

BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Meeting at 3pm on 29 June 2005

Paul Tucker (Chairman)	Bank of England
Ben Wensley (Secretary)	Bank of England

Alex Merriman	BBA
Amanda Sudworth	LIFFE
Andrew Thursfield (alternate for Adrian Gray)	Citigroup
Antony Littleton	APACS
Clive Jones (alternate for Ian Firth)	Lloyds TSB
David Lally	JP Morgan
David Nichols	Deutsche
Douglas Hull	FSA
Euan Harkness	GEMMA
Graham Niblock	RBS
Ian Fox	HBOS
Jo Whelan (alternate for Robert Stheeman)	DMO
John Burke	LCH
Jonathan Curry	IMMFA
Jonathan Wood	HSBC
Nigel Dawes	Prebon
Peter Fingland	AFB
Ronny Maiti (alternate for Ian Mair)	LMMA
Warren Alsop (alternate for Robert Fair)	CRESTCo

Also present

Roger Clews	Bank of England
Richard Wellington	Bank of England
John Rippon	Bank of England
Barry Harrison	Bank of England
Sumita Ghosh	Bank of England
Kieren Wright	Bank of England
Howard Jones	Bank of England

Apologies

Barry Holland	LIBA
David Hynes	Morgan Stanley
David McFarlane	CHAPS
Richard Pattinson	Barclays
Ian Stevenson	WMBA
Tim Hayter	ACT

BANK OF ENGLAND POLICY ITEMS

Agenda Item 1 – introduction

Paul Tucker said that, following conversations with members, the Bank had decided to change the format of MMLG meetings in order to make a greater distinction between discussion of developments and issues affecting the sterling money market where the Bank was in the chair as facilitator, and discussions about official Bank policy. “Bank of England official policy items” would be covered first, followed by discussions of wider market issues led by MMLG members, including regular reports, as needed, from infrastructure providers, trade associations, FSA and DMO. Short notes on items for discussion would be circulated to members ahead of meetings.

Agenda item 2 – Money market reform (MMR) update

Richard Wellington reported that the responses to the questionnaire circulated in April had indicated that most participants were well advanced in their preparations and on track to meet a go-live date in the proposed March-June 2006 period, although there were some differences in the preferred date within this period.

He also mentioned that an external communications policy document would shortly be issued by the Bank to prospective participants (its since been released).

In David Rule’s absence, Paul Tucker said that a new version of the Bank’s operational notice describing the detailed procedures for its reformed money market operations would be issued in draft form during July and asked that any comments be provided to David Rule’s team at the Bank well ahead of it being finalised. He also mentioned that an independent review of the Bank’s MMR implementation programme had found it to be proceeding as planned. He finally noted that the Bank was currently looking at ways of managing the increase in the size of its balance sheet with the addition of remunerated reserves following MMR. It was likely that the Bank’s sterling operations team would consult OMO counterparties over the summer/autumn.

WIDER MARKET ISSUES

Agenda Item 3 – Reports from:

a) APACS Liquidity Managers Group (LMG)

Antony Littleton noted that the LMG was producing guidelines for a sterling compensation scheme along the lines of the Euro and US dollar schemes. The draft guidelines would be circulated shortly among interested parties (including MMLG members and the BBA) for comment, ahead of the implementation of the proposed scheme, planned to be around the same time as the launch of the Bank's reformed money market operations.

b) Infrastructure

- **LCH.Clearnet**

John Burke reported that an alteration to LCH's IT platform had pushed back the timing of the introduction of their services for gilt DBV repo and gilt repos linked to SONIA. He also mentioned a recent large increase in gilt repo clearing through LCH, with €7 trillion equivalent term-adjusted gilt repo being processed in May (up from €3 trillion a year earlier), bringing the volume close to the equivalent German government bond repo figure cleared by LCH.Clearnet in the same month.

- **LIFFE**

Amanda Sudworth noted that activity in the short sterling futures market, which had already grown strongly over the past year, had noticeably accelerated in recent months. Volumes in future contracts in May had reached a record monthly high with a daily average of 320,000 contracts (2005 average had been 260,000 contracts). In addition, a record number of contracts, 828,000, were processed on the day that June's MPC minutes were released. She wondered whether activity had in part been boosted by trading activity being switched from less volatile euro markets.

