

BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Wednesday 19 July 2006

Bank of England

MINUTES

Attendees

Peter Lightfoot (Alternate)	APACS Liquidity Managers Group
Ian Hares	Alliance and Leicester
Antony Littleton	APACS
Richard Pattinson	Barclays
Alex Merriman	British Bankers Association
John Ewan	British Bankers Association
Richard Turrell	CrestCo
David Nicholls	Deutsche
Robert Stheeman	DMO
Douglas Hull	FSA
Euan Harkness	Gilt Edged Market Makers Association
Phil Rawlins (Alternate)	HBOS
Mike Wareham (Alternate)	HSBC
Jonathan Curry	Institutional Money Market Funds Association
Dave Lally	JP Morgan
John Burke	LCH
Amanda Sudworth	LIFFE
Clive Jones	Lloyds TSB
Ronny Maiti	LMMA
Graham Niblock	RBS

Bank of England

Paul Tucker (Chairman)
David Rule
Toby Davies (Alternate)
Simon Wells (Secretary)

Apologies

Cliff Broadhurst	APACS Liquidity Managers Group
Peter Fingland	Association of Foreign Bankers
Alastair Wilson	Bank of England
David MacFarlane	CHAPS
Ian Fox	HBOS
Jon Wood	HSBC
Nigel Dawes	Prebon

In attendance (Bank of England)

Peter Andrews
Roger Clews
Sarah Breeden
Stephen Denby
Sumita Ghosh
John Rippon

1 **Introduction**

1.1 Paul Tucker said that, following the reforms to its money market operations, the Bank had reviewed MMLG membership to ensure that all types of participants in its operational framework (eg reserves scheme banks, banks with access to the standing facilities) were represented. As a first step in filling identified gaps, Paul Tucker welcomed Ian Hares (Alliance and Leicester) to the group. Paul Tucker also reintroduced Peter Andrews, a former head of the Bank's Sterling Markets Division, who would be involved in the Bank's liaison with sterling markets for a six month period from September before becoming the Bank's Regional Agent for London.

BANK OF ENGLAND ITEMS

2 **New framework for money market operations**

2.1 David Rule reported that, at least from the Bank's point of view, the change to the new framework had been smooth so far. Members agreed that the changeover had gone well.

3 **Changes to mechanics for payment of interest on OMO gilt DBV repos**

3.1 David Rule explained that the Bank wished to eliminate the unsecured intraday exposures to its OMO counterparties that arose owing to interest payments on term gilt DBV repos. The exposures occurred because gilt DBV collateral is returned to the counterparty automatically in CREST against the principal amount of the repo first thing in the morning on the day of maturity, whereas interest is paid separately outside of CREST later in the day. The amounts involved had increased since the launch of the Bank's money market reforms and so needed to be addressed. Members said that it was important that the solution adopted was straightforward to implement operationally. The Bank would consult with counterparties on possible solutions.¹

4 **Changes to implementation of Bank collateral concentration limits**

¹ Subsequently, David Rule wrote to OMO counterparties on 26 July inviting comments on the preferred method to eliminate this exposure.

4.1 David Rule said that the Bank had decided to remove the current one-day grace period for breaches of its collateral concentration limits. In future, overnight and intraday breaches would be subject to an immediate one-day interest charge. This was a response to persistent one-day breaches notwithstanding the discussions at previous MMLG meetings. In addition, the Bank intended to amend the concentration limit provisions so that in future the £1 billion threshold above which the concentration limits apply would be calculated on a group basis.

4.2 One member pointed out that it might be difficult to comply with the change on Thursdays when the Bank did not allow collateral substitutions. David Rule agreed to seek feedback on any issues raised by the change ahead of implementation.

5 Bank use of ICSD ‘links’ for settlement of RTGS and OMO repos

5.1 David Rule reported that the Bank was considering accepting delivery of euro-denominated government bond collateral using Euroclear and Clearstream ‘links’ into national central securities depositories (CSDs). At present, the Bank only accepts delivery of euro-denominated collateral into national CSDs via the Correspondent Central Banking Model; that facility would continue under any new proposals. The Bank would write to OMO counterparties and settlement banks in order to gauge their demand for the use of these links.²

6 Proposed survey of money market participants, including end users

6.1 David Rule noted that the Bank’s objectives for its reformed operations in the sterling money markets included creating a simple, straightforward and transparent operational framework, and competitive and fair sterling money markets. To help assess the degree of success in meeting these objectives, the Bank intended to conduct a survey of sterling money market intermediaries and end-users. Before conducting the survey, the Bank would write to MMLG members requesting feedback on proposed questions and the optimal timing of the survey.³ Initial reaction from group members was that at least six maintenance periods would be required before the survey could be conducted reliably, pointing to conducting the survey in 2006Q4.

