BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Meeting at 11.00 on Friday 11 July 2003 in the Main Oak Room

Paul Tucker (Chairman)	Bank of England
David Rule	Bank of England
Paul Mikhailoff (Secretary)	Bank of England

Peter Fingland	Association of Foreign Banks
Ian Firth	LloydsTSB Bank
Simon Hills	British Bankers' Association
Barry Holland	London Investment Banking Association
Adrian Gray	Citibank
Antony Littleton	Association for Payment Clearing Services
Tony Main	HBOS
Ian Mair	London Money Market Association
Brian Morrison	Abbey National Treasury Services
David Morrison	Royal Bank of Scotland
Dick Newman	CrestCo
Mark Painting	Goldman Sachs
Richard Pattinson	Barclays Bank
Jason van Praagh	Rabobank
Claire Poots	Financial Services Authority
Robert Stheeman	UK Debt Management Office
Amanda Sudworth	LIFFE
Les Winnister	Association of Corporate Treasurers
Jonathan Wood	HSBC

Also present:

Roger Clews	Bank of England
Sarah Breeden	Bank of England
John Rippon	Bank of England
Alison Emblow	Bank of England

Apologies

Mike Beales	Wholesale Markets Brokers' Association
John Burke	London Clearing House
Nigel Dawes	Prebon Marshall Yamane
Euan Harkness	GEMMA

Agenda Item 1 - Introduction by the Chairman

Paul Tucker welcomed new members: Jason van Praagh (Rabobank), Mark Painting (Goldman Sachs) and Les Winnister (Association of Corporate Treasurers), and also the first attendance of Robert Stheeman (Chief Executive of the Debt Management Office). He also introduced to the group Roger Clews and Sarah Breeden, both of the Bank of England.

Changes to Bank of England Operations in the Sterling Money Markets

David Rule reported that the Bank was that morning putting out a consultative paper setting out a number of small adjustments to its sterling money market operations. There were four proposed changes. The Bank was asking for comments by 15 August, with the intention of implementing from 15 September. First, the Bank proposed to cease accepting bills of exchange drawn by a bank (so-called 'bank-on-bank' bills) as collateral in its money market operations and against intra-day liquidity in RTGS. Bank-on-bank bills outstanding on the day of implementation (currently envisaged as 15 September) would remain eligible until maturity. Second, the Bank proposed that the overnight 15.30 deposit facility should move from a secured to an unsecured basis. Third, the exchange rate used for the valuation of non-sterling collateral would be that observed at 16.00 on the previous day rather than at 9.45 on the morning of any transaction and, at the same time, the exchange rate risk element of the Bank's margin requirements would increase from 2% to 3%. Finally, the Bank proposed to publish each afternoon the maturity dates of any bills purchased outright in its money market operations. The Bank team ran through the reasons for these proposals as set out in its consultation paper.

A few preliminary comments were made. Some members thought liquidity in the bill market might decline further if the value of outstanding bills were to decrease when bank-on-bank bills were no longer eligible. One member asked whether this might deter accepting banks from preparing for CREST settlement of bills. David Rule observed there were few banks currently accepting bills drawn by other banks that did not also accept bills drawn by non-banks – so they would still need to prepare.

One member thought that the proposed 3% margin for exchange rate risk was rather high. David Rule explained that the change would bring it into line with the margin required on non-sterling collateral used to obtain intra-day credit in the Bank's RTGS and euro-RTGS systems.

Paul Tucker said that the consultation period would allow time for comments, and that David Rule was planning to hold individual meetings with each of the settlement banks and each of the Bank's counterparties in its money market operations.

Agenda Item 2 – Progress on dematerialisation of money market instruments

(a) Pro forma terms of issuance for MMIs

John Rippon (Bank of England) summarised progress. The necessary legislation had come into force in June. The Bank, on behalf of MMLG, had published *pro forma* terms of issuance for eligible debt securities as a guide for issuers that wanted to issue money market instruments into CREST. The Bank and CRESTCo had held a series of seminars for eligible banks to help them in their preparations; and they had also produced short guidance notes for issuers of all types of money market instruments. The Bank was preparing with CRESTCo some question and answer briefing to cover matters frequently raised by market contacts. The issuers' legal documentation with CRESTCo and with the Issuing and Paying Agents needed to be finalised, with a target completion date of 1 August. Issuers incorporated outside the United Kingdom would have to provide CRESTCo with legal opinions on capacity and jurisdiction. CRESTCo had said that it would accept opinions on capacity from in-house lawyers and the Association of Foreign Banks (AFB) was seeking opinions on jurisdiction for various countries on behalf of member banks.

Dick Newman (CRESTCo) said CREST system preparations were on track and there had been no major trialling issues. Work on documentation was progressing well. Peter Fingland added that most overseas banks had signed up to the AFB's collective initiative to obtain jurisdictional opinions.

(b) Migration of certificates of deposit (CDs)

Dick Newman reported that a meeting had been held earlier that week at the Bank to consider issues surrounding the CD migration. CRESTCo were planning for it to take place on Monday 13 October, with CREST open throughout the preceding weekend for input of settlement instructions. He expected CRESTCo shortly to publish its Blue Book setting out the approach to migration.

