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Collateral Pooling Implementation

September/October 2014

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Introduction

Toby Davies

Head of Market Services Division

Seminar Agenda

- Introduction
- Impact on Bank of England Operations
- Legal & Reporting Changes
- Overview of Collateral Pooling
- Key Operational Processes
- What Do You Need To Do Before Go Live?
- Questions?
- Contacts

Impact on Operations

- There is no impact! No change to the form of the operations themselves or the Bank's policy approach

- Change is purely to the way the transactions are collateralised

- Switch from repo model to secured lending with outright transfer of title to allow collateral pooling to reduce the number of transactions between participants and the Bank

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Legal & Reporting

Michael Jones

Senior Manager, Market Services Division

Legal Documentation

- SMF T&Cs will change automatically on 13 October
  - Includes a clause to move collateral held to the new framework
  - If you want to provide Loans as collateral in SMF operations, a new Loans Annex must be signed

- RTGS T&Cs require settlement Banks to sign a new Mandate letter and, in some cases, provide a capacity opinion

- All due to be returned now – action if not.

- New documents (including Op Procedures and RTGS Reference Manual) will be available on the Bank's website – final drafts there now.

Encumbrance

- Under the new legal framework, all collateral delivered to the Bank will be ‘owned’ by the Bank

- Pooling works best when excess collateral is held. But this would not be attractive if excess collateral was then encumbered for PRA reporting purposes

- In order to facilitate holding of excess collateral BIPRU 12.7 has been changed

- Collateral held at the Bank but not required to cover a specific exposure can therefore be reported as unencumbered

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Reporting

- The Bank is currently reviewing the impact of these changes on liquidity and statistical reporting
- Based on our analysis so far, we do not anticipate major changes
- Should this position change we will inform you
- Any questions should be directed to your normal contacts

Overview of Collateral Pooling

Michael Jones

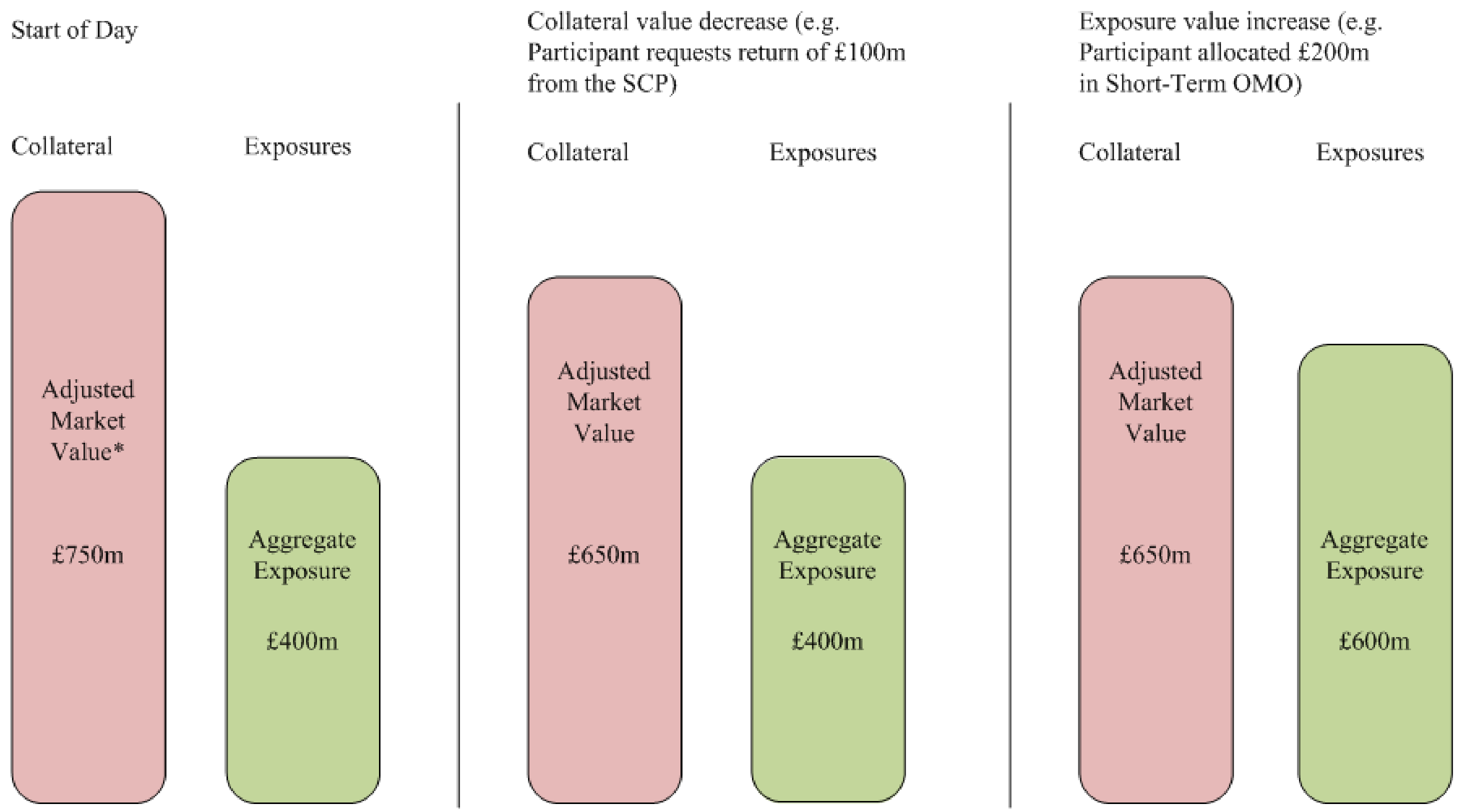
Senior Manager, Market Services Division