² Feedback was requested in David Rule’s letter of 26 July.

³ Views were sought in Simon Wells’ letter of 2 August.

7 **Provision of longer-term financing through outright bond purchases**

7.1 Sarah Breeden outlined the Bank's plan, announced on 15 May, to provide longer-term finance to the banking system via outright purchases of gilts and high-quality foreign currency government bonds (with the foreign-currency cash flows swapped into fixed-rate sterling). The Bank would shortly be issuing a consultation paper setting out the background to the proposals and the principles underlying the purchases and management of the resulting bond portfolio.⁴

7.2 The paper would also seek feedback on a proposal that the Bank should move to electronic bidding for all its OMOs. The consultation process was welcomed by group members, who highlighted that any electronic bidding system would need to be rigorously tested given experience in other countries.

8 **FSC Website / test conference call**

8.1 Simon Wells reported that the new contact cards contained details for a secure area on the Financial Sector Continuity website. This included key contact and contingency information for members. Members were also reminded of the imminent test of the conference call facility.⁵

WIDER MARKET ISSUES

9 **Reports from:**

9.1 **MMLG operations sub-group**

- Richard Pattinson reported that the sub-group wished to make a contribution to the industry-wide contingency test starting in October. The test would constitute a flu pandemic-type scenario played out over a six week period. The sub-group's involvement could constitute regular physical meetings with game players during October or virtual meetings (e.g. with members replying to a weekly email). The sub-group thought the latter approach would allow for wider involvement. MMLG members agreed with the sub-group's recommendation. It was also agreed that,

⁴ The paper, issued on 27 July, is available at www.bankofengland.co.uk/markets/money/documentation/consult_bond_purchases.pdf

⁵ Following the meeting, a test was conducted on 21 July. All group members who were expected dialled in successfully with three exceptions (GEMMA, Lloyds and AFB).

ideally, the autumn meeting of the MMLG would take place at some point during the six week industry-wide test. David Rule said that the Bank would investigate how MMLG could be involved in the test.

- Richard Pattinson also outlined options for the a contingency test for the sterling money market that the sub-group had discussed. This related to the findings of the FSA's resilience testing work, which identified that a gap in testing was the simultaneous use of back-up facilities. The three options identified to facilitate simultaneous moves to back up sites were: (i) full moves for *large parts* of the sterling money market and market infrastructure; (ii) full moves for *certain parts* of the sterling money market and market infrastructure; (iii) for *elements of certain parts* of the sterling money market and market infrastructure with sufficient staff and systems left at main sites to allow rapid reversion if necessary. Option (iii) was preferred by the sub-group as this gave an initial test that was most likely to be successful and allowed the scale of testing to be built up subsequently.
- Some members noted that many contingency sites were shared, so it was important to conduct simultaneous testing. Also, it was vital that firms used their actual backup plans in any test. Any exercise should be conducted on a day when the Bank was implementing OMOs, but it was agreed it should test more than the ability to participate in Bank OMOs. Members were in favour of testing more than one part of the sterling market simultaneously, provided institutions retained the capacity to revert to main sites if contingency sites failed. Ideally any test would take place within the next six months and it was agreed that the sub-group would take forward the agreed approach, including assessing the extent of preparatory work.

9.2 LCH plans for netting of gilt DBV repos

- John Burke updated the group on LCH's initiative to develop central clearing of gilt repos using CREST's delivery-by-value (DBV) service. Since the March MMLG meeting, some key features had been finalised. In particular, the 'shape' size had been set at £250 million and the cut-off time for receiving DBV trades in LCH had been set at 14:30.

- Testing was due to commence in September and there had been a positive initial reaction from liquidity providers.

