

STERLING MONEY MARKETS LIAISON GROUP - CONTINGENCY PLANNING RATES SUB-GROUP

Minutes of a meeting at the Bank of England on 5 June 2002

Present:

Richard Pattinson (Chairman)	Barclays
Bob Brown	WestLB
Graham Forster	LloydsTSB
Bill Goss	Credit Lyonnais
Paul Mikhailoff (Secretary)	Bank of England
Bob Brown	WestLB
Graham Forster	LloydsTSB
Mark Painting	Goldman Sachs
Lesley Poltock	JPMorgan
David Reid	Dresdner Kleinwort Wasserstein
John Rippon	Bank of England
Jim Snookes	National Australia Bank
Neil Snowdon	UBS Warburg
Mike Wareham	HSBC

Apologies were received from Adrian Gray, Citibank and Nick Hodge, Rabobank

The Chairman read out the terms of reference and asked members to confirm their understanding of and agreement to them.

“To propose to MMLG non-binding guidelines for the interest rates that might be applied to unexpected long and short balances in the event of major market disruption or infrastructure failure.

The proposals might be in the form of various options with pros and cons in different circumstances.

The sub-group might helpfully review practice in other markets and note relevant past events in the sterling market.

Background: relevant section of the NIPS code.” (Paragraph 106 gives the Bank of England discretion to determine and publish the rate(s) to be applied in such circumstances)

Members confirmed their understanding. The Chairman said that although any proposed guidelines were non-binding they would be expected to be given weight in the Bank's determination of rate(s). The sub-group was giving a recommendation rather than setting out options. The Chairman informed the group that CLS were considering approaches adopted in constituent markets and would in due course publish these.

As background the Chairman pointed out that no ground rules for compensation existed in London, adding that the purpose of the sub-group was not to discuss undue enrichment in a day-to-day context but to consider the best way to deal with a major event involving a prolonged interruption to the working of the settlements/payments infrastructure. The recent Crest interruption was referred to, the Secretary suggesting that that event could have developed into an outage approaching the scale of event that the sub-group was asked to consider.

The Chairman said that events in other international markets, though of interest, were probably of more relevance in their own context given differing short date conditions and operational techniques. A member of the group helpfully pointed out that on 11 September NY markets followed long-established NY Clearing House guidelines applying the effective Fed funds rate of the day plus an administration fee for displaced balances. It was pointed out that the funds target may have been better because the effective rate might not have been able to have been formed, but the Fed on that day made sure the effective rate was very close to the funds target. It was mentioned that a Federation Bancaire agreement existed between European banks to apply EONIA +/- 25 bps to compensation claims in respect of ordinary business. But the present group was not discussing general compensation arrangements.

The Chairman mentioned a range of scenarios - a Crest specific problem, a CHAPS problem, a SWIFT problem or a systems failure affecting one settlement bank for example.

If Crest had a major interruption, settlement banks could do some recycling but there would still remain long and short positions arising from failed cash transfers which would have been the counterparts to gilt and equity movements. What rate should be applied? If CHAPS was unable to complete the day's payments, what rate should be applied to the residual positions?

If a settlement bank could not function the Chairman suggested that the other settlement banks could achieve some liquidity recycling. But there would be bound to be residual longs and shorts. If RTGS failed, it was noted, CHAPS by-pass was a flexible mechanism for clearing up large positions.

In any event, the group felt there need be no difference between the approach applied in all these various possible situations – long and short positions would result because of an inability to complete the day's business in one or more of the settlement and payment systems.

The Chairman then asked the group whether a spread of rates, as applied to settlement bank long and short positions on the day of the recent Crest interruption, was

appropriate in the event of a disruption of the scale being considered by the group. There was unanimous agreement that there should be no spread. The location of long and short positions would be arbitrary. There seemed no point in penalising either party. How could any spread be determined anyway? The group also saw no justification for the application of administration fees, it being unclear what the concept meant in this context. And in any event administration costs tended to net out between parties. It was noted that at the time of the 1987 hurricane and a 1990 CGO interruption, rates very close to the policy rate had been used.

The Chairman then asked the group, if there was to be one rate, which rate should it be? What if the market had been dealing that day? Some deals may have been struck? There were several arguments. The first speaker thought the Bank's repo rate was the only choice, any SONIA-type rate was open to challenge and would take time to determine and, indeed, might be impossible to determine following a major disaster. Then the use of the previous day's SONIA was suggested or some long-run average of it, but the next two speakers thought this quite inappropriate – repo was right. Although another member thought there was merit in considering how a BBA-type panel might be used to arrive at some average mid-rate, the majority thought it would be too slow and complex and again open to challenge: use repo, which was a neutral and certain rate. The aim was to give rapid certainty and transparency to the market. It was also felt that deals agreed before any disruption occurred should stand at the rates at which they were struck.

If the MPC had sat on the day of the disruption, the repo rate to be applied to the balances at the close should be that announced by MPC at noon.

Maturing transactions, if extended because of the inability to return funds, should run on at the Bank's repo rate, not the rate applicable to the original transaction.

The Chairman summarised the recommendations to be put to MMLG. Apply the Bank's repo rate to unexpected long and short positions in both the secured and unsecured markets where these have arisen from major systemic disruption or failure. Money market trades executed that day before the disruption should stand at the rates agreed.

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Post Script: the Chairman of the sub-group has commented that, in the event of such an emergency, there may need to be agreement to use the recommended rate in the APACS end of day transfer system.

