

BANK OF ENGLAND STERLING MONEY MARKETS LIAISON GROUP

Friday 25 November
Bank of England (Oak Room)

MINUTES

Attendees

Tony Hibbit (alternate)	Abbey
Peter Fingland	AFB
Antony Littleton	APACS
Richard Pattinson	Barclays
Adrian Gray	Citibank
Katrina Sartorius	CrestCo
David Nicholls	Deutsche
Joanne Perez (alternate)	DMO
Douglas Hull	FSA
Euan Harkness	GEMMA
Ian Fox	HBOS
Jon Wood	HSBC
Jonathan Curry	IMMFA
David Lally	JP Morgan
John Burke	LCH
Amanda Sudworth	LIFFE
Clive Jones (alternate)	Lloyds
Ronny Maiti	LMMA
Graham Niblock	RBOS
Ian Stevenson	WMBA

Bank of England

Paul Tucker (Chairman)
David Rule
Ben Wensley (Secretary)

Apologies

Alex Merriman	BBA
David McFarlane	CHAPS
Nigel Dawes	Prebon

In attendance (Bank of England)

Sarah Breeden
Roger Clews
Toby Davies
Paul Fisher
Howard Jones
Paul Mikhailoff

1 Introduction

David Rule welcomed five new members to the committee: Ronnie Maiti replacing Ian Mair as the LMMA's representative; Ian Fox replacing Lindsay McKay as HBOS's representative; Jonathan Curry replacing David Hynes as the IMMFA's representative; Katrina Sartorius replacing Robert Fair as CrestCo's representative; and Joanne Perez as an alternate for Robert Stheeman (DMO).

BANK OF ENGLAND POLICY ITEMS

2 Proposed MMLG operations sub group

David Rule reported that the Bank had decided, following consultations with members, to set up an operations sub group along the lines of the model successfully used by the FX Joint Standing Committee. It would be beneficial in allowing, where appropriate, operational issues to be examined in more detail away from the main committee, such as on contingency matters.

David Rule said that Richard Pattinson had agreed to chair the committee. He also asked for any comments on the draft terms of reference for the sub group (provided at the meeting) to be fed back to the Bank. He will write to institutions to ask them for nominations from operational areas to sit on the group.

3 Money market reform (MMR) update

General progress

- David Rule reported that the Bank's, and seemingly market participants', preparations for the launch of the reserve-averaging scheme had been progressing well since the June MMLG meeting. The numbers of likely participants looked like being 40-50 reserve account members (of which around 30 had already successfully connected to the reserves software), 50-60 standing facility holders, and 25-30 open market counterparties. He mentioned that the Bank had begun talking to participants about dress rehearsals ahead of go-live.

Timetable

- David Rule said that the Bank was close to being able to narrow the go-live window; almost all of the key milestones identified by the Bank in September¹ had been passed successfully. Paul Tucker added that the Bank hoped to make an announcement by mid-December. The Bank also hoped to make an announcement on long-term repos in the next few weeks, with long-term repo tenders possibly starting in January.
- Paul Tucker said that the Bank was aiming to make an announcement in the spring about how the new system would work in contingency situations (eg following a major operational disruption). One option, he said, would be to narrow the rate ‘corridor’ between its standing lending and deposit facilities (200bps in normal times) to zero to facilitate inter-bank flows of funds, although there were operational issues to consider. Another option would be to inject greater liquidity into the market via OMOs. This did not necessarily mean the overnight rate would tend to zero (as happened with the Fed’s rate following 9/11), as in these circumstances the Bank could increase the targeted level of reserves or widen the range around reserves targets.

WIDER MARKET ISSUES

4 Reports from:

APACS Liquidity Managers Group (LMG)

- Adrian Gray reported that the sterling settlement banks had agreed to adopt guidelines, circulated ahead of the meeting, for agreeing compensation when sterling CHAPS payments fail to settle. The compensation rate would be set above or below the MPC official rate, depending on whether value was received earlier or later than agreed, so that mistakes did not go unpunished. The guidelines related to bilateral failures; market-wide problems were covered by the MMLG’s earlier guidelines, which recommended use of the Bank’s official rate for unintended long and short balances.

¹ ‘Near-term Milestones and Overall Timetable’, Money Market Reform, Bank of England (September 2005). See <http://externalboeweb/markets/moneymarketreform/smmreform050923.pdf>

The guidelines were being presented to the MMLG and other bodies (the LMMA, BBA and AFB) for their endorsement. MMLG members were content.

