BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP MEETING AT 3 PM ON THURSDAY 4 APRIL

Ian Plenderleith (Chairman)	Bank of England
David Rule	Bank of England
Paul Mikhailoff (Secretary)	Bank of England
John Rippon	Bank of England
Mike Beales	WMBA
Toby Davies	CRESTCo
Stewart Devine	FSA
Barry Holland	London Investment Banking Association
Graham Forster	LloydsTSB
Anthony Littleton	Association for Payment Clearing Services
Ian Mair	London Money Market Association
Peter Martin	CIPFA
David Morrision	Royal Bank of Scotland
Richard Pattinson	Barclays
Lesley Poltock	JP Morgan
Mike Williams	DMO
Roger Woodbridge	HBOS

Agenda Item 1 – Introduction

1 Ian Plenderleith welcomed David Rule (Bank of England) and Peter Martin (CIPFA) to the group.

Agenda Item 2 – Current developments in sterling money Markets

2 David Rule (Bank of England) invited the group to discuss the steepness of international curves, uncertainty as suggested by implied volatilities, the apparent fall in liquidity and turnover at the end of last year and the effect of recent adaptations in the Bank of England`s money market operations.

3 David Rule noted the recent steepening in UK rates, and the greater steepness in the dollar curve while the euro curve was less severe. He asked if curves exaggerated expectations and if term risk premia had risen, as might be indicated by comparing surveys of expectations with the curves themselves. He described the continuing relatively high implied volatility of STIR futures which contrasted with the lower volatility of equity derivatives. Money market and futures turnover fell last December, more so than in the previous two years, and liquidity seemed less as perhaps evidenced by the unusually high proportion of overnight financing in the Bank of England`s operations: were balance sheet constraints becoming more severe? Although it was too early to gauge the impact of the December announcement that scaling may be applied to individual OMO counterparties if operations became unduly concentrated, it was the case that participation had increased in breadth and both softness and tightness had been less persistent. Longer moving averages of the SONIA rate were closer to the repo rate than before.

4   One member thought that about 70% of the curve`s steepness was expectational and that out to one year, at which point the natural investor base diminished, the risk premium had increased as the market found it hard to judge the appropriate return on assets and was not prepared to bear mark-to-market losses. Beyond one year it was suggested that the risk premium had not changed. A hump in the curve at 2-3 years was described which was caused by hedging by mortgage lenders; 2 and 5 year auctions in the US influenced the dollar curve. Others described uncertainty about the timing of any first step to tighten official rates and, also, the risk that higher oil prices might dent the shallow recovery. The Budget added another dimension. The reduction in equity implied volatility was attributed to the recent narrow trading range of the market and the collapse of demand for products such as ISAs.

5   Members noted that over two previous year-ends, which had embraced EMU then Y2K, authorities had kept markets liquid whereas at the end of 2001 there had no special reason to do so. Also, after a profitable year in a bull market, desks had been happy to close books down and had little incentive to trade or get short in order to take part in Bank of England operations: hence reduced liquidity.

6   Members agreed it was too early to comment on the impact of the scaling arrangements introduced in December. WMBA commented that that SONIA swap volumes were said by brokers to have fallen and suggested that this might be related to changed conditions at the short end of the market. Ian Plenderleith (Bank of England) said that on some measures volatility was reduced; he added that the fall in SONIA volumes should be looked at further.

Agenda Item 3 – Money Market Instruments Review

7   John Rippon (Bank of England) said that the Treasury and the Bank of England were taking the necessary work forward and preparing for a public consultation on legislation to facilitate dematerialisation. The timing had yet to be decided, but in the meantime officials were working on the basis that dematerialisation would begin in about mid-2003.

8   In the light of this decision, the Bank and CRESTCo would begin the next stage of work with the market on the practical preparations. The Bank would be reconvening its *Next Steps Group*, under the chairmanship of David Rule, to consider the work to date and the overarching issues relating to the timetable and outstanding work. David Rule would write to the market about this in the near future. CRESTCo would also be convening a market group to consider the more detailed technical aspects of preparation. The Bank and CRESTCo would work closely with the Treasury on the legislative preparation.

Agenda Item 4 – Contingency Planning

9   Ian Plenderleith invited Paul Mikhailoff (Bank of England) to summarise progress since the last MMLG meeting. He told the group that, as agreed in December, the Bank had prepared an agenda and held a series of meetings with market principals, WMBA, SLRC, gilt-edged market makers and DMO and LMMA.

10 There was a consensus that the Bank, were it able to do so in the circumstances, would be looked to by the market to disseminate guidance on conditions and procedures to be followed in the event of large scale disruption. The more means of communication the better: e-mail, the Bloomberg mail system and mobile `phones should be considered. Brokers might well have a role given their screen services and network of contacts. A directory of contacts and contingency sites, containing e-mail addresses, mobile and landline numbers for principals, the authorities, payment and clearing and settlement systems was thought essential.

