

## **BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP**

Meeting at 3.00pm on Thursday 22 April 2004

Paul Tucker (Chairman)	Bank of England
David Rule	Bank of England
Alastair Wilson	Bank of England
Sarah Breedon (Secretary)	Bank of England
Nigel Dawes	Prebon
Rob Fair	CRESTCo
Peter Fingland	AFB/Bankgesellschaft
Ian Firth	LloydsTSB
Ian Fox	LMMA (alternate for Ian Mair)
Adrian Gray	Chair APACS Liquidity Managers/Citibank
Euan Harkness	GEMMA/Barclays
Simon Hills	BBA
Nick Hodge	Rabobank
David Hynes	IMMFA
Michael Knight	FSA
Antony Littleton	APACS
Brian Morrison	Abbey National Treasury Services
Richard Pattinson	Barclays
Jeremy Richardson	FSA
Robert Stheeman	DMO
Valerie Urbain	CRESTCo
Les Winnister	ACT
Jon Wood	HSBC

### **Apologies**

John Burke	LCH
Barry Holland	LIBA
Lindsay Mackay	HBOS
Graham Niblock	RBS
Conrad Santos	Lehmans
Amanda Sudworth	LIFFE

Also present:

Roger Clews	Bank of England
John Rippon	Bank of England
Thomas de Vecchi	Bank of England

### **Agenda Item 1 – Collateral taken in the Bank's Open Market Operations**

David Rule (Bank of England) said that the Bank had decided, in the context of contingency planning, that it should add to its operational framework the flexibility to take US Treasuries as collateral in its routine operations in stressed or otherwise

extraordinary circumstances. Given the large pool of eligible collateral currently available (around £3trn), the Bank did not consider it necessary to extend the pool for its routine operations in normal market conditions. But in the event of, for example, some major operational disruption - eg to CREST or at a firm - the flexibility to use US Treasuries might be valuable. Furthermore, establishing agreed procedures in advance would be important because the time zone difference made the timetable for same-day settlement tight. The Bank planned to use the Federal Reserve Bank of New York as its custodian and was in the process of agreeing the precise mechanics with them. Once these had been finalised, the Bank would issue a supplement to its operational notice.

David Rule said that the Bank had that day announced an additional criterion applied to sterling and euro bonds issued by sovereigns and supranationals in order to be eligible for use as collateral in routine open market operations, namely that issues should be rated Aa3 or higher by at least two of the three major ratings agencies. This would apply to OMO transactions undertaken after 1 May. Jeremy Richardson (FSA) said that the FSA was likely to make a similar change to its definition of liquid assets for those institutions subject to the sterling stock liquidity regime, although this might not be implemented until after 1 May.

## **Agenda Item 2 – Market Codes**

John Rippon (Bank of England) said that a number of market participants were wondering whether structured CDs (ie CDs with embedded derivatives) were compatible with the market notice on CDs issued by MMLG. Although floating rates of interest and the ability to call CDs early were possible features of CDs described in the market notice, what was proposed in these structures went further, linking, for example, the coupons on CDs to equity index levels or exchange rates. Mr Rippon recalled that when drawing up the guidelines, MMLG had not wanted to discourage market participants from considering new forms of CD, but it had been felt at the time that if new types of CD were to be introduced into the UK market they should be brought in after discussion with the market, including in MMLG, so that the existing guidelines could be modified if necessary. Given that context, did MMLG have views on whether such instruments were, or should be, compatible with the terms of the CD notice?

A range of members commented. The clear view of MMLG was that, at a minimum, no instrument should be described as a CD (certificate of deposit) if principal repayment was at risk, depending on the terms of an embedded derivative. Jon Wood (HSBC) noted that in permitting CDs to have a role in the prudential liquidity framework, the FSA had recognised the homogeneity and liquidity of the London CD market. However as instruments became more tailored, meeting this definition became harder, and so in his view such structured instruments were better not labelled as CDs. David Hynes (IMMFA) noted that one reason for labelling these securities as CDs rather than as MTNs was to permit their purchase by certain classes of investor. That was, however, potentially misleading: money market funds were permitted to invest in CDs because they were assumed to involve interest rate risk at short maturities and not, for example, payoffs related to commodity prices. Brian Morrison (Abbey National) added that issuance of structured MTNs involved sophisticated issuers and investors, and detailed, complex documentation: issuance of CDs did not necessarily. There was also the risk of confusion in secondary market trading of CDs. It was agreed that the Bank would explore whether there was an established market for structured CDs and, if so, whether it was clearly separate from the mainstream CD market. MMLG would then reconsider. (**Action: Bank to speak to issuers of structured CDs ahead of next MMLG meeting**).