Collateral Pooling– How Does it Work?

- Simple stylised example
  - The central bank aggregates its exposures to a participant
  - The aggregate exposure position is compared to the participant's aggregate collateral position
  - If aggregate collateral =>aggregate exposure, no further action is required
  - If participants hold a 'buffer' of excess collateral with the central bank it can be used to absorb day to day fluctuations without the need for transactions
  - Excess collateral can also be used to supply IDL in RTGS

- Worked examples

Non Settlement Bank Participant



*Adjusted Market Value - the value of securities after haircuts have been applied.

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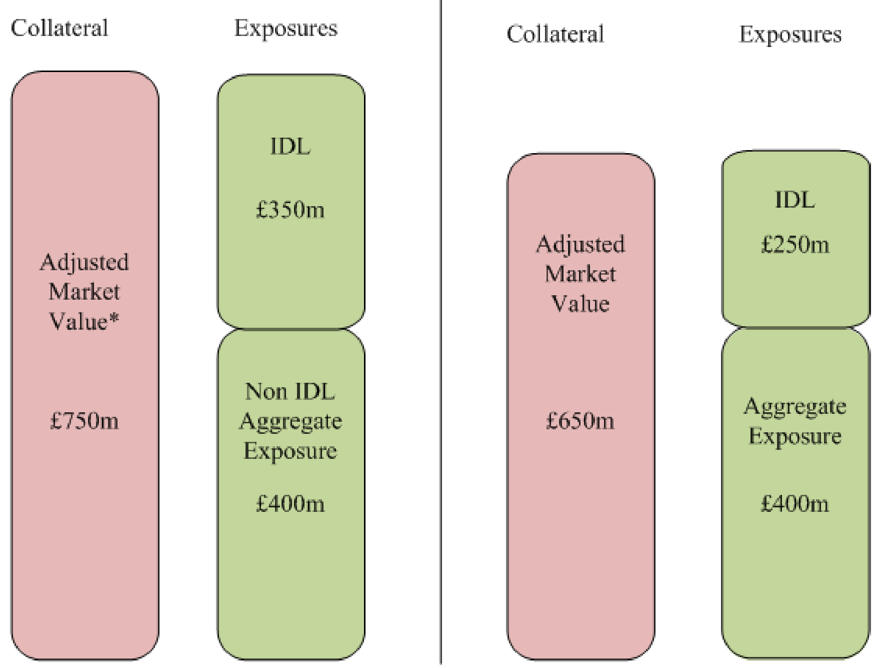
Settlement Bank Participant

Start of Day: Excess eligible collateral provided as IDL

Collateral value decrease (e.g. Participant requests return of £100m from the SCP, reduces the amount of IDL available)



