

BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Thursday 1 February 2007

Bank of England

MINUTES

Attendees

David Hopton (Alternate)	Abbey
Peter Fingland	Association of Foreign Bankers / Bankgesellschaft Berlin
Mark Griffin (Alternate)	Alliance and Leicester
Cliff Broadhurst	APACS Liquidity Managers Group / ABN Amro
Antony Littleton	APACS
Richard Pattinson	Barclays / Chair of operations sub-group
Steve Nichols	Britannia Building Society
Alex Merriman	British Bankers Association
David McFarlane	CHAPS
David Wyatt	CrestCo
David Nicholls	Deutsche
Joanne Perez (Alternate)	DMO
Douglas Hull	FSA
Euan Harkness	Gilt-Edged Market Makers Association
Andrew Dausch	Goldmans
Ian Fox	HBOS
Jon Wood	HSBC
Danny Corrigan	ICAP
Jonathan Curry	Institutional Money Market Funds Association / BGI
Dave Lally	JP Morgan
John Burke	LCH
Rob Verillo (Alternate)	London Money Markets Association / Lehman Brothers
Clive Jones (Alternate)	Lloyds
Graham Niblock	RBS

Bank of England

Paul Tucker (Chairman)
Simon Wells (Secretary)
Michael Cross
Peter Andrews
Sarah Breeden
Roger Clews
Stephen Collins
Al Wilson
John Rippon
Stephen Denby

Apologies

Amanda Sudworth LIFFE

1. Introductions

1.1 Paul Tucker introduced Michael Cross to the group, the new Head of the Bank's Sterling Market Division. Paul Tucker also welcomed three other new members to the meeting. Andrew Dausch (Goldman Sachs) had joined the group as part of the Bank's ongoing review to ensure all types of participant in its sterling money market operations are represented; David Hopton (Abbey) as alternate for Richard Williams; and Rob Verillo (LMMA) as alternate for Ian Mair.

BANK OF ENGLAND ITEMS

2. Volatility in the overnight market over year-end

2.1 Peter Andrews summarised the Bank's understanding of moves in overnight interest rates over the year end. SONIA had fixed around 20 basis points above Bank Rate on 29 December, which was similar to the spread in euro although slightly higher than in US dollar. Liquidity appeared to have been satisfactory and some reserves account holders ran down reserves held at the Bank to benefit from higher market rates. Volatility had been fairly low.

2.2 Group members commented that the year-end had gone well. In part this reflected the five week MP, which gave banks an extra week to square up. Another factor had been increased use of SONIA swaps to hedge interest rate risk over the year end, whereas in previous years they had been more exposed in cash markets. It was suggested that more stability in overnight rates had helped improve confidence in using SONIA swaps for hedging. Some banks had also elected to increase their reserves targets during the maintenance period ending 10 January 2006 as a buffer against the additional uncertainty surrounding the year end.

2.3 Unrelated to the year end, one member noted that there had been some days since the previous MMLG meeting when gilt collateral had seemed in short supply, which had driven down secured overnight interest rates on these days. However, there had been no repeat of the situation that occurred on 31 July 2006, when an apparent scarcity of gilt collateral had driven repo rates close to zero. Paul Tucker

reminded the group that the Bank had extended the deadline for its counterparties to send (via email) notification of substitution of euro-denominated for gilt collateral in its operations (from 10:30am to 1:30pm). This change had been made to help prevent shortages of gilt collateral.

3 Update on CREST / SSE problems

3.1 David Wyatt explained that the problems experienced by CREST during the second half of 2006 (outlined at the previous MMLG meeting) had been resolved satisfactorily. CRESTCo had shared with the Bank and FSA a report on the problems that occurred during the implementation of the Single Settlement Engine (SSE), identifying a number of important lessons. The Bank had scrutinised the report and relayed comments to CREST. Actions had been or were being implemented already.

3.2 However, the period since MMLG's previous meeting had not passed without incident. A software release in mid-January had generated errors that had triggered a very significant CREST outage during the morning and led to a very late close of sterling payments. Otherwise, there had been a small number of short service interruptions and of extensions at the end of day (though these were mostly the result of customer issues). At its recent meeting, the MMLG operations sub-group had queried the number of extensions and whether enough discipline (to complete on time) was being maintained by CRESTCo in the market. David Wyatt said that there had been no obvious pattern to the extensions granted, but that CREST would work with the sub-group to analyse firm-level data in order to be sure that all extensions had been warranted.

4 Outright bond purchases and electronic bidding

4.1 Sarah Breeden referred to 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). In co-operation with the market, the Bank had made good progress in developing the necessary IT systems. A market notice on the detailed plans had been published in November 2006.

4.2 On the build of the IT systems, the Bank had just starting testing connectivity with its OMO counterparties using the SWIFT network. This would soon be followed by the publication of the appropriate operational and legal documentation. There would then be a trialling/familiarisation period for all OMO counterparties in June/July. Sarah Breeden thanked the group for the helpful engagement of their institutions.

