BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Meeting at 3.00 on Tuesday 18 March 2003 in the Main Oak Room

Paul Tucker (Chairman)	Bank of England
David Rule	Bank of England
Paul Mikhailoff (Secretary)	Bank of England
Mike Beales	Wholesale Markets Brokers' Association
John Burke	London Clearing House
Robert Fair	CrestCo
Ian Firth	LloydsTSB Bank
Nick Fisher	UK Debt Management Office
Ian Fox	HBOS
Adrian Gray	Citibank
Euan Harkness	GEMMA
Tim Hayter	Association of Corporate Treasurers
Simon Hills	British Bankers Association
Barry Holland	London Investment Banking Association
David Hynes	Institutional Money Market Funds Association
Antony Littleton	Association for Payment Clearing Services
David Morrison	Royal Bank of Scotland
Pavel Pinkara	LIFFE
Claire Poots	Financial Services Authority
Richard Vardy	LMMA
Jonathan Wood	HSBC

Also present

Dan Lambeth	H M Treasury
Adrian Hilton	Bank of England
Howard Jones	Bank of England

Apologies

Amanda Sudworth (LIFFE)
Joan Lavery and Peter Martin (CIPFA)
Peter Fingland (Bankgesellschaft)
Robert Stheeman (DMO)
Lindsay Mackay (HBOS)
Richard Pattinson (Barclays Bank)
Brian Morrison (Abbey National Treasury Services)
Nigel Dawes (Prebon Marshall Yamane)
Ian Mair (London Money Market Association)

Agenda Item 1 – Introduction by the Chairman

Paul Tucker welcomed the new members: Robert Fair (CrestCo), Tim Hayter (ACT) and David Hynes (IMMFA).

Agenda Item 2 – Progress on Dematerialisation of Money Market Instruments

Howard Jones (Bank of England) reported that a second consultation document on *pro forma* terms of issuance for eligible debt securities in CREST would be published shortly [it was published subsequently on 24 March for comments by 18 April 2003]. This would respond to the issues raised in the first consultation and include revised terms and explanatory notes. Howard Jones drew attention to two of the issues highlighted in the document: whether the terms should be drawn up such that the main body contains only the legal terms necessary for the constitution and issue of the securities, with commercial terms in an annex (which would follow the model of many standard industry master agreements such as the ISDA Master and allow the main body of the deed to be a fixed standard); and how to find the least onerous way of bringing drawers into the contractual arrangements for the electronic equivalent of bankers' acceptances. He also referred the group to the facility for electronic notices and the possibility of using the IPA Issuance Message, which could, if needed, include a "box" to indicate that a CD was a "London CD".

Rob Fair (CRESTCo) gave an update on the progress of CREST's preparations for settlement of money market instruments. Design work was complete and the building of software well under way. The approach to member trialling was being discussed with market participants.

Rob Fair said that CRESTCo's proposed approach to migrating from CMO to CREST was being presented to the market currently. First, the CMO counter would close and all new issuance take place through CREST. Then, over a series of weekends, outstanding instruments in CMO would be migrated across (ie the paper instrument in CMO cancelled and a replacement instrument issued into CREST on the same terms) – first euro-denominated instruments, then Treasury bills, then bankers acceptances and finally CDs. No major objections had been raised, Rob Fair said. CRESTCo was keen to reduce parallel running costs and hence the decision to migrate across outstanding instruments rather than to allow them to run off in CMO over a prolonged period.

One member mentioned the brief liquidity squeeze in the gilt general collateral repo market at the end of January. He was concerned that a similar squeeze might occur again if CDs used as collateral for gilt stock loans were withdrawn from that market over the weekend of the CREST migration. Rob Fair responded that CRESTCo would consider the views of market participants on this point. One possible alternative was to phase the migration of CDs over two weekends; another was to grant a longer window allowing, if the timetable permitted, individual holdings of CDs to be migrated across in advance of the deadlines. Mr Rule said that the Bank would keep an eye on the issue.