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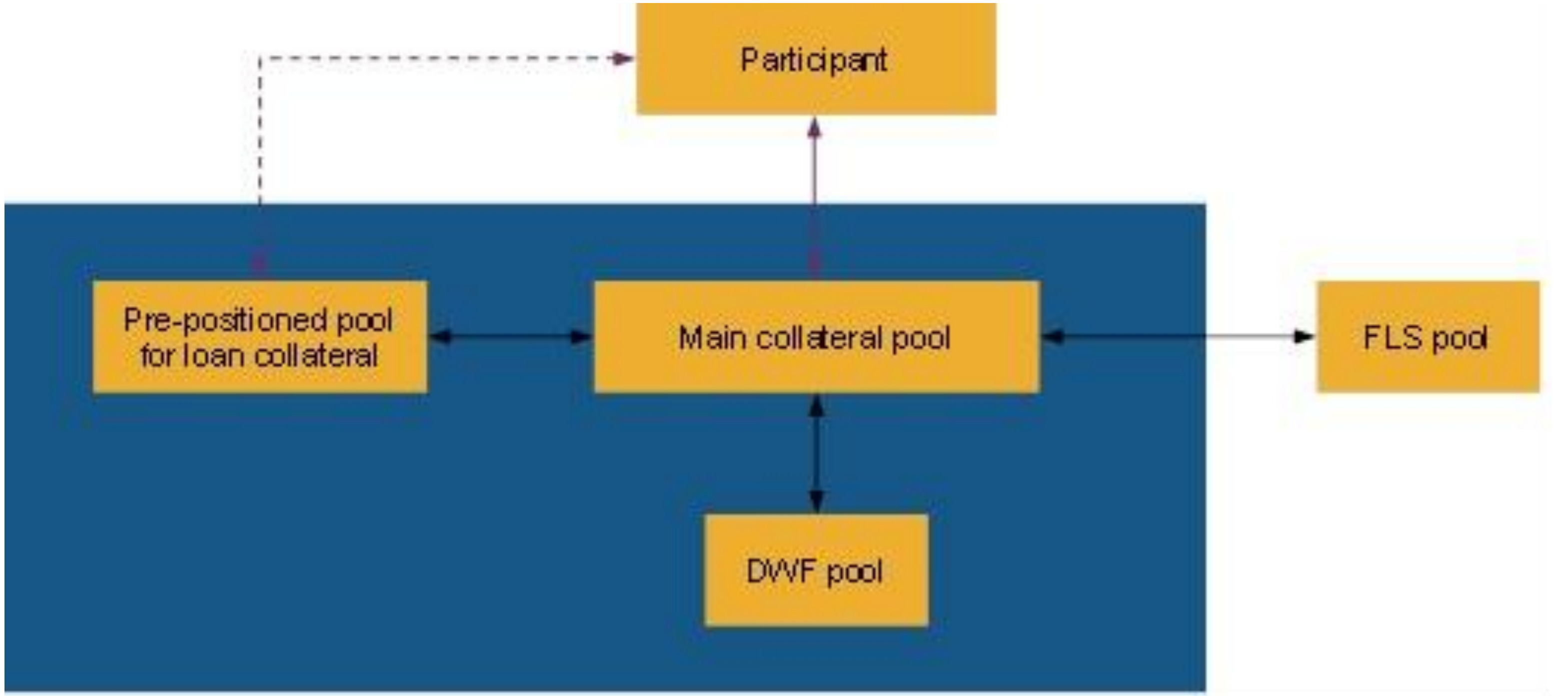
Collateral Pooling Model – Bank Implementation

- The Bank model is more complex e.g. separate DWF and FLS pools & IDL Maximum concept



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Collateral Pooling Model – Bank Implementation

- And assesses exposures given the collateral level eligible to be used
- For example different ILTR exposures have a different minimum level of collateral allowed
- In the event of a shortfall, the pool will look to cover an exposure using better quality collateral if possible e.g. if ILTR Level B exposure could also use Level A but not Level C
- NB one Main Pool and associated if required per legal entity

Collateral Pooling Model – Bank Implementation and Benefits

- But the benefits are expected to be the same:
  - more efficient use of collateral and a reduction in transaction volumes
  - This should lead to lower costs and less operational risk
- Confident given evidence of Euro zone banks and BoJ
- Key is to hold excess collateral
- The Bank is also using the opportunity to automate the remaining activity as far as possible to further increase efficiency e.g. portal

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Key Operational Processes

Michael Jones

Senior Manager, Market Services Division

Collateral Delivery & Custody

- Notification via either the Portal or (revised) templates as now
  - Could support SWIFT messages in future if interest
- Portal is a SwiftNet application using same underlying architecture as EnquiryLink and Btender
- Allows participants to view and manage, in near-real-time, collateral used in the Bank's official operations
- Also supports eligibility checking and, for settlement banks, adjustment of IDL Max
- Open from 09:00 until 18.00 for input and c19:00-09:00 for view only, during working days

