18.06.2008

Members/Traders Questionnaire
"The Functioning of the Money Markets 2008"

INTRODUCTION

In the run to the 47th ACI World Congress, held in Vienna between the 29th to the 31st of May 2008, ACI International came up with a questionnaire for its members on the "Functioning of the Money Markets". The aim was to learn from first hand experience about the views of those working in the recent market conditions. As promised, the main views and some of the findings from the replies received are being communicated back to the members through this report.

Overview: A total of 106 replies have been returned to the Paris office, out of which 5 were put aside because of faulty completion. A region analysis showed that 59% came from Europe, 13% from Africa and 9% from the Middle East, with the remaining being unidentified. Meanwhile, 31% of respondents stated having between 10 to 20 years of experience, followed by 29% having more than 20years and with 24% and 16 % having between 5 to 10 and up to 5 years experience, respectively.

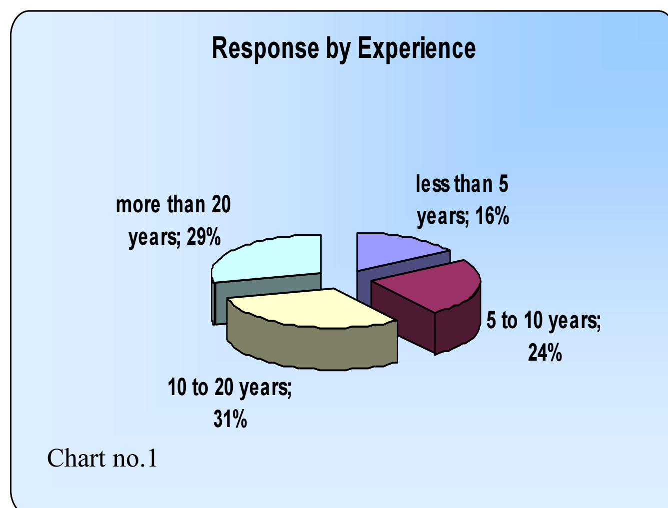

Chart no.1

The questionnaire was deliberately kept short to encourage completion and a prize draw was attached to it. It focused on three main issues related to the liquidity crunch, Libor Fixing, confidence and role of Money Market Trader. The questions asked included both closed and open ended questions.

RESULTS TO THE QUESTIONNAIRE

Question 1

It has been widely reported in the press that some Libor Fixings does not reflect the actual prevailing money market rates for cash. Do you agree?
Which Fixings need to be improved and how to improve the quality of such Fixing?

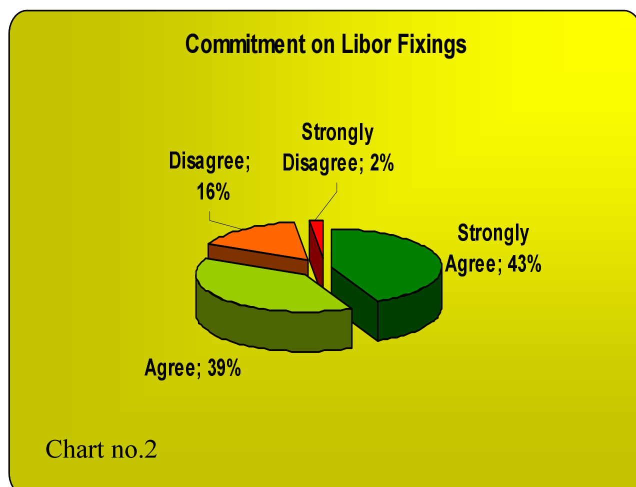

Chart no.2

Results related to the first part of the asked question exhibited in chart no. 2.

From those agreeing that the fixing does not represent prevailing cash rates, 24% indicated that this mainly concerns the USD Libor fixing, which varied between 15 to 25 bps from the actual rates. A handful has also pointed to off-market Libor fixings for the Swiss Franc and the Sterling. Interestingly, a comment which came up twice indicated that fixing for the CHF below actual market rates was also a normal characteristic, prior to August 2007.

On the other hand 18% did not agree to the statement posed. From these, the following three main points have emerged:

i) the Libor fixing is still the best reference of actual market rates that one can get;

ii) that there has simply been a reassessment of credit risk and some lost access to Libor borrowing;

iii) it could well be true for other banks but this has not effected our funding.

To the second part of the question on how could the fixings be improved, the strongest call with 14% was to increase the number of panel banks participating in the fixing, followed by 6% who suggested that the fixing should be calculated as a weighted average of concluded trades throughout the day as is done to the OIS. Additionally, 5% asked for new methodology and essentially to change the definition of Libor from being where institutions would be prepared to 'Borrow' to where institutions would be ready to 'Lend'.

