

**MONEY MARKET INSTRUMENT REVIEW NEXT STEPS WORKING
GROUP**

**MINUTES OF A MEETING AT THE BANK OF ENGLAND, MAIN OAK
ROOM ON 26 APRIL 2000**

Attendees

Peter Andrews (Chair)	Bank of England
John Rippon	
David Rule	
Tanveer Hussain (Secretary)	
Toby Davies	CRESTCo
Mike Jones	
Antony Littleton	APACS
Ross Jones	Gerrard & King
Mike Wareham	HSBC Bank plc
Tony Hibbitt	Cater Allen
Allison Holland	DMO
Reg Dobson	LSE
Tom Casteleyn	Bank One
Richard Pattinson	Barclays plc
Ian Mair	LMMA
Ian Firth	Lloyds TSB Bank Treasury
Anna White	Goldman Sachs

Apologies

Alastair Wilson	Bank of England
Maurice Cleaves	Bank One
Angus Cameron	Bank of Scotland
Mike Williams	DMO
Michael Blane	Foreign Banks Association
Jim Coleman	Association of Corporate Treasurers

1. **Mr Andrews** began the meeting by summarising the work already undertaken. The Bank's November consultation, 'The Future of Money Market Instruments', and the March follow up document 'Next Steps', showed unanimous support for the dematerialisation and integration of money market instruments (MMIs) with gilt and equity settlement.
2. **Mr Andrews** said a single system would enable market participants to treat MMIs on the same legal and operational basis as gilts and equities and exploit new

settlement opportunities in an integrated system e.g. market participants could hold gilts and MMIs in the same pool of collateral. The market would benefit from an integrated system that would bring economies of scale and efficiency in back office systems and could facilitate straight through processing (STP) and a settlement environment where settlement banks are willing to assure payments on MMIs (and move to full DVP idc). Fungible MMIs would also allow holdings of the same issue to be interchanged and divided into smaller holdings, and help create a liquid and deep market, which in turn would benefit issuers, who could issue more cheaply.

3. **Mr Andrews** went on to summarise the Group's task. This was to settle terms of reference, discuss the work programme (contents and timetable) for implementation, ensure the Group has identified the main issues for consideration in the preparation work, and to discuss formation of sub-groups to consider particular topics.
4. **Mr Andrews** continued by saying that the preparation work would be co-led by the Bank and CRESTCo. The Bank's interests are primarily as monetary authority and in the effectiveness of the United Kingdom's financial infrastructure. CRESTCo's role is that of provider of the settlement system and much of the detailed preparation work will fall to CRESTCo working with the market. Toby Davies and Michael Jones will be leading CRESTCo's work. The Bank and CRESTCo will also be working closely with HM Treasury and Treasury Solicitors on the associated legislative work.
5. **Mr Andrews** said the Bank would chair this Working Group with CRESTCo chairing the sub-groups. Tanveer Hussain is secretary to this Working Group, and John Rippon, David Rule and Alastair Wilson will also attend for the Bank. Agendas and papers will be circulated before the meetings and he envisaged that the **finalised** minutes would be placed on the Bank's and CRESTCo's website to ensure a wide audience.

Terms of Reference

6. **Mr Hussain** provided a brief explanation of the terms and reference and these were agreed.

- To advise the Bank and CRESTCo on all aspects of preparation and implementation of the integration of the CMO into CREST.
- To produce interim reports for the market on proposals and assist any further Bank or CRESTCo consultations.
- To establish sub-groups to consider and report to the Working Group on particular aspects of preparation.

Work Programme

7. **Mr Davies** said that there were multiple projects already under way including the integration of MMIs into CREST. CRESTCo was also involved with improving the risk profile within the CREST system, principally through the introduction of DvP by end 2001. The key issue therefore was to position the integration of MMIs around this, especially if MMIs were not integrated by a 'big bang' since the transition could be quite long. He also noted the importance of progress on legislation by Treasury Solicitors. With these factors in mind, MMI integration would be feasible in late 2001 or early 2002. Mr Andrews added that there existed several interdependencies in the work programme and queried whether MMIs could be integrated into an assured payment environment followed by DvP.
8. **Mr Davies** replied that there was a concern about appetite for concentrated change since there were several significant operational changes already scheduled and it was a question of how closely these should be aligned. He noted that the payment arrangements were not the driver in this instance but that the legislation and operational impact were more important.