Collateral Delivery & Custody (cont'd)

- Bank seeks to cost recover - annual charge levied based on average monthly collateral holdings for past year

Tier	MV of Holdings, £	Charge per year, £
A	>30 bn	12,000
B	10-30 bn	8,000
C	1-10 bn	4,000
D	<1 bn	1,000

Collateral Delivery & Custody **(cont'd)**

- Securities
  - Initially held in Main Pool – use there or can be moved to other pools

- T/DBV
  - Only in main pool
  - If against payment, best practice to match to an exposure
  - Will also support free of payment TDBV including for IDL

- Loans
  - Pre-positioned loans visible in Loan Pre-positioning pool
  - Bank moves to main pool (or FLS) once encumbered

Collateral Delivery & Custody (cont'd)

- No concept of substitutions
- Current deadlines will apply
- Holdings visible in portal or via statements (latter via email or MT535 as elected)
- Also able to provide a range of information in line with already expressed preferences
  - MT544/546 settlement confirmations provided (if elected)
  - MT548 settlement status advices provided (if elected)
  - MT564/MT566 corporate action notifications provided (if elected)

New Exposures

- Exposures settled as soon as eligible collateral is available

- Repayment of maturing exposures
  - Gross
  - Netted against new exposures
    - Permitted at operation level only e.g. Short-Term OMO vs Short-Term OMO

- Rolling collateral to cover new exposures requires no participant intervention

Daily Process

- Margin calls
  - Excess collateral should help avoid
  - If they occur, must be satisfied within operational deadlines
  - Minimum transfer amount (MTA)
  - All funds owing withheld until satisfied

- Minimum maturity limit applied to collateral
  - Normally 10 days but less in some cases e.g. Bank Bills
  - New collateral within limit not accepted
  - Existing collateral given zero value

- Concentration limits will be applied intraday in real-time - not possible for participants to actively breach concentration limits

Intraday Liquidity

- IDL start/end of day postings applied (no change)

- IDL Max
  - Set default value – will ask for day 1
  - Can be changed intraday

- IDL takes precedence over new exposures

- The BoE will ‘claw-back’ IDL to satisfy margin calls

- Note Circulation Scheme start/end of day postings applied (no change)

Discount Window Facility

- Drawings agreed with the Bank's sterling front office based on collateral already held at the Bank – No change to the initial agreement process

- Bank will move collateral from the main pool to the DWF pool. Gilts delivered to participant only once complete

- All future movements (margin calls/withdrawals) work this way

- Any excess collateral in DWF pool is *encumbered* because it cannot be withdrawn freely.

LFCA/LLSA Pools

- Not part of the Bank's pooling model – Bank acting as security trustee for the schemes

- But links:
  - LFCA/LLSA pools will align to Bank rules e.g. eligibility on 13 October
  - Can use the portal to manage these pools

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What Do You Need To Do Before Go-Live?

Michael Jones

Senior Manager, Market Services Division

Remaining Actions

- Internal Processes
- RTGS Settlement Bank – Mandate Letter &, if needed, Legal Opinion
- User of Loans as Collateral in the SMF – New Loans Annex
- Portal User – Registration Forms complete and connectivity checked
- If requested, confirmation of readiness via e-mail

Go-live (13 October)

- Reminder on 6 October
  - If RT Settlement Bank will request starting IDL Max
- Confirmation of Outcome of Go-Live weekend waiting Monday
  - Normal Contacts – can add to if asked.
  - Website will also be updated
- Collateral will be moved automatically to the correct pool – no action required
- Portal Users – recommend an early check
- Business as usual using either the portal or templates/reports
- Ensure your processes are in place

Questions?

Contacts

- If you have questions about the Collateral Management Portal prior to go live or are interested in signing up to it, please contact Danny Smith (020 7601 5204 or cor.team@bankofengland.co.uk)

- If you have any questions about go-live of collateral pooling, including on the legal documents, please contact Michael Jones (020 7601 4375 or michael.jones@bankofengland.co.uk)

- The key business as usual contacts are:
  - Manager – Claire Pearson (020 7601 5296 or claire.pearson@bankofengland.co.uk)
  - General queries: BSCMC@bankofengland.co.uk
  - Collateral pooling related queries: CMC.SCP@bankofengland.co.uk
  - Tel No: 020 