

BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Friday 27 April 2007

Bank of England

MINUTES

Attendees

David Hopton (Alternate)	Abbey
Andrew Thursfield (Alternate)	Association of Foreign Bankers / Citigroup
Dave Whelan	ACT/Capita plc
Ian Hares	Alliance and Leicester
Cliff Broadhurst	APACS Liquidity Managers Group / ABN Amro
Antony Littleton	APACS
Miles Storey (Alternate)	Barclays
John Ewan (Alternate)	British Bankers Association
Joanne Whelan (Alternate)	DMO
Eric Lepore (Alternate)	Deutsche
David Wyatt	Euroclear
Richard Turrell	Euroclear
Douglas Hull	FSA
Olly Benkert (Alternate)	Goldman Sachs
Ian Fox	HBOS
Chris Walker (Alternate)	HSBC
Danny Corrigan	ICAP
Frederic Mouchel (Alternate)	JP Morgan
Clive Jones (Alternate)	Lloyds
Nigel Bradley (Alternate)	LCH
Richard Stevens (Alternate)	LIFFE
Rob Verillo (Alternate)	London Money Markets Association/Lehmans
Graham Niblock	RBS

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Paul Tucker (Chairman)
Simon Wells (Secretary)
Michael Cross
Peter Andrews
Roger Clews
Toby Davies
John Rippon
Stephen Denby

Apologies

David McFarlane	CHAPS
Jonathan Curry	IMMFA / Barclays Global Investors
Euan Harkness	GEMMA
Steve Nichols	Britannia Building Society

BANK OF ENGLAND ITEMS

1 OMOs for outright bond purchases and electronic bidding

1.1 Michael Cross introduced Graham Young as the new project manager overseeing the Bank's plans to reduce the amount of OMO repo lending by making outright purchases of gilts and high-quality foreign currency bonds (with the foreign currency cash flows swapped into fixed-rate sterling).

1.2 Graham Young said the Bank intended to hold a workshop on 14 May, which would give OMO counterparties the opportunity to view the new electronic bidding system and for the Bank to explain the training and familiarisation stages. The workshop would focus on electronic bidding in repo operations and outright purchases of gilts. Asset-swapped foreign currency bonds would not be covered in great detail as these will be introduced on a longer timetable and therefore covered in a separate familiarisation process later this year. Following the workshop, the Bank will offer bilateral training on the bidding system between mid-May and mid-June. There will then be a more formal process of familiarisation between mid-June and early August, which would culminate in a formal dress rehearsal of a gilt tender.

1.3 Michael Cross reminded the group that the Bank had circulated, on 30 March, a consultation version of its sterling monetary framework (SMF) operational documentation that included revisions covering electronic bidding and some aspects of swaps. The deadline for comments was 27 April and any further comments should be sent to the Bank urgently.

1.4 The Bank had published a revised (electronic) version of the Red Book outlining its SMF in February. This was to reflect the change in the rules governing collateral concentration limits, which had been discussed at previous MMLG meetings. There had also been changes to the operational documentation to reflect, amongst other things, the collateralisation of interest payments on repos, the changes to collateral concentration limits, and the Bank's dollar bond as eligible collateral. These changes were summarised in the 2007Q1 *Quarterly Bulletin*.

2 Settlement of self-collateralising repos (SCRs) in CREST

- 2.1 Toby Davies informed the group that, following CREST's problems last August, the Bank had been discussing with CREST and APACS members how the SCR process worked within the new SMF. These discussions had revealed a need to clarify the mechanism by which any outstanding SCRs would be rolled overnight into the Standing Facilities in the event of CREST disruption. Specifically, if CREST's core settlement process was inoperative, the Bank's securities could be released only when the settlement was restored. An orderly resumption of business would then be easier if opportunities were available to the banks to manage their own credit exposure to clients before full-scale settlement started and, separately, if the collateral could be returned in a managed fashion before settlement resumed. This raised some procedural issues which had not been tested.
- 2.2 Paul Tucker wondered whether or not the settlement banks' customers would be content for their SCR'd stock to be held by the Bank overnight, leaving them with credit exposures to their banks. David Wyatt explained that, in such a scenario, the procedure was that all intraday SCRs would be rolled into overnight transactions. The Bank already had and would retain legal ownership of collateral, even though the daylight repos could not be rolled into overnight transactions formally until CREST operations resumed. However, CREST banks would need to find a satisfactory way of clearing or managing their credit exposures to clients so that, when settlement resumed, they were not forced to 'double up' on potential credit exposure. CRESTCo also needed to consider its other customers, and ensure that they, as well as the banks, were able to achieve an orderly closure of the day.
- 2.3 David Wyatt noted that the scenarios outlined presumed CREST would be either fully operational or completely inoperative. In reality, it was more likely that some functionality would be available during any outage, which would facilitate workarounds and fixes, and particularly the provision of information on credit and other exposures. However, CREST were working to improve processes so that they can return any outstanding SCRs (after conversion into overnight repos) in a quick and orderly manner early in the subsequent trading day. The subsequent CREST day would not start until there had been an opportunity for the previous day's repos to be returned. This would require tweaks to a few bits of software

