not seen as a strong signal of change as the Fed typically begins cutting cycles with a similar move. Economic Conditions in Europe The economic environment in Europe, particularly in France, is characterized by significant uncertainty. This is compounded by political unpredictability, with concerns about how future governments might impact monetary policy and economic stability. The broad sense of insecurity continues to dampen consumer confidence and affect investment decisions across the region. US Elections and Their Impact on ECB Policy The upcoming US elections could potentially influence the ECB's monetary policy, especially regarding inflation projections. Some members highlighted that the outcome could shift expectations around inflation and impact the ECB's data-driven approach. The interconnection between global political events and monetary policy continues to play a crucial role. Lagarde's Hesitation on Future Policy Path During the most recent ECB press conference, Christine Lagarde was perceived as hesitant regarding the future direction of monetary policy. For

some, this hesitation is justified by the ongoing geopolitical uncertainties, which contribute to inflation volatility. Some members believe inflation may decline further, but caution is warranted given the unpredictable external factors at play.

Repo Market Dynamics and Bond Compression

There has been noticeable compression in the repo rates of different government bonds. This trend is somewhat surprising given the current market conditions, but some members interpret this as a "calm before the storm." If external shocks were to materialize, issues like market fragmentation and concentration in Europe could become problematic.

October Rate Decision Timing

An important consideration for the ECB is the timing of its next rate cut. If no action is taken in October, the next meeting is a significant distance away, potentially leaving the market in an unnecessarily prolonged period of high rates. Members emphasized the importance of carefully timing rate decisions to avoid exacerbating market instability.

Unsecured vs Secured Market Dynamics

In the current market environment, unsecured lending is predominantly managed by larger banks, while a broader range of institutions, including smaller banks, participate in the secured (repo) market. This divergence has significant implications for market rates and liquidity. ESTR (Euro Short-Term Rate) is not expected to rise substantially, even though the overall level of excess liquidity is projected to decline. As long as liquidity remains above a certain threshold, the unsecured market is unlikely to fully recover, especially if excess liquidity never returns to zero. This reinforces the idea that large banks dominate the unsecured market due to their stronger balance sheets and bigger appeal from depositors.

ECB’s Efforts to Encourage MRO Usage

The ECB has taken steps to promote the use of the MRO facility, reducing the spread with the Deposit Facility Rate (DFR) to 15 basis points. This adjustment was made to highlight the availability of MRO as a viable option, and the ECB has been in contact with its Single Supervisory Mechanism (SSM) colleagues to emphasize this point.

Members also suggested that an operation designed to positively impact the Net Stable Funding Ratio (NSFR) would be more attractive. This perspective suggests that the stigma surrounding MRO participation is not solely related to pricing but also to how monetary policy operations affect liquidity ratios.

ECB's New Framework and MRO Uptake

The introduction of the European Central Bank's (ECB) new framework has not yet led to a significant increase in Main Refinancing Operations (MRO) uptake. This is largely due to the substantial levels of excess liquidity in the market, which have reduced the need for banks to access MRO facilities. However, members anticipate that the MRO will see higher take-up in the future.

Currently, the participation in MRO—limited to 53 participants—appears to be more of a test of the system rather than a significant move towards broader usage of this operation. The low level of underlying volumes supports this interpretation. Nonetheless, the potential for banks to refinance illiquid collateral through the MRO in the future was highlighted, making it a more attractive option in scenarios where market conditions change, and liquidity becomes scarcer.

Stigma and Perception Around MRO

Despite its potential benefits, the discussion revealed that stigma continues to surround participation in the MRO facility. This stigma, particularly among smaller banks, was highlighted as a significant barrier to broader participation. For smaller institutions, the risk of reputational damage and the complexity of the decision-making process—typically made at the CFO level rather than by trading desks—could deter them from utilizing the facility. Members noted that overcoming this stigma will be crucial for increasing the attractiveness and usage of the MRO.