Finally, the following is a small selection of the individual comments received in this section, in point form:

i) let the Treasurers set up the rate and not people out of the market, e.g. loans department;

ii) Libor has no real representative for interbank any more, Treasurers use Eonia and Fed funds rate instead;

iii) peak spread is located in USD 3M Libor which has a significant influence in derivatives;

iv) banks should contribute their rates without reference to rates contributed by other contributing banks, yet it is known knowledge that Libors are pretty much predetermined by consultation with the brokers earlier in the day;

v) sponsors of the fixing (BBA & Euribor) should ensure that panel banks are aware of the rules for the price finding and contribute only rates which are in compliance with those rules. Moreover, the sponsors should obtain informal rates from other banks to spot and investigate any differences to the actual quoting from the panel banks.

Question 2

Central Banks around the world have tried in various ways to restore trust in the markets. They have injected unprecedented amounts of liquidity into the banking systems.

2.1 What do you think that is needed to restore confidence to the markets?

To this question, 14% replied that first there need to be a full disclosure of all losses and risks being hidden in the balance sheets of the big banks. Also 14% have noted that the banks needed time and that eventually a few positive quarterly results by the banking industry will restore confidence.

As with the role of the Central Banks in managing the credit crunch respondents were somewhat divided with 10% asking for more injections for long tenors whereas 7% thought that Central Banks should reduce their intervention in the markets. The general view of the latter was that through their interventions, Central Banks are simply buying time and prolonging the crisis.

Other selective replies to what is need to restore confidence in the markets included:

i) a good benchmark;

ii) tighter regulations on leveraged buyouts;

iii) simplified accounting standards that could be understood by all.

Finally, an interesting point was that the ECB should reduce fine tuning operations by which it absorbs extra liquidity at the end of each maintenance period so as to penalize more those banks hoarding unnecessary cash.

2.2 Has Money Market gone out of style?

74% marked NO
26% marked YES

2.3 Is well functioning MM of importance and what will be the future role of the MM trader?

To the above question, 18% of the respondents said that the money market trader will remain of vital importance to banks and that its role will remain that of doing what they have always been doing i.e. funding in the cheapest way, investing funds actively and nurturing a stable funding base for the bank. Additionally, a good number of respondents have highlighted that having a well established and well educated money market traders was one of the most important assets to have during the turmoil.

Still 17% pointed out that the job of a money market trader has changed and that nowadays it is becoming more related to that of a liquidity manger rather than to a trader. Additionally two respondents have anticipated that in the future MM Desk will become a service centre rather than a profit centre.

Other statements included in this section worth mentioning are:

i) money markets are of utmost importance to the macro economy as they are key to an efficient transmission of monetary policy;

ii) liquidity risk and its management has become a top priority for Supervisory Boards, Regulators and Legislators alike;

iii) MM traders will always be there as firefighters, ready to fight the next financial crisis.

Question 3

When will the credit crunch be over and what do you think is the main reason behind the high cash interbank rates?

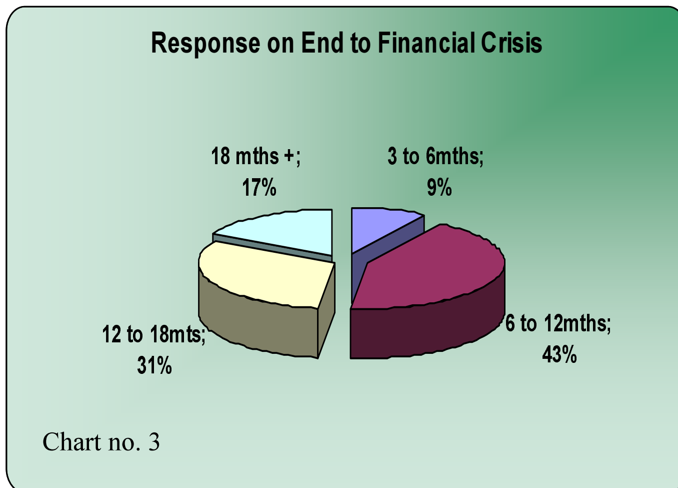

Chart no. 3

The results of the first part of the question are represented in Chart 3. As for the second part, 28% thought that it has simply to do with supply and demand; 20% pointed to credit concerns or lack of trust between banks; whereas 10% cited management's strict orders not to lend in the interbank market. Additionally, 6% noted over reserving or hoarding of cash; 5% exploitation by liquid banks to earn more money since many assets are linked to variable rates; and finally 2% noted desperation for cash.

A selection of the arguments or statements provided by respondents in their claim to why rates are so high is included below:

i) an erroneously low Libor fixing means that traders would end trapped short of funds at a rate which they cannot fund themselves. Therefore, traders are hoarding all funds that they have or can obtain so as to rectify any their positions. Moreover, those having access to Central Bank money do not have an incentive to offer it back in interbank;

ii) liquidity cost prior to August 2007 was too low whereas now they are arguably too high, therefore the market is trying to adjust itself to find the appropriate level;

iii) Basel II and other regulations concerning liquidity discourage banks to lend money in the interbank other than for very short periods;

iv) finally one mentioned that cash is a commodity which has suddenly become scarce as the big banks need it to finance the number of Special Investment Vehicles brought on their balance sheet, following the collapse of the sub-prime market.

Summary by,
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on behalf of ACI International