11 There was support for a central coordinating group able to take decisions. It was felt that such a group should sit regularly which would help it to function better in an emergency. The group might have to decide on confirmation, trading and settlement conventions.

12 With regard to market liquidity, it was apparent from the meetings that had been held that the Fed`s encouragement to the market to maintain credit lines had been most helpful last September. Tri-party agreements could be helpful in a UK context. Means by which to mobilise collateral in other centres could be put in place.

13 Ian Plenderleith then asked the group to consider the next steps in putting a contingency planning framework in place for the sterling and allied money markets. He explained the roles in this context of the tripartite Standing Committee, comprising the Treasury, the Bank of England and the Financial Services Authority, which carried the lead responsibility for overseeing work on contingency planning. Within this framework, the FSA had the lead interest in individual firms` plans as part of its line supervisory responsibilities. The Bank had oversight responsibility for the payments system, and for assuring that core markets were making appropriate arrangements. He said that those markets which were exchange traded would be already likely to have had their needs considered.

14 He referred members of the group to the Financial Sector Joint Continuity Website being established by the Standing Committee and said that they would all be provided with the necessary codes and passwords to access it. He asked them to be discreet with regard to the circulation of these codes. He invited members to comment on the site and to suggest how it could best be used.

15 Another step would be the establishment of the directory of contacts and addresses mentioned above.

16 He thought that MMLG, on which sit some of the senior management of key institutions in the money market, was analogous to the Foreign Exchange Joint Standing Committee, which has set up an operational sub-group. He asked if a similar sub-group should be set up by MMLG to put into effect the proposed contingency planning measures and oversee the production of the contact directory and guidelines on best practice.   He thought that in any case progress on contingency planning should be a regular topic at future meetings of MMLG.

17 MMLG were asked to give their views on these proposals. The view was advanced that it may be a mistake for markets to be looked at in too much isolation,

particularly after the introduction of CLS via which national RTGS and securities markets would be connected. The proposed way forward was fine for trading purposes but, the argument ran, inter-related settlement systems meant that liquidity in one market affected that in another and there was need for a global overview. The risks associated with the millennium change, it was suggested, had been looked at with a global perspective.

18 Ian Plenderleith responded that such a wide brief, although theoretically desirable, may not in practice be manageable. What was important was that there was a UK practitioner group which understood and was examining the issues germane to their markets. MMLG was just such a practitioner group. It was the authorities` job to make the wider connections. He also suggested that the nature of the risks arising from the millennium change were more easily anticipated than those that might arise from a terrorist event. Support for this view and for the appropriateness of MMLG to carry this work forward was expressed. Ian Plenderleith noted, however, that in reviewing issues that arose, MMLG might find it useful to set up specialist groups to draw up agreed guidelines to good market practice.

19 One member stressed how, in the aftermath of 11 September, funding and liquidity had been sought in various currencies as was reflected in the swap arrangements introduced by central banks. It may be appropriate to have such facilities permanently in place. Ian Plenderleith suggested that the FX Joint Standing Committee was the natural forum to debate this.

Agenda Item 5 – Money Market Spreads

20 Paul Mikhailoff (Bank of England) reviewed the spread between one- month CDs and one-month gilt repo since 1998, observing the widening at the time of the Russian default and the long-term decline which has since taken place to levels close to those seen in the euro money market. The fall in the spread, he suggested, has benefited banks operating in London because it has made gilt repo more affordable as an instrument of liquidity. Gilt repo has over the last few months become a larger part of the stock of refinancing. He suggested a number of reasons behind this, particularly the expansion of eligible collateral during 1999, increased availability of gilts from lenders, the bull market and the lower absolute level of rates. MMLG concurred that it was a beneficial change and agreed with the underlying reasons suggested.

Agenda Item 6 – Market abuse rules

21 Stewart Devine (Financial Services Authority) said that the new market abuse regime had been in operation for four months. The regime was not rule-based but evidential. Nearly all the calls the FSA had received had been related to misuse of information, insider dealing. It was unlikely that the regime would have significant relevance for money markets. He recommended the Marketwatch newsletter, a concise and helpful document of 2 to 4 pages which was clear and concise although not formal guidance. He noted that the FSA had issued CP124 - FAQs on the market abuse and price stabilising regimes. The FSA welcomed comments from market participants.

Agenda Item 7 – Any other Business

22 Ian Plenderleith told MMLG that he will retire at the end of May when his MPC term ends and that Paul Tucker would succeed him as Executive Director responsible for markets and hence would assume chairmanship of MMLG.