Policy Directions for Money Market Stability: Importance of Trade Reporting and Disclosure

Baek, In Seok*

The Korean government recently unveiled its policy for building a systematic reporting and disclosure scheme for money market data. If related organizations can get an accurate picture of short-term funding of financial institutions, this would make risk monitoring much easier, contributing greatly to the establishment of concrete policy measures for higher money market stability. At the same time, a systematic disclosure system is expected to help provide market participants accurate, well-timed information and thus improve money market transparency.

Since the global financial crisis, enormous policy efforts have been made for improving money market stability. The money market plays a pivotal role in helping financial institutions finance and manage capital, but its direct involvement in deepening the global financial crisis exposed the innate susceptibility. An important lesson learned from the crisis was that financial authorities failed to recognize the systemic risk accumulating in the money market. To improve market stability by detecting money market risk factors in a timely manner, developed countries such as the US and European nations have pushed for mandated trade reporting related to money market transactions done by financial institutions.

Recently, the Korean government also followed suit by releasing its policy plan to systemize how money market data are reported, compiled, and disclosed.[1] Korea's move has grave implications because the policy considers not only trade reporting, but also how to utilize the

＊ All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

＊ Ph.D., Research Fellow, Capital Markets Department, Tel: 82-2-3771-0633, E-mail: bis@kcmi.re.kr

1) Financial Services Commission, Plans to facilitate the money market, September 1, 2016, Press Release.

compiled trade data and systemize the way data are disclosed for greater market transparency, whereas other countries are still working on the trade reporting regulation. This article tries to explore money market trade reporting and the relevant regulatory work underway in the US and Europe. Then, it discusses the expected policy outcomes, and the challenges ahead.

Money market trade reporting regulation in the US and Europe

The money market refers to a marketplace where institutions with professional knowledge, not retail investors, trade short-term financial instruments. Prior to the global financial crisis, it was predominantly viewed as an efficient marketplace where market participants regulate borrowers' excessive risk-taking.[2)] This aspect was also reflected in regulators' money market policy directions in the pre-crisis era. Rather than directly overseeing and controlling the market, regulators used to focus on the market environment to ensure that market discipline works efficiently. This became the reason that the US and European regulatory authorities had not properly figured out money market situations right before the global financial crisis, failing to take well-timed action to contain risk factors that were growing in the financial system.

For promoting global financial stability in the post-crisis era, G20 nations established the Financial Stability Board (FSB) that came to recommend a well-timed, accurate assessment on market situations as a prerequisite to money market stability.[3)] Reflecting the FSB recommendation, US and European regulators have been pushing for policies for collecting money market data from financial institutions.

The European Parliament announced a law on securities financing transactions[4)] that mandates financial institutions to report their repo and SLB transactions to the European Securities and Markets Authority (ESMA). Under the law aiming for enhanced transparency and monitoring on the securities financing market, not only every financial institution including banks and non-banks, but also non-financial firms will have to report all of their securities financing transactions to ESMA on a daily basis.[5)] Earlier in 2014, the ECB enacted a law on statistical reporting of money market trade data,[6)] based on which banks shall report to the

2) Min, D., 2015, Understanding the failures of market discipline, Washington University Law Review, 92(6).

3) FSB, 2013, Strengthening oversight and regulation of shadow banking.

4) Regulation (EU) 2015/2365 of the European Parliament and of the Council on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (EMIR).

5) Banks will be subject to the law in April 2018, and the law will expand to other institutions.

6) Regulation (EU) 1333/2014 of the European Central Bank concerning statistics on the money markets.

ECB all money market transactions such as unsecured, secured, short-term debt securities transactions on a daily basis starting from the second half of 2016. Similar to the ECB, the Bank of England has had banks and major financial investment companies report their short-term funding transactions on a daily basis.

This also is the case for the US where since 2014 the Fed has mandated daily reporting of federal funds transactions, euro dollar transactions, and CD transactions by banks; and secured, unsecured, short-term debt securities transactions by bank holding companies.[7] When it comes to non-bank financial institutions, the regulatory focus is placed on figuring out the state of repo transactions. While clearing banks, in charge of collateral management in the market, have been obligated to report all data related to tri-party repo market transactions, the SEC and the Office of Financial Research are still considering a measure mandating trade reporting related to bilateral repo market transactions as recommended by the FSB.[8]

Korea's money market trade reporting and disclosure policy

As are the cases of the US and Europe, Korea's incomplete data collection related to short-term funding between financial institutions leads to difficulties for market participants and the government to figure out the accurate picture of the market. For example, financial institutions currently submit a report of their monthly outstanding balance per money market sector to the relevant authority not later than the end of the following month, which cripples market monitoring of financial authorities.

Against the backdrop, the Korean government is planning to mandate related organizations to report issuance and trade data on the call, CD, CP, short-term electronic bonds, and repo markets to the relevant authorities (regulatory/supervisory authorities and the central bank). The US and European models where financial institutions directly report the data to regulatory authorities and the central bank could add cost burdens for establishing a necessary computer system, etc., and increase workload for separately reporting the same information to regulatory authorities and the central bank. To reduce the workload, the Korean government plans to collect data from related organizations, instead of from individual financial institutions. Although such an

7) FRB, FR 2420, 2052a, 2052b.

8) The US repo market consists of the tri-party and bilateral segments. While the tri-party market has been thoroughly monitored by the Fed since the crisis, even the overall market size of the bilateral market is still unknown.

arrangement may necessitate an additional procedure to verify data accuracy, Korea's policy plan seems to put the convenience of individual financial institutions ahead of other factors.

On top of trade reporting, the government is also moving ahead with a plan for a systematic disclosure system that aims to publicize money market-related information to market participants via related organizations in a transparent manner. The US and Europe are working on data collection policies, but yet to engage in concrete discussions on information disclosure. Although central banks disclose information on limited parts of the market, this is insufficient to grasp the overall market situation. Hence, if Korea successfully introduces an integrated information disclosure system for the money market, this will be a meaningful step forward in the aspect of enhanced market transparency.

Expected outcomes and future challenges

One of the culprits behind the global financial crisis was that regulatory authorities failed to take well-timed action to monitor systemic risk accumulating in the money market. For greater money market stability, the US and Europe have adopted multi-faceted regulatory efforts in the post-crisis era. However, giving regulatory authorities proper access to market information is an important prerequisite to policy design and assessment. From that perspective, the Korea's government's plan for money market data collection is viewed as an important stepping stone for Korea's ultimate goal of improving market stability. But the currently proposed arrangement, in which financial institutions indirectly report their trade data to the government authorities via the related organizations, will require an additional verification procedure to ensure data accuracy.

Moreover, a systematic disclosure system is expected to help disseminate accurate market information to market participants. The issue of disclosing money market information has yet been sufficiently discussed by the US and Europe. During the process of giving concrete substance to the plan, market participants, related organizations, and financial authorities should engage in thorough discussions. Especially, as the money market interest rates serve as a reference rate for other financial markets and transactions such as bank lending, the equitability and accuracy of data are critical. Going forward, it is necessary to give market participants clear guidance about how to calculate and disclose interest rates by each subsector. An efficient disclosure system, if established successfully, is expected to give impetus for lowering information asymmetry among market participants, and promoting money market efficiency and transparency.