Larger banks, which typically have stronger Liquidity Coverage Ratios (LCR), might want to demonstrate their liquidity positions using MRO strategically to signal financial strength. This can be achieved by showing their liquidity ratios with and without the MRO take-up. This behavior mirrors strategies seen in previous Targeted Longer-Term Refinancing Operations (TLTRO), although the pricing mechanisms differ.

However, members also discussed that the low level of MRO take-up is primarily driven by the current pricing structure, which is less favorable than other market funding options. While LCR is not a pressing issue for most banks and excess liquidity remains abundant, the operation is not considered attractive at this stage.

Liquidity Coverage Ratio (LCR) and Collateral Considerations

A crucial point raised during the discussion was the relationship between MRO participation and the Liquidity Coverage Ratio (LCR). The impact on LCR depends on the type of collateral used. If banks use non-marketable High-Quality Liquid Assets (HQLA), such as retained bonds, to back their MRO participation, their LCR will increase along with the liquidity take-up. In contrast, if they use highly marketable assets, such as German government bonds, their LCR will remain unchanged. This distinction affects how banks

	approach MRO participation, with some potentially viewing the MRO as an opportunity to enhance their liquidity positions by using non-marketable HQLA as collateral.
Item 2	**Presentation on "Tracking the Transition: Initial Effects of the new ECB's Operational Framework" by Christoph Rieger, Head of Rates & Credit Research, Commerzbank:** • Mr. Rieger provided an overview of the current status of the ECB's outstanding operations, noting that the reduction in the ECB's balance sheet has unfolded exactly as anticipated by the ECB. However, he cautioned that it is still early to make conclusive predictions, as the uncertainty surrounding ECB operations in the coming years is much higher. He highlighted that while the balance sheet is shrinking as planned, the future uptake of ECB operations remains difficult to predict. Nevertheless, he emphasized that short-term operations should not contribute to significant growth in the ECB's balance sheet moving forward. • Mr. Rieger drew a comparison with the Bank of England's (BoE) short-term operations, stressing that the BoE's operations have become more attractive relative to those of the ECB. He suggested that the BoE's approach could offer valuable insights into the differences between the two central banks' liquidity provision strategies. • Mr. Rieger highlighted an interesting trend in bank liquidity management, where the liquidity buffer (LCR numerator) of banks has not decreased in tandem with the reduction in excess liquidity. During the expansion phase, these two metrics moved together; however, banks are now replacing central bank liquidity with highly liquid assets such as central government bonds. This indicates a shift in banks' strategies towards managing liquidity under tighter monetary conditions. • Examining the spreads of various assets held by banks—including SSAs (Sovereigns, Supranationals, and Agencies), covered bonds, and French sovereign bonds—Mr. Rieger noted a clear and steady upward trend in spreads. Despite this, bank deposits have remained stable or increased in recent quarters, while the level of loans has declined. He explained that this situation suggests banks have excess cash, which is being recycled into bond purchases. This dynamic can be attributed to funding pressures, where issuers are being forced to offer a premium to attract the necessary capital. • Focusing on the repo market, Mr. Rieger discussed the widening spread between the Bund repo rate and €STR (Euro Short-Term Rate). He observed that the market has shifted from a state of collateral scarcity to one of relative abundance, as evidenced by the fact that very few bonds are currently trading "special" in the repo market. He further noted that although trading activity in the repo market increased until late 2023, it has since started to decline. This suggests there may be factors beyond ECB policy normalization contributing to the recent changes in repo market dynamics. • Despite recent comments by ECB President Christine Lagarde that there will be no rate cuts in October, Mr. Rieger suggested that

depending on forthcoming inflation data, it remains possible that the ECB may cut rates sooner than expected. He predicted that cumulative rate cuts of around 100 basis points (bps) could occur by March 2025, contingent on inflation and economic conditions.

- Mr. Rieger concluded by going back to the "conundrum" the FED faced under Greenspan and making the link to current market circumstances. He explained that a 25 bps rate hike or cut may disproportionately affect the short end of the yield curve while leaving longer-term yields relatively stable. This could create a misalignment in market expectations and central bank policy transmission, making it harder to achieve desired outcomes in monetary policy.