9.3 Euroclear consultation paper on securities financing for the Single Platform

- Richard Turrell reported that publication of a service description, expected at the end of July, had been postponed until September.
- Euroclear intended to offer a DBV facility for the UK market. Investigation of the case for a term DBV product (ie keeping DBV transactions intact during the day for term trades) would take place later. Paul Tucker underlined the Bank's interest in such a product. Andrew Bailey, Executive Director for Banking Services, had written to Euroclear SA outlining the direct benefits of a term DBV product to CREST's users and their settlement banks and the indirect benefits from a potential reduction in risks to the financial system.

9.4 BBA LIBOR business continuity proposals

- John Ewan presented the BBA's proposals for how LIBOR would be fixed in exceptional circumstances. If the BBA itself was unable to function, the Bank could play a role in instructing Reuters to calculate LIBOR and, if necessary, act as arbiter for any issues arising. Reuters being unable to operate was not seen as a significant risk, given the extent of their global contingency measures. Contingency arrangements in the event of members of the LIBOR panel being unable to contribute to the fixing were also proposed. These included publishing using a depleted panel and/or delaying the time of publication.
- MMLG members offered a range of views in response to the proposals. Some members thought it was important that LIBOR remained an 11:00 fixing and that, if publication needed to be delayed, it might be unrealistic to ask banks to submit an 11:00 rate well into the afternoon. LIFFE already had contingency arrangements in the event that LIBOR could not be published. There was a case for basing EuroLIBOR rates on Euribor rates EuroLIBOR could not be fixed normally. The BBA would consult further, on a bilateral basis if necessary, and revert to the MMLG at the next meeting.

9.5 IMMFA report on impact of UCITS eligible asset criteria on sterling CD market

- Jonathan Curry updated the group on the CESR proposals for the eligibility of asset types within UCITS vehicles. The proposals were currently with the European Commission. London CDs were expected to remain eligible. The situation regarding asset-backed commercial paper (ABCP) was less clear. Under the current proposals, steps could be taken to make ABCP eligible, although there were costs associated with them.

9.6 Recent volatility in secured/unsecured spreads

- Ronny Maiti led a discussion on recent volatility in overnight unsecured /secured interest rate spreads. In large part, the size of the spread depended on whether banks that were short of cash (and not part of the Bank's reserves scheme) took funds from the secured or unsecured market. Spreads could widen if participants that had access to the secured market only were long of cash and needed to accept unfavourable interest rates on the cash in order to obtain gilt collateral. Collateral shortages occurred largely without warning, although could be anticipated to some extent around quarter and half-year ends because of the decrease in the flow of gilts into the repo market via stock lending, associated with a reduction in intermediaries' CD holdings. Other factors influencing secured/unsecured spreads included the availability of T-bills, now that they were popular in DBV.

10 Gilt repo code

10.1 David Rule reported that, in conjunction with the Securities Lending and Repo Committee (SLRC), the Bank was resuming work on the revision of the gilt repo code. This was relevant to MMLG given members' involvement in repo markets. The MMLG and its sub-group should therefore be involved in the group revising the code. Peter Lightfoot had already volunteered to represent the MMLG sub-group. Members wishing to offer input should inform John Rippon⁶, who was chairing an SLRC sub-group on the code.

⁶ john.rippon@bankofengland.co.uk.

11 2006 work programme

11.1 The Bank circulated the latest work programme at the meeting. David Rule reminded members that the Bank welcomed any comments/suggestions.

12 MMLG table on decision-making in a crisis

12.1 The contingency matrix had been updated to reflect the new framework for the Bank's operations in the sterling money markets and was publicly available on the Bank's website.⁷

13 AOB

13.1 MiFID's best execution requirements

Several group members from the private sector raised the FSA's discussion paper on implementing MiFID's 'best execution' requirements. Group members reported that many market participants (buy side as well as sell side) had reservations about the paper. The FSA representative noted that the paper had been issued for discussion and encouraged feedback.

13.2 Credit conditions survey

Paul Tucker said that for many years the Bank had conducted an informal credit conditions survey of major UK banks. The Bank would be consulting the market later in the year regarding the possibility of making this process more formal and more frequent, along the broad lines of the quarterly US Loan Officer Survey conducted by the Federal Reserve.

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⁷ http://www.bankofengland.co.uk/markets/money/contingency_matrix060317.pdf