9. **Mr Littleton** emphasised the crowdedness of the timetable and cited the introduction of the CLS Bank, New CHAPS development, and the general IT development work being undertaken by banks which mean that end 2001 would be very congested. Mr Pattinson also highlighted the proposed introduction of RTGS + in Germany and changes to settlement platforms in general. **Mr Davies** agreed and said that the changes in the second half of 2001 primarily affected the settlement bank community.
10. **Ms Holland** noted the DMO's desire to see Treasury bills dematerialised as soon as practical given other developments. **Mr Andrews** said that DMO support would be welcome when dialogue is progressed with Treasury Solicitors.

Sub-groups

11. **Mr Andrews** said that the consultation process identified a number of other issues on which further work was required and that the following issues merit discussion in sub-groups, which can be flexible both in terms of membership and the issues to be discussed.

- The valuation of money market instruments and their grouping for collateral purposes;
- Operation of an integrated CMO/CREST system including issuance procedures e.g. the allocation of ISINs; and
- The transition.

12. **Mr Andrews** said that CRESTCo are preparing a paper on the role of the Issuing and Paying Agent in an integrated system, which could be the basis for discussion in the sub-group.
13. **Mr Davies** said that CRESTCo , in taking forward the MMI work would not be looking at the fundamental CREST system for settlement but concentrating on

how MMIs could fit into the existing framework. At the agent level, the objective was to make issuance possible in a matter of minutes. Administrative responsibilities post-issuance and maturity processes will need to be picked up in due course.

14. **Mr Andrews** said that the consultation had recommended that the same transitional arrangements (rather than a series of separate transitions should cover all MMIs for different types of different types of MMIs) and suggested that it may be best to have a period of transition followed by a 'big bang' when remaining physical MMIs due to move into CREST are dematerialised. There were various views from respondents. Some favouring dual running followed by 'big bang'; others preferred 'mini-bangs'.

15. **Mr Hussain** said that once the necessary legislative provisions for dematerialised MMIs were in place, then issuers should be able to issue new issues of MMIs directly into CREST. Existing paper MMIs could in principle be transitioned in the following ways:

- a) First, existing MMIs could remain in CMO until maturity and new issues of MMIs could be issued directly into CREST. This would however mean that CMO and CREST run concurrently for up to a year - the maximum maturity of MMIs in CMO. The average maturity of MMIs is around 4 months; about half of the MMIs in CMO would mature within a period of 1- 4 months. A division in the market would also exist with different settlement practices and fungibility in one system but not in the other. He noted that the market could be given a long notice period and issuers could plan accordingly. For example, corporate securities went into CREST in batches over a period between July 1996 and April 1997 (when TALISMAN was switched off).

He added that some members of last year's Working Group favoured this approach and estimated that about 70-80% of their holdings of MMIs would mature within 4 months. This approach could help reduce the operational risks associated with market participants adapting to a new settlement system but it was important that the cost of CMO did not become uneconomical.

- b) Secondly, a 'big bang' approach could be followed where all MMIs are moved in one go, similar to the CGO merger plans. It may be difficult to transfer individual bearer MMIs into CREST, as they would not be “new issues” and it would be important to address how MMIs would be input into CREST and by whom, as well as how ISINs would be assigned. However, a big bang could be combined with a transitional approach i.e. allow a large volume of MMIs to mature, after which the smaller number of outstanding MMIs could be integrated into CREST in a later big bang.
- c) Finally, a phased approach could be adopted where the transition is divided into phases by instrument (for example, one phase for CDs, one phase for Treasury Bills etc) either as a series of transitional periods, or a series of mini-bangs. A phased approach would seem sensible if different legislative provisions were required to dematerialise various types of MMIs and if these changes involved different lead times. If this were the case, then such a phased approach would be sensible as the delays in dematerialising one type of MMI need not delay the dematerialisation of other types of MMIs.