Discussion among members on the following points:

- Participants asked Mr. Rieger about his outlook on the future operational framework of the ECB. In response, he indicated that the ECB is likely to transition from its current fixed-rate full allotment system to a pricing mechanism for the allocation of ECB operations. Regarding the ECB's bond portfolio, Mr. Rieger expects the ECB to maintain a portfolio with shorter maturities, designed to provide liquidity as needed while minimizing exposure to interest rate risks associated with longer-term bonds.
- One participant pointed out that the Main Refinancing Operation (MRO) rate being set at the deposit rate plus 15 basis points, might be too expensive under current conditions. However, the same participant noted that in the event of a crisis, such pricing could prove to be generous. Another member pointed out that the pricing of longer-term structural operations will also play a critical role in how the MRO pricing is evaluated, particularly in terms of relative attractiveness.
- The issue of stigma surrounding short-term operations was raised, with particular attention to the contrast between the Bank of England (BoE) and the ECB. One participant noted that there is no stigma associated with short-term operations at the BoE. When asked for his view on the matter, Mr. Rieger explained that the uptake for the BoE's 6-month operations is not high, primarily because market participants often prefer repo market options, which offer better terms. He added that stigma is not a significant factor in this low demand.
- Participants inquired about the potential impact of the combined reduction of the Asset Purchase Programme (APP) and the Pandemic Emergency Purchase Programme (PEPP), alongside increased government issuance, on High-Quality Liquid Assets (HQLA) portfolios. Mr. Rieger responded that while the absolute level of HQLA holdings will likely increase, he is uncertain whether this will translate into higher Liquidity Coverage Ratio (LCR) levels. He also noted that foreign investors are expected to play a larger role in this space moving forward, and the spread trends observed in recent years are likely to persist.
- There was some discussion about the appropriate duration for longer-term structural operations. Several participants expressed

	the view that operations longer than one year would be preferable, as a one-year horizon is considered too short to provide sufficient stability or impact.
Item 3	Presentation on "Leading the Money Market Digitalization" by Pascal Lauffer, CEO and Co-Founder, Onbrane: • Mr. Lauffer explained that while money market infrastructure functions, it is inefficient in the commercial paper (CP) and certificate of deposit (CD) markets. Additionally, the money market is largely restricted to large organizations, excluding much of the real economy—SMEs have no access. • He further elaborated that the main pain points in the money markets are fragmentation, opacity, and process inefficiencies. The money markets in their current state grew out of legacy domestic solutions which have remained out-dated and domestic up to a large extent. • This inefficiency impacts all participants: issuers find that over 10% of transactions contain input errors, intermediaries spend more than 50% of their time on administrative tasks, and investors face limited visibility into the market. As a result, the CP/CD market restricts which issuers and investors can participate. • Mr. Lauffer emphasized that all participants can benefit from increased efficiency by industrializing processes through technology. Onbrane aims to be the "One Money Market" (1MM) platform, bringing together market participants, democratizing price discovery, streamlining the entire process, and acting as a central interface for all stakeholders. • Onbrane is a platform that believes finance evolves step by step, working collaboratively with market actors. It is open, adaptive to changing dynamics, and responsive to emerging needs. To date, the platform has facilitated over 900 deals and is doubling annually. • A member asked about Onbrane's data module and the information it provides. Mr. Lauffer explained that the data module is very much in demand as it gathers all market data available further enriched by Onbrane proprietary data. He then clarified that the platform displays aggregated data to different stakeholders. While available data is accessible to all platform users, non-public or sensitive name-specific information is not shared. • Several members agreed that the CP market needs improvement. Mr. Lauffer noted that while Onbrane seeks to industrialize processes step by step, the long-term goal is to enable standardization, fostering market growth. Onbrane does not intend to compete with market participants; rather, it aims to be a technological enabler.