Members discussed the possible causes of the gilt repo liquidity squeeze in January. It was agreed that a number of factors including the month-end, the nature of the positions held by some large market participants, the recycling of tax payments by DMO, increased holdings of gilts by life insurers which had not entered into stock lending agreements and, perhaps, a contraction in principal intermediary activity could all have played a part. Nick Fisher (DMO) said that DMO had a facility to relieve squeezes in particular stocks in their role as debt manager, but this did not address a shortage of general collateral available for settlement of secured money market transactions using the delivery-by-value (DBV) mechanism in CREST. Members said that gilt general collateral repo liquidity had returned and there was no continuing or structural problem.

Agenda Item 3 – Presentation of New Crest Repo Functionality

Rob Fair (CRESTCo) updated the Group on CRESTCo's proposed new mechanism for term repo settlement. He explained that, while it was being introduced to support repo of money market instruments, it could also be used to support settlement of term repos of other CREST securities, notably gilts. A new enquiry facility would also show counterparty exposures aggregated across different transactions. CRESTCo had received numerous expressions of interest from market participants, was considering how to progress the market practice issues involved and would include a request for views in its next newsletter.

David Rule said that the Bank saw merit in the proposed settlement mechanism for term gilt repo if it would allow term, general collateral repos to remain 'intact' during the day whereas at present such transactions often take the form of an agreement to enter into a series of overnight DBV transactions in CREST, giving rise to large intra-day payment flows and exposures between CRESTCo members and their settlement banks.

Agenda Item 4 – Consultation on possible revised version of the CD Notice of November 1996

David Rule (Bank of England) said that the 1996 Bank of England notice setting out guidelines to standardise the terms of paper 'London' CDs needed replacing in the light of the planned issuance of CDs in electronic form into CREST. He asked members whether the guidelines and, in particular, the concept of a 'London' CD were likely to remain useful to market participants or whether knowledge that CDs had been issued into CREST would in future give sufficient information. If a notice was thought useful, what were the important characteristics of a 'London' CD? Was it necessary or even meaningful to stipulate a minimum issue size for a CREST security (as opposed to paper instruments)? And did members agree that the notice should be issued by MMLG as a market notice?

One member said that the definition of a 'London' CD had been helpful for paper instruments but he thought it would be sufficient in future that a CD had been issued into CREST. Another member, however, put the view that the existing framework and definition of a 'London' CD had worked well and provided comfort: why not keep the concept of a 'London' CD issued by a UK authorised bank but now settled in CREST and issued under the proposed *pro forma* terms of issuance? Most members agreed that there was no reason to drop the distinction between 'London' and 'non-London' CDs with the key difference being issuance by a UK-authorised bank in the UK. On that view it was important that London CDs were issued by the London (UK) entities of banking groups so that there was no complication about jurisdiction.

Most members wanted a notice issued either by the Bank or by the MMLG. The Bank's own preference was for an MMLG notice promulgated by the Bank.

The stipulation of a minimum denomination size for a 'London' CD was also discussed. Members noted that the purpose was to make it clear that CDs were traded in a wholesale rather than retail market. The size of a holding was, however, no longer a reliable indication of whether the underlying business was retail or wholesale given the role now played by investment managers. They would sometimes value the ability to trade in small or odd lots. But other members said that some 75% of the £130 billion sterling CDs in issue remained held by banks. David Rule said that more work was needed to clarify any regulatory or tax reasons for wanting to make it clear that CDs traded in a wholesale market before a decision could be taken on whether a minimum denomination was desirable. Issuance into CREST rather than in paper form clearly made much less costly the option of having CDs divisible into odd amounts for settlement.

Simon Hills (BBA) told the group that BBA was reviewing its separate guidelines for CP and CDs, which set out the standards for London good delivery and best practice. Dematerialisation made this necessary. Market participants were being given the opportunity to comment and suggest changes.

Agenda Item 5 – Report from WMBA on progress towards changing the definition of a qualifying overnight deposit for the purpose of calculating the SONIA rate

At the previous meeting, Mike Beales (WMBA) had explained why there was a need to change the definition of a qualifying deposit, the alternatives and why the WMBA had recommended a new definition that included all broked overnight trades of £25 million or over, involving banks or non-banks. Members had agreed at that meeting that an extended parallel run, comparing the new method with the old, which had included interbank trades only, would be necessary before any change was confirmed. It was also agreed that WMBA would post the comparative data on its website with an explanation of why the change was necessary, and that WMBA would visit major users of SONIA swaps to seek their comments.