5 Changes to the documentation for the Sterling Monetary Framework operations

5.1 Peter Andrews told the group that, following discussions during the second half of 2006, the Bank would shortly be publishing revised documentation for its SMF counterparties. The main changes would cover full collateralisation of principal and interest amounts for all term repos, the removal of the one-day grace period for breaches of the collateral concentration limits and the application of a single threshold for concentration limits for banking groups. Reflecting these technical changes, there would be minor revisions to the Red Book.

6 Proposed survey of money market participants, including end users

6.1 Simon Wells said that, owing to staff changes within the Bank, the proposed survey of the results of Money Market Reform (initially planned for 2007Q1) would now take place in early summer. This would have the advantage of allowing the survey to cover a whole year under the new operational framework.

7 Credit conditions survey

7.1 Paul Tucker confirmed that, following last year's consultation, the Bank was going ahead with its plans to conduct a quarterly survey of credit conditions along the lines of the Federal Reserve's senior loan officer opinion survey and the ECB's bank lending survey. A pilot survey targeting a subset of intended respondents would be carried out in 2007Q1 (the results of this would not be published). The first full survey would be conducted in Q2, with the results published at the same time as the results of the Q3 survey.

8 Bank of England survey on term delivery-by-value (DBV) repos

8.1 Al Wilson said that, as had been discussed at previous meetings, it had been a long-standing objective of the Bank to improve the existing mechanism for term DBVs. The Bank had discussed such an initiative with Euroclear, which in turn had informally consulted clients. These initial discussions had suggested little market appetite for a term DBV product as most term DBVs were, apparently, with the Bank in its repo OMOs. This had been surprising.

8.2 The Bank had decided to collect more information on usage of term repos and talk to market participants directly to gather more complete feedback on the term DBV mechanism. In particular, the Bank wished to establish what features an alternative term DBV product would need to have for it to be useful to the market.

WIDER MARKET ISSUES

9 Reports from:

9.1 MMLG operations sub-group

Richard Pattinson reported on the recent meeting of the operations sub-group.

- *CREST extensions*

As mentioned under item 3, the sub-group would be working with CREST to ascertain whether the recent CREST extensions were arising because of problems with systems or inefficiency of CREST members.

- *Term DBV repos*

Related to item 7, the sub-group intended to work with the Bank, CREST and LCH to develop ideas on a term DBV product. The first stage for the sub-group would be to establish how a term DBV would work operationally.

- *The market-wide flu pandemic exercise*

Members of the sub-group had contributed to the recent market-wide exercise (MWE). The general view among sub-group members was that it had been more useful than previous two exercises. In particular, it had forced participants to think about the implications of the closure of key pieces of infrastructure. In future meetings, the sub-group would discuss the potential implications from an operational standpoint and report back to the MMLG.

Stephen Collins said the Bank also thought it had been a useful exercise and that a report on issues arising from the test had been published on the FSC website, to which MMLG members have access.

– *The proposed sterling money markets test*

The proposed sterling money markets test, which had been discussed at previous meetings, was expected to take place in late May. A wide range of institutions were expected to participate, including all of the major players in the sterling money market. The external steering group for the test, chaired by Richard Pattinson, had had its first meeting. The group comprised a cross section of the sterling market, and included front office, back office and business continuity representatives of CHAPS members, the Bank's OMO counterparties and reserves account holders, and infrastructure providers. The Bank's internal steering group was chaired by Stephen Collins.

Richard Pattinson reminded the group that the proposed test was intended to be the first of a series of tests, which would get progressively more challenging. The first test would not be over zealous, although there would have to be some risks for it to be a worthwhile exercise. Richard Pattinson acknowledged that some market participants had concerns and that the steering groups would work closely with the market to address these.

9.2 Infrastructure providers

– *LCH plans for netting of gilt DBV repos*

John Burke reported on LCH.Clearnet's initiative to introduce a central counterparty service for Sterling GC repo trades utilising CREST's delivery-by-value (DBV) settlement mechanism. Testing by LCH.Clearnet members was undertaken successfully in 2006Q4. In response to the recent system difficulties experienced by CREST, an exercise was initiated between LCH.Clearnet and CREST to analyse the impact that the introduction of the central counterparty could have on sterling liquidity. The results of the analysis will be forwarded to the Bank for review. Provided no obstacles were hit, LCH.Clearnet would expect to be able to launch the product in March.

It was noted that the Bank might wait for this to launch before surveying the market about term DBVs.

9.3 Market associations

– *Impact of UCITS eligible asset criteria on sterling money funds*

Jonathan Curry updated the group on the eligibility of asset types within UCITS vehicles. Under the latest proposals, sterling money funds would not be restricted in their holdings of either bank-issued sterling CDs or euro ABCP.

10 AOB

10.1 John Rippon reminded the group that the NIPS Code is being updated, following work by the Foreign Exchange Joint Standing Committee. No changes had been proposed for the sterling sections. A track changed version of the code, showing the proposed amendments, could be made available to MMLG members, as the group is one of the bodies which helps to draw up the code.

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