	• Another member asked if broker-dealers perceive the platform as a competitor. Mr. Lauffer responded that Onbrane is intermediary-centric, designed to reduce their administrative burden and scale their businesses. The platform does not alter existing business relationships; instead, it frees up time for current participants and lowers the barrier of entry for new ones. He reiterated that the market's inefficiency results in a smaller, less liquid market than it should be. • One member inquired about Onbrane's business model and ownership. Mr. Lauffer explained that platform users pay an annual fee, and Onbrane has been financed by angel investors rather than by market participants or business groups. He also mentioned that at this stage, it would make sense for a banking consortium or an industry market infrastructure provider to fund Onbrane's rapid growth and join its governance. • The link to Distributed Ledger Technology (DLT) was also discussed. Mr. Lauffer clarified that while current execution is carried out traditionally, the platform is DLT-ready and is already running it in parallel mode for clients interested in participating in the experiment. • To conclude, Mr. Lauffer looked ahead, noting that beyond modernizing money market infrastructure, Onbrane could play a key role in advancing the Capital Markets Union (CMU). As a platform connecting all actors and abstracting the complexity of domestic rules, regulations, and infrastructures, Onbrane could help realize the CMU for money markets, starting with the CP/CD market, within 3 to 5 years.
Item 4	<u>Members roundtable:</u> • Members engaged in a thorough discussion about the upcoming implementation of Instant Payments, scheduled for 2025. The conversation centered on both the opportunities and significant challenges this new framework presents. A major concern raised was the impact on banks' ability to manage their balance sheets. Instant Payments, by enabling real-time transfers, could reduce banks' control over their liquidity management. This reduction in control may directly affect banks' current accounts, potentially decreasing their overall profitability and revenue streams as they lose flexibility in managing liquidity buffers. • Another key issue discussed was the potential for Instant Payments to increase the risk of bank runs, particularly during times of market stress. The rapid and frictionless nature of instant transactions could amplify liquidity withdrawals if customers lose confidence in a bank, exacerbating financial instability. Members expressed concern that several issues related to compliance, fraud prevention, and system resilience remain unresolved. There is uncertainty as to whether the Instant Payments framework will be robust enough to mitigate these

	risks, and members questioned whether sufficient safeguards would be in place to prevent manipulation, misreporting, or system vulnerabilities. • The conversation also touched on the difficulties banks may face in regulatory reporting due to the instantaneous nature of money movements. Last-minute transfers, especially near reporting periods, could distort liquidity ratios and make accurate end-of-period reporting more difficult. Members highlighted that large inflows or outflows of funds at the end of a reporting cycle could create significant challenges in maintaining transparency and meeting regulatory obligations, leading to potential discrepancies in reported liquidity positions. • Members also raised concerns about the effect of large, unexpected transfers on the Minimum Reserve Requirements (MRR) set by central banks. Significant money movements occurring close to the end of a maintenance period could lead to discrepancies in a bank's ability to meet its reserve requirements, creating further complications for regulatory compliance. This could make it more challenging for banks to accurately manage their reserves, potentially triggering penalties or other regulatory consequences. • An example was cited from India, where the Reserve Bank of India has imposed stricter Liquidity Coverage Ratio (LCR) requirements for banks with current accounts linked to mobile phones. This allows instant transfers between banks' accounts, creating a more challenging liquidity environment. The Indian regulatory approach raised questions among members about whether Europe might adopt similar frameworks which would result in sudden and dramatic declines in banks' liquidity ratios. • Towards the end of the discussion, members briefly addressed the situation in China, particularly the severe challenges facing its real estate sector. The potential repercussions of the U.S. trade policies which might revamp if Donald Trump is re-elected, were also mentioned. Members noted that while the Chinese economy has been under significant pressure for the past two to three years, the effects of this slowdown have not been fully felt in Europe yet. However, it was pointed out that the ongoing economic struggles in China could have ripple effects across global markets.
Item 5	• Members compiled a survey for EMMEC evaluation to identify possible improvements and to evaluate the overall organization, topics, the role of the chair and the secretariat.
Item 6	Presentation on "Impact on bank's capital and liquidity from issuing stablecoins or onboarding stablecoin issuers" by Charles-Enguerrand Coste, Crypto & Payment Oversight Expert, EBC: • Mr. Coste began by explaining the fundamental differences between traditional e-money and e-money tokens, as well as providing an overview of stablecoins and how they differ from other crypto assets. Traditional e-money is typically a digital representation of fiat currency, regulated and used for everyday payments. In contrast, e-money tokens are a newer form of digital asset, often issued on blockchain technology. Stablecoins, he