Mike Beales (WMBA) reported that the old and new methods of calculation had been run in parallel for three months. The average rate difference during that period had been less than three basis points. Whilst this was material in terms of a sterling OIS book, none of the banks visited was against the change provided there was a reasonable notice period before the cutover date. It was noteworthy that all banks had been surprised at the size of the increase in turnover (varying day-by-day but averaging around 50%) resulting from the inclusion of trades involving non-banks in the definition. Members agreed that on most days about 70% of overnight interbank trades were broked, so this share of non-bank business should be reasonably representative of the whole market.

On the basis of this report, MMLG members approved WMBA's proposed change to the SONIA calculation, and its recommendation that the change should take effect from 2 June 2003. The decision would be communicated to the market in four ways: the minutes of this meeting, a BBA market notice; WMBA's website; and the relevant SONIA pages of Moneyline Telerate, Reuters and Bloomberg; and in due course in the Bank's Quarterly Bulletin.

Agenda Item 6 – Presentation of Institutional Money Market Funds Association's Code of Conduct

David Hynes representing IMMFA, which association was a new member of MMLG, told the group that IMMFA now had twenty seven members, with the majority from fund management groups. The total assets of funds managed by IMMFA members in all currencies was US$130 billion equivalent. Preservation of capital value was a key aim of IMMFA fund managers. Data on fund composition and valuations were available from iMoneynet. Many of the topics discussed by MMLG would be of interest to IMMFA members, including CREST developments and contingency planning.

He explained that the new code was intended to define and promote best practice among members and also to encourage further membership of IMMFA. The code embraced the admission process to IMMFA, management processes, best practice, constancy of valuation and transparency. David Hynes thought that the admission process, particularly the entry criteria, and the management processes were the most important. The code is subject to change by the technical committee of IMMFA.

Paul Tucker asked whether members of IMMFA were mainly offshoots of banks or of fund management groups. David Hynes explained that 20 out of the 24 sterling IMMFA members were offshoots of banks.

Agenda Item 7 – Contingency Planning

(i) HM Treasury consultation on the financial system and major operational disruption

Dan Lambeth (HMT) presented the main points of the consultation paper, which asked whether new statutory powers should be sought to assist in promoting order in the financial system in the extreme circumstances of operational disruption. He stressed that the main responsibility for contingency planning in the financial system lay with the private sector and identified two types of private sector approaches: contractual contingency planning and market co-operation. In order to strengthen these, the paper proposed two possible new statutory powers: a power to suspend financial obligations temporarily and a power to direct financial infrastructure providers. Both powers would be used only in extreme situations and never in a purely financial crisis. Also, they would only be used with support from the private sector and if the benefits could be seen to outweigh the costs. The consultation ends on 25 April.

Paul Tucker emphasised that market participants should focus on the proposed new powers and give HMT Treasury considered views. Robert Fair (CRESTCo) asked what would happen if a direction

to change the rules of an infrastructure provider conflicted with existing legislation. Dan Lambeth explained that HMT would ask market participants what they wanted in an emergency: dialogue would be vital. Simon Hills (BBA) said that the international dimension was important given London's role as a global financial centre and the market's reliance on infrastructure located overseas. Members were not ready to provide comments at the meeting but said they would encourage their firms and associations to comment before the deadline.

(ii) MMLG emergency conference calls

Paul Mikhailoff (Bank of England) outlined the revised arrangements for a conference call between members should it become necessary following a major disruption to sterling money markets. The main change since the rehearsal call in November has been the move to a "dial-in" approach. This had the advantages that members could participate from any telephone number (which might be important if they had vacated offices) and that, if desirable, the call could be opened up to the wider market by putting the dial-in details on the Bank's screen pages. Another rehearsal would be held shortly [a rehearsal was held successfully on 27 February].

Agenda Item 8 – Any other business

Paul Tucker mentioned the imminent release of the Bank's Spring Quarterly Bulletin. The Bank was aiming to make the Markets and Operations article more issues-based and to put the section on the Bank's market operations into the context of developments in its balance sheet. He would welcome any feedback.

The next meeting will be on 26 June at 11.00 am.