David Rule explained that the meeting at the Bank had followed questions raised at the June meeting of the Stock Lending and Repo Committee. He thought that good progress had been made and the market was close to a consensus on how to approach the migration, based on stock lenders accepting cash collateral in CREST intra-day on the Monday morning as a substitute for CDs during the process of redemption in Central Moneymarkets Office (CMO) and reissue in CREST. The Bank would be posting a note on its website later that day (a copy is attached to these minutes). He hoped that both stock lenders and stock borrowers would, as far as they judged prudent, continue their business as usual through the period in order to minimise any reduction in liquidity in the CD or gilt repo markets.

Paul Tucker stressed that if there were any concerns ahead of migration, it was important that they were clearly expressed and understood. One member said that the great majority of the market was content. Another member said that it would help to reduce the need for intra-day credit on the Monday morning if some of the bigger stock lenders could be persuaded to accept letters of credit from settlement banks in substitution for pledged CDs. He added that if problems were experienced with the migration process and the intra-day CREST payments to the stock lenders did not return as quickly as planned, it would be helpful if, temporarily, the Bank could consider greater flexibility in the collateral it was willing to accept for intra-day credit in RTGS.

(**c) Treatment of Eligible Debt Securities in Bank of England money market operations**

David Rule confirmed that the Bank would continue to accept as collateral in its money market operations, and for intra-day credit in RTGS, the equivalents of Treasury bills and eligible bank bills once issued into CREST. After CMO had closed, the Bank would no longer accept any remaining physical securities.

Agenda Item 3 – MMLG CD notice

John Rippon said that at the previous MMLG meeting the consensus had been that MMLG should produce a successor to the 1996 notice to reflect the general dematerialisation of money market instruments and the CREST settlement developments, but that otherwise the key elements of the 1996 notice should be preserved. A second consultation document and draft notice would be issued soon (it was issued on 14 July), seeking comments by 1 August.

He asked the group in particular whether the notice should specify a minimum transfer amount and minimum unit value for any units of a CD above this amount. The new draft notice envisaged a minimum transfer amount of £100,000 so that CDs could not be issued and traded in an amount less than £100,000; and a unit value of one penny, so that CDs could be issued and traded in any amount above £100,000 down to a penny. This would help to ensure that the CD market remained a wholesale market whilst taking advantage of dematerialisation and CREST settlement to give the maximum flexibility for trading in units above the £100,000 minimum. An alternative approach would be to have a unit value of say £100,000, which would be consistent with the current approach for negotiable CDs. The consultation also raised a few other questions, including whether *London CDs* could be guaranteed by non-banks. John Rippon said that the intention was to finalise the notice before CDs began to be issued into CREST.

John Rippon noted that the BBA would be considering in parallel what guidance might be given on unit values and minimum transfer amounts of other money market securities. This would take account of the implications of the FSMA Regulated Activities Order for commercial paper and the results of the consultation on the CD notice.

Agenda Item 4 – BBA Market Guidelines on money market securities

Simon Hills (BBA) said that the BBA planned to issue an interim document around 15 August, covering CDs, commercial paper and bankers' acceptances. This would be largely a compendium of existing documents and was intended to help the market in the final stages of preparation for the transition. The intention was to produce later fuller guidance notes on money market securities, which could reflect the experience of the transition.

Agenda Item 5 – Contingency Planning

Alison Emblow (Bank of England) said that, following its consultation on possible emergency powers to respond to financial disruption, HM Treasury had decided not to proceed with legislation at this time. But a task force had been set up, chaired by Sir Andrew Large, to make recommendations on the need for, and possible form of, a legislative response to the threat of major operational disruption in the UK financial system. Three working groups had been set up to look at implications for contract law (such as force majeure), structural and regulatory powers, and infrastructure issues (such as payment systems and power supplies); two MMLG members, Adrian Gray (Citibank) and Simon Hills (BBA) were sitting on working groups. The task force planned to make an interim report in early November and its final report by the end of February.

Agenda Item 6 – Any other business

Sarah Breeden (Bank of England) said that the final recommendations of the ACI Financial Markets Association's Task Force on the integration and development of the short-term securities market in Europe – the so-called ACI STEP initiative - were expected to be released in the early Autumn. While the focus of the initiative was on developing the market in short term euro-denominated securities (including euro-denominated issues in the London-based Euro commercial paper market), the proposals were intended by the ACI to be wide ranging – including, for example, sterling short-term paper – if issuers and investors so wished. It was also possible that the STEP recommendations might become a de facto market standard for short-term securities. Thus the recommendations would perhaps be of relevance to those active in such securities in London, even if only in sterling markets, and she encouraged MMLG members to ensure that their firms offered comments on the recommendations with this context in mind.

Paul Mikhailoff (Bank of England) reported that the Bank would soon undertake a review of its quarterly statistical survey of gilt repo and stock lending, the results of which are published in Monetary and Financial Statistics, the Bank's monthly statistical bulletin. The results of previous surveys had been discussed at MMLG in the past. The Bank intended to contact institutions that already contributed to the survey together with any others that were active in the markets, including recent entrants. One possibility being considered was to extend the survey to include corporate bond and possibly equity repo and stock lending. The purpose of the review was to ensure that the information in the survey continued to meet the needs of market participants and the Bank.