

Discussion of “Does limited use of limits limit the use of limits?”

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Key Points

- Bilateral net debit limits can reduce the level of liquidity withheld by “free riders” and therefore result in liquidity being “more evenly distributed.”
- In theory, the net system-wide efficiency impact of limits is ambiguous.
- The potential benefits of limits are greater when liquidity is scarce.
- Few participants (about 17 out of 1,000) set limits.
- Simulations indicate that, in Target2, the use of limits has a net negative impact on efficiency, both under the basis and the stress scenario.

Comments on Context

- What is the main policy objective of bilateral net debit limits?
- What is the “right” balance between “liquidity fairness” and efficiency?
- Who are the free riders?
 - 67% of bilateral limits = €1 million
 - 15% of multilateral limits \leq €100 million, 55% \leq €500 million
- Why are so few participants setting limits? High level of liquidity? Risk of delaying payments? Other reasons?

Canada's Approach

- The Large Value Transfer System allows a tranche of payments to be supported by collateral sufficient only to cover the single largest default.
- Under this tranche, each receiver may choose to provide a “bilateral **credit** limit or BCL” to its senders. The sender’s required proportionate share of collateral contribution is then calculated.
- In the event of a default, the survivors need to cover their proportionate share of the financial loss based on the size of the BCL they had extended to the defaulter.
- This approach ensures participants internalize the balance between
 - The risk associated with providing BCLs; and
 - The liquidity savings benefits of making payments under this tranche.

Potential Areas of Further Research

- What are the Target2 senders' externalities in setting limits and how can they be internalized?
- Who are the current limit setters and why?
- Should the use of limits remain limited?
 - Are they part of the solution?
 - Part of the problem?
 - Both?

Thank you

