Discussion of:
Use of liquidity and interest rates for overnight loans: An example of an oversight indicator

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Summary

- Objective of the study
  - Study interest rate patterns over a period of just over 5 years
    - Interest rate versus perceived riskiness
  - Look at liquidity utilisation patters over the same period
  - Combine the findings in an effort to create an indicator that can be a used as an oversight tool

Summary

- Methodology
  - Literature review
  - Measured liquidity usage as a percentage of total available liquidity
  - Identify interbank loans and the interest charged on these loans
    - Comparing the findings with a benchmark being the EONIA
    - Are premiums being levied on certain counterparties?
  - Combined the liquidity usage and interest patterns to arrive at an indicator
    - Highlights when high liquidity usage and a "risky" interest profile could be regarded as a signal for potential intervention
  - Indicator was tested over a period consisting of four periods using a sample of 2 banks

Summary

- Conclusion
  - During the financial crisis participants had very different confidence levels in the 2 banks under review and although this recovered somewhat, the view continues post crisis
    - One bank used a large portion of its liquidity on average, but was perceived to be a low risk borrower and therefore the high level of liquidity utilisation was not seen as a liquidity risk
    - The other bank, however, was not perceived as being low risk a borrower, but did use a lower average percentage of its total liquidity

Summary

- Challenges and next steps
  - Broaden the sample to 15 to 20 of the largest banks in the Euro area to reach more concrete conclusions
  - Calibrating the risk premium and liquidity usage grid of the indicator
  - Exclude peaks, false alarms and errors in the observations

Comments

- General
  - Although literature scarce, methodology is corroborated by recent sources
  - Offers new perspective on payment system oversight
    - The more perspectives the better
    - Often no single conclusive risk indicator
  - Will be interesting to have an ex-post view of a bank in a stress situation

Discussion and questions

- Liquidity usage
  - Definition of liquidity
    - Should one monitor account balances as well or only collateral usage for intraday liquidity (and preferably at end of day)?
    - Experience regarding liquidity management in different countries – settlement account balances often cleared to call or reserve accounts
    - Outcome should be the same

Discussion and questions

- Interest rate for overnight loans
  - Higher interest rates COULD be an indication of perceived higher riskiness
    - My opinion is that this causal relationship could be vague
    - Banks have their usual counterparties that they lend to / borrow from. Lending to anyone outside of this 'club' is unusual but if it does occur, the pricing structure is different
    - Price discrimination based on bank size - smaller banks tend to pay more
    - Interest rates charged are also often determined by market forces

Discussion and questions

- Interest rate for overnight loans
  - "...information on interest rates paid for overnight credit is not readily available" + the challenges in identifying the interbank loans
    - Solutions that I’ve come across to alleviate these problems
      - Dedicated window at the end of the day during which only interbank loans can be settled
      - Using receiver codes to identify the purpose of a transaction
      - Being more prescriptive as the central bank with regard to the population of these types of instructions

Discussion and questions

- Interest rate for overnight loans
  - Procedure for executing the overnight loans: negotiated before lunch before the end-of-day positions are known
  - Would expect this to be done closer to end of day when final positions are known
    - reflected by the graph in figure 2, from which it would appear that borrowing peaks between 16:00 and 17:00, which is what I would have expected

Discussion and questions

- Interest rate for overnight loans
  - Loans are made at ".. some interest rate r...“
    - Notice that the method used to identify repayments is looking at the EONIA
    - Do central banks in Europe pay interest on end-of-day balances
    - Would expect that the interbank interest will always lie between the rate paid and received by the central bank

Discussion and questions

- Indicator result interpretation
  - it seems to be from a bank's point of view rather than the overseer's
  - I would feel more comfortable with Bank C's position than with Bank A's
    - A bank consistently utilising 80 per cent of its liquidity might point toward efficient liquidity use, but the liquidity risk of such a bank is in my opinion higher than that of a bank that does keep some excess liquidity / collateral