and CREST were introducing new functionality to automate some of the process the following morning. Discussions between CREST and settlement banks were ongoing at liquidity manager level. For the wider CREST membership, there would be further communication as needed, though standard documentation would mean all SCR users were aware that their collateral would be on-repo'd to the Bank and, in principle, could be held overnight in the event of a liquidity or system issue.

3 Proposed survey of money market participants, including end users

3.1 Simon Wells said that the proposed survey of the effects of the 2006 reforms of the Bank's operational framework, mentioned at previous meetings, would be sent out before the next meeting of the group. It would be sent to end users, including corporate treasurers, as well as financial institutions.

3.2 Paul Tucker said that this was part of the Bank's effort to understand how the dynamics of the sterling money markets might have been affected by the 2006 reforms. As discussed at previous meetings, the Bank was trying to understand the drivers behind the average level of secured overnight interest rates as well as isolated incidents of their falling significantly below Bank Rate.

3.3 Danny Corrigan said that the Wholesale Markets Brokers' Association (WMBA) would have a wealth of data that might help the Bank conduct analysis on the various episodes.

4 Changes to the Gilt Repo Code

4.1 John Rippon reported that a working group had been established to oversee the updating of the Code. He had written to members of the group with an agenda (the first meeting would take place in May) and a rough draft of an updated code for discussion at the meeting. The working group would discuss the details of the code and decide how to move the process forward. The working group would report to both the MMLG and SLRC.

5 Sterling money markets contingency test

5.1 Peter Andrews updated the MMLG on progress made towards a live sterling market contingency test. A plenary group of business continuity officers had

discussed the scope and objectives for the test. These discussions had revealed some practical and technical issues in contingency procedures (such as the splitting of Reuters dealing codes and restrictions in voice-recording facilities). Such issues underlined the benefits of committing to, and preparing for, a live test.

5.2 Some business continuity officers had expressed concern about the need to define more precisely the scope of the test. Meanwhile, front office managers had suggested to the Bank that there was significant support for a tightly defined live test that focused on establishing whether enough trading could be conducted from contingency sites in order to square off positions in an orderly manner. Such a test would, they envisaged, include OMOs.

5.3 Some MMLG members thought that that a better focussed and smaller steering group was needed. The size of the steering group had discouraged the type of candid discussion required in designing the exercise. Participants would need to be honest about the problems they might face for the planning to be thorough and the test successful. Similarly, members thought more focus on the scenario was required. The idea of moving all sterling trading to contingency sites and conducting ‘business as usual’ was unrealistic, since in any emergency scenario banks would seek to square off positions in as few transactions as possible, and was not what the MMLG operations sub-group had originally envisaged. There was broad agreement that conducting such a test exercise ‘for real’ would be preferable to a desktop simulation.

WIDER MARKET ISSUES

6 Reports from:

6.1 Infrastructure providers

– *LCH’s sterling GC product*

Nigel Bradley briefly summarised developments in LCH.Clearnet’s central counterparty clearing service for Sterling GC repo trades utilising CREST’s delivery-by-value (DBV) settlement mechanism, which had been launched on 14 March 2007.

No technical or procedural problems were reported. Initial volumes had reflected banks ‘dipping their toes in the water’ and were expected to grow. In particular,

activity was expected to increase following a review of RepoClear tariffs. Initial volumes of term trades had been higher than expected at this early stage.

Bank of England

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