Simon Hills (BBA) said that the BBA intended to circulate a near final draft of its publication on money market securities for discussion by the BBA working party in May.

### **Agenda Item 3 – Issuance of ISINs for sterling CDs in CREST**

Ian Fox (LMMA) said that LMMA had become increasingly concerned at the delay in issuance of ISINs for new CDs. This could take up to 5 hours, which was much too long given same-day settlement, and led to operational and reputational risks. Delays appeared to arise in communication between issuers and IPAs rather than with CREST. LMMA therefore considered that having some guidelines on issuance of ISINs would be helpful in order that all involved in the process knew what was expected of them. LMMA had also considered that MMLG, given its wider interest in market structure, would be the appropriate group to issue such guidelines. Rob Fair (CREST) agreed that the issue was how quickly CREST received the relevant data

from IPAs, a process that was still largely manual. Jon Wood (HSBC) agreed that having guidelines would be helpful: it would enable IPAs to make clear to issuers what was expected of them. It was therefore agreed that MMLG would take this issue forward. **(Action: Bank to circulate draft LMMA guidelines ahead of discussion at next MMLG meeting.)**

#### **Agenda Item 4 – Bank of England Repo Survey**

Sarah Breeden (Bank of England) said that a summary of the results of the Bank's recent survey of the largest participants in the sterling repo market had been circulated to MMLG members. The survey showed that the data on activity in the repo market published regularly by the Bank appeared to be comprehensive; that the overnight gilt repo market appeared to be larger than the Bank's estimate of the overnight unsecured money market; and that use of non-gilt repo in the sterling market appeared to be small (although gilt stock borrowing was collateralised by a broader range of collateral and activity in corporate bond repo was expected to rise). She added that the Bank would be happy to inform individual institutions of their market share ranking (based on size of positions reported to the Bank), although it would not publish either 'league tables' or data on the position of individual institutions.

#### **Agenda Item 5 – Business Continuity**

Sarah Breeden (Bank of England) noted that one recommendation in Andrew Large's report on major operational disruption to financial markets was for MMLG to satisfy itself, by end April, that members had the relevant level of representation given the committee's role in the event of such disruption. Paul Tucker said that the Bank saw MMLG as an important mechanism to pool information and take binding decisions in a crisis. Some institutions might consequently prefer to be represented at a more senior level in such an event. **(Action: Members to consider their level of representation by end-April.)**

#### **Agenda Item 7 – MMLG Terms of Reference and Agenda for 2004**

Sarah Breeden (Bank of England) said that the Bank would be happy to incorporate any comments on the draft terms of reference for MMLG circulated before the meeting, with the aim of finalising them by the end of May. Looking forward it was

hoped that in 2004 MMLG would further discuss its role in a contingency (perhaps going further than testing the conference call facility to include, for example, an assessment of how MMLG's role fitted with that of APACS Liquidity Managers Group and CREST's contingency arrangements). MMLG might also discuss the use of CREST's RPO functionality, LCH's proposal to clear gilt DBVs, the market abuse directive and the impact of Basel II on money markets.

#### **Agenda Item 8 – Update on FSA Work on Prudential Liquidity Requirements**

Jeremy Richardson (FSA) described the FSA's work over the past few years in establishing a single set of prudential liquidity requirements. The FSA had hoped to follow the issue of its Autumn 2003 Discussion Paper with a Consultation Paper in Autumn 2004. However, staff had had to be redeployed to other areas of work (particularly Basel II), and so work on liquidity had been reduced. The FSA hoped to restart work in April 2005, with a Consultation Paper issued perhaps in early 2006, but implementation remained some way off, perhaps late 2007. He added that the FSA, as well as the Bank, were involved in the international Basel-IOSCO Joint Forum Working Group on Liquidity Management and it was hoped that the new FSA rules would, in due course, benefit from these discussions.

#### **Agenda Item 9 – Update on the Bank's review of its Open Market Operations**

Paul Tucker said that the Bank expected to issue a consultation document on reform of its operations in the sterling money markets within a few weeks. [Published on 7 May and available at [www.bankofengland.co.uk](http://www.bankofengland.co.uk)]. The paper would set out the Bank's objectives and consult on the broad framework of the Bank's operations.

#### **Agenda Item 10 – Any Other Business**

John Rippon (Bank of England) said that the final report of the ACI committee on the short-term European securities markets - the so-called ACI STEP initiative which had been discussed in previous MMLG meetings - had been published in March.