She also pointed out that growth had been even stronger in short sterling options over the past year, with volumes doubling over the past 12 months. A practitioner thought that the recent growth in call options had been driven by relative value hedge funds moving to cover delta positions.

c) Market associations

- **BBA**

Alex Merriman reported that there had been some slight changes to the BBA's LIBOR panels; this included the replacement of Bayerische Landesbank on the sterling panel by Citibank.

- IMMFA

Jonathan Curry noted that IMMFA were currently lobbying to get more favourable capital treatment for money market fund investments under Basle II. Money market funds currently attracted a risk weighting of 100% but they hoped under the new regulations to be treated the same as bank deposits. While this would make them a more attractive product for liquidity management, he acknowledged that it could be at the expense of inter-bank deposits.

Agenda Item 4 – Updating the NIPS code

Howard Jones (Bank of England) reported that the updated code was now available in draft form for comment¹; the last major revision had been carried out in 2001. He asked members to provide any comments to the Bank by 29 July so they could be incorporated in a final draft, which would be re-circulated ahead of the code being published in the Autumn.

Agenda Item 5 – Update from LIFFE on the possibility of OIS futures in sterling and tick size for short sterling contract

Amanda Sudworth reported that further consultations had taken place between LIFFE and interested parties on the possibility of introducing a sterling OIS future and reducing the tick sizes in short sterling.

On the possibility of sterling OIS futures, Ronny Maiti (LMMA) described a meeting at LIFFE attended by the main traders in the SONIA market at which the issue had been discussed. A number of attendees had opposed the introduction of a futures contract.

Amanda Sudworth said LIFFE was not planning to explore the possibility of a sterling OIS futures contract further at this stage. But it could be revisited at a later date, not least because there seemed to be some demand among end-users.

She also noted that broadly half of those surveyed (and spoken to) had been opposed to the introduction of half-basis-point tick sizes in short sterling, so LIFFE was going to remain with the current tick sizes for the time being. Ronny Maiti thought banks

¹ The draft version was provided at the meeting and circulated electronically afterwards.

were generally in favour of half tick sizes but were mindful of the need for liquidity across tick sizes.

Amanda Sudworth said LIFFE were currently working on something that might appeal to both sides of the tick size debate, but would be unable to provide details before the Autumn. In the interim, LIFFE were allowing trading packs and bundles to be used so that the bid-offer spread per contract could potentially be reduced. They would also be conducting further visits to gauge the degree to which half-tick sizes were being used in OTC contracts.

Agenda Item 6 – Activity and liquidity in the sterling money market

Ronny Maiti introduced the agenda item on behalf of the LMMA. He noted concerns among some of its members that there had been less activity in cash instruments in the sterling money market over the past year, which they thought might in part relate to the increased stability in overnight rates. This had been seen particularly in the CD market for issuance with a maturity of three months or below.

The reduced activity had increased the concentration of issuance and investment among the remaining active participants, mainly the large clearing banks, which, in turn, meant buyers were increasingly constrained by their inter-bank limits. One practitioner was concerned that growth in interbank exposures between the large UK banks, arising from purchases of each others' CDs, had reduced the liquidity value of CDs in an emergency. Another view was that there would be more reason to worry if weaker investor demand spread to longer-dated paper.

One member remembered a similar discussion at a MMLG meeting in 2002, and thought, as was the case then, any reduction in activity was mainly due to derivatives offering a more capital efficient way of expressing rate views than money market instruments. Ronny Maiti acknowledged this was a factor but thought, nevertheless, that it could make it difficult for banks to raise funds via CD issuance in order to obtain collateral for use in OMOs. Paul Tucker said the Bank's Sterling Markets Division was assessing the possible effects of MMR, alongside other developments, on the money market, including utilization of inter-bank limits, and this was likely to involve further conversations with members.

Another view expressed by a member was that the CD market had not really recovered from the retrenchment of the German banks as issuers a few years ago.

They also thought that weak investor demand recently had related to the flatness of the money market yield curve.

Ronny Maiti wondered whether the discussion might be better informed by a clearer picture of where the reduced activity, if anywhere, was concentrated – eg which types of instruments and at which maturities. Paul Tucker agreed and said the Bank's Sterling Market Division would investigate ahead of the next MMLG meeting.

Agenda Item 7 – AOB

Ronny Maiti reported that the Bank's counterparties had welcomed the successful outcome of the operational test involving the Bank taking US Treasuries as collateral (as might happen in certain emergencies). Paul Tucker said the Bank was similarly pleased and anticipated the exercise being repeated annually.

Bank of England