clarified, are digital assets designed to maintain a stable value by being pegged to a reserve asset, such as fiat currency.

- Mr. Coste highlighted the rapid expansion of the stablecoin market, pointing to data and trends that illustrate significant growth in both issuance and usage. This growth is attracting both fintech companies and traditional financial institutions into the stablecoin space.
- In the next part of his presentation, Mr. Coste outlined several scenarios in which an entity, such as a fintech or financial institution, issues stablecoins. He explored the implications for banks' balance sheets, emphasizing that stablecoin issuance diverts deposits away from traditional banking accounts. This displacement can result in a reduction in bank-held deposits in the form of fiat money, impacting liquidity and altering the composition of liabilities on banks' balance sheets.
- Mr. Coste concluded by stating that the issuance of stablecoins will invariably reduce banks' liquidity ratios. Since stablecoins move deposits out of traditional bank accounts and into other forms of deposits, banks will actually have higher outflows, thus lowering their liquidity coverage ratios (LCR).

Discussion among members on the following points:

- Members inquired whether the same regulatory treatment applied to stablecoins would also be applied to Central Bank Digital Currencies (CBDCs). Mr. Coste responded that the regulatory treatment for CBDCs would differ. He emphasized that CBDCs should be exposures to the Central Bank therefore out of the scope of banks liabilities.
- Members sought clarification on whether stablecoin issuers could remunerate deposits. Mr. Coste explained that under the Markets in Crypto-Assets Regulation (MiCAR), deposit remuneration is not foreseen by stablecoin issuers to make a clear distinction between deposit of value and mean of exchange. This suggests that while issuers themselves will not provide remuneration, clients could potentially earn interest or returns through other financial services, separate from the issuing entity.
- One member highlighted the distinction between "zero interest" and "no interest," raising the possibility of differing treatments between stablecoins and fiat money in a negative interest rate environment. Mr. Coste responded that, in theory, someone else than the issuer could pay a positive remuneration to borrow stablecoins, depending on the framework or mechanism in place. This would create a potential avenue for earning interest, even when traditional bank deposits might be subjected to negative rates.
- A member asked whether central banks should allow Non-Bank Financial Institutions (NBFIs) access to their balance sheets. Mr. Coste highlighted that this is a topic currently being considered by the European Commission. He mentioned that China has already implemented such a system, allowing NBFIs access to central bank liquidity. Furthermore, he noted that the Bank of England is considering similar measures, particularly if a global stablecoin

	emerges, as it could necessitate a broader liquidity framework for non-banks. • Members asked whether there would be a different impact on banks' liquidity ratios depending on whether a stablecoin is classified as an e-money token or an asset-referenced token. Mr. Coste explained that the impact would vary depending on the nature of the asset-referenced token. Specifically, the effect on liquidity ratios would depend on whether the token is linked to a commodity, a basket of currencies, or other financial assets. The pegged asset would determine the instruments the issuer needs to hold to back it, thereby influencing whether it affects liquidity ratios.
AOB	The last meeting of 2024 will be held in Utrecht, hosted by Rabobank. Proposed dates for the 2025 EMMEC meetings are as follows: April 2, June 17, October 2, and December 11. The April meeting could be hosted by EMMI in Brussels, while the June meeting may take place in Paris, hosted by ACI France.