WMBA

- Ian Stevenson reported that two electronic trading platforms had recently been launched for short-term unsecured loans and deposits in sterling by E-mid and RP Martin. In addition, ICAP were due to launch an equivalent platform next year.

Usage of electronic platforms was expected to pick-up markedly upon introduction of full MMR next year, particularly for overnight trading. Ian Fox thought with time the market was likely to gravitate towards one of these providers. John Burke saw the launch of these platforms as part of a steady move to electronic trading and settlement.

5 Contingency management

Updated sterling market contingency tables

- David Rule reported that the latest draft of the decision-making table (circulated ahead of the meeting) had been updated in the light of further comments from CHAPSCo. The Bank would now give members an opportunity to provide any more comments before publishing it on the MMLG internet site in the new year. The table would be updated where necessary and could be reviewed by the new Operations Sub-group in due course.

Market-wide Contingency Exercise

- David Rule noted that there was likely to be a conference call for the MMLG in the market-wide test on 28 November involving a discussion about the crisis scenario. He envisaged that participants in the call would generally be MMLG members taking part in the exercise. Those MMLG members not taking part in the exercise should consider nominating a colleague who could take part in any call, particularly if they were a market-infrastructure provider.

MMLG wallet contingency cards

- David Rule drew members' attention to the wallet cards that were handed out at the meeting. They would provide ready access to contact details in a crisis. New cards will be sent out on a quarterly basis. Members should advise the Bank as soon as any details change.

6 Updating the NIPS code

Howard Jones thanked members for their comments on the draft of the code circulated at the June MMLG meeting, all of which had been incorporated. The final draft was about to be sent to the six endorsing associations², and would be re-circulated to the MMLG secretary ahead of publication, it was hoped in December.

7 Activity and liquidity in the sterling money market

Update on discussion at the June MMLG meeting

- David Rule reported that the Bank had followed up some of the points about liquidity in the cash sterling money market raised at the previous MMLG meeting.

Preliminary work using CREST data suggested that the breakdown of CDs by maturity had not noticeably changed over the past couple of years. The data also suggested that almost 4% of CDs in issuance passed through the CREST system in any given day, whether as a new issue, secondary market transaction, or collateral movement. However, these findings did not necessarily chime with market anecdote so the Bank was investigating further.

- David Rule also mentioned that the Bank had been having bilateral conversations with market participants about interbank limits – eg how full were they, what drove their utilisation etc. The pattern appeared to vary between banks, with activity in the CD market one of the key factors. In most cases average utilisation had been steady over the past couple of years.

He noted that some banks had suggested that interbank credit limits were not only a function of a bank's appetite for credit risk, but were also often

² CIPFA, BSA, ACT, BBA, WMBA and LIBA.

related to activity levels and could act as an internal flag for the exposure to be reviewed, eg before a limit was increased. A number of members seemed surprised by the latter point: limits were predominantly seen as credit driven and generally inelastic.

Liquidity around reporting dates/quarter ends – is this becoming a bigger factor?

- Ronnie Maiti presented a paper on behalf of the LMMA that asked whether balance sheet and capital restrictions were constraining activity to an increasing extent around reporting dates and, as a result, were reducing liquidity in the sterling money market. Members said that there were two phenomena:
 - o Banks needed to ensure that balance sheets met targets set by management on reporting dates, which constrained activity as the targets were invariably lower than the regular levels.
 - o Reducing unsecured money market lending (eg CDs) was typically the easiest way to trim risk-weighted assets around reporting dates. This had two effects on market liquidity: there were fewer willing unsecured lenders and the supply of gilts into the repo market could be lowered by a decreased willingness to hold CDs to give as collateral in order to borrow gilts. Both effects could put upward pressure on secured/unsecured spreads. Market participants were aware of the potential for reduced liquidity around reporting dates and adjusted their trading accordingly. But pressures could still emerge unexpectedly as they had at end-October, perhaps following large failed trades or for other reasons.
- John Burke noted that LCH saw significant changes in flows of gilt repo over month-ends, particularly at quarterly reporting period ends, suggesting significant behavioural issues.

8 AOB

Paul Tucker said that some settlement banks and OMO counterparties had been frequently exceeding the Banks' collateral concentration limits for one day. At

present, financial penalties were charged only for breaches of two days or more, but if the frequency of these breaches continued then the Bank would consider reducing the penalty period to one day. He noted an alternative would be to reduce the collateral limit from the current 25%.

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