Legislation would, at the least, need to cover any transition involving a 'big bang' or phased approach. The task for the sub-group was to work out how to proceed on this issue

Order of the work

16. **Mr Andrews** asked whether the Group had views on the order of the work in the sub-groups. The resource cost is important given the time pressures on all present. As such, perhaps the valuation and grouping of collateral sub-group could start later, say 3 months from now. The sub-group looking at operational issues could go ahead as it can discuss a number of self-contained issues and the transition group could also proceed.
17. **Mr Davies** noted that Treasury Solicitor feedback was very important since they will be able to inform us if the big bang solution is feasible from a legislative perspective.

18. **Mr Andrews** agreed and said the output of the sub-groups would be important input to Treasury Solicitors. **He highlighted to members the summary sheet of questions which it was felt the sub-groups should tackle and asked for any comments to be sent to the secretary.**
19. He added that it was envisaged that the sub-groups would carry out the detailed work with a membership to reflect expertise, and the policy issues to be discussed in this Group. These sub-groups would be tasked to produce reports for this Group to consider and ultimately bring together all the conclusions and outstanding issues that may require further consultation or policy decisions. He said that the sub-groups should meet quite frequently; and for the first time over the next month so that they can report their initial views on issues and the way forward to this Group in early June.
20. On the membership of sub-groups, **Mr Andrews** said that this would include the Bank, CRESTCo, and representatives of the main market associations plus individuals with other relevant expertise. The main associations will be contacted for nominees, and preliminary lists will be sent shortly. **He added that members of the Group may also wish to suggest members and any comments or suggestions should be sent to the secretary.**

Other items

21. **Mr Andrews** said that there was no obvious demand expressed by respondents to the consultation for a paper interface in CREST. One bank felt that although CREST did not need to provide facilities to accept or create physical instruments, an option to re-materialise should be made available; and that Issuing and Paying Agents should be able to provide the necessary link here. This issue could, if necessary, be picked up in the sub-group looking at operational aspects of an integrated CMO, along with the allocation of ISINs.
22. **Mr Andrews** continued by noting that some respondents had queried whether other instruments, e.g. letters of credit, could also be dematerialised. Although this

could be kept on the agenda, it was not a priority and not central to the reform proposals.

For information

23. **Mr Andrews** said that the Bank and CRESTCo will be meeting HM Treasury and Treasury Solicitors soon to discuss the work needed to put in place the necessary legislation - probably just secondary legislation - to allow dematerialisation and the other changes necessary for MMIs to be settled in CREST. Treasury Solicitors will require a detailed explanation of how the various MMI issuance and settlement arrangements etc will work; and the output of the Working Group and sub-groups will be important in feeding into this.
24. **Mr Davies** added that CRESTCo will need to check the contractual framework, which is more likely to affect IPAs than investors.
25. **Mr Littleton** said that the settlement banks were interested in Treasury Solicitors' thoughts especially on certainty of transfer and enquired as to whether any papers would be circulated. Mr Andrews said the point would be raised at the meeting though he noted that Counsel had already given an opinion, which could be found in the November 1999 consultation. Mr Davies added that the main secondary legislation for transfer was intended to be the Uncertificated Securities Regulations.
26. **Mr Rippon** noted that Treasury Solicitors would need to be provided with a lot of detailed information about the proposed arrangements for the dematerialisation, issuance and settlement of MMIs, and the envisaged procedures for transition. He agreed that they should be made aware of settlement bank concerns and interests. **Mr Andrews** asked for members' questions or concerns to be passed on to the Bank, which could then raise them at the meeting.
27. **Mr Mair** asked whether there was a timescale for discussions with Treasury Solicitors. **Mr Rippon** replied that the Bank had been in dialogue with Treasury

Solicitors over the course of the past year but they had been preoccupied with the FSMB and CREST related secondary legislation. Also, Treasury Solicitors had still to turn to the large amount of secondary legislation needed to implement the FSMB. Treasury Solicitors have promised to engage after Easter but they will require a detailed description of how the new system is envisaged to work before they could begin detailed drafting. This work would inevitably be iterative in that the proposed arrangements may have to be amended if there were any statutory obstacles which could not be overcome by secondary legislation. **Mr Andrews** noted that the meeting would be before the next meeting of this Group in June and highlighted again the interdependencies in the work programme.

Date of next meeting.

28. The next meeting will take place on 6 June, 10am - 12pm, Princes Training Room, Bank Buildings, Princes Street. Please see attached map for directions.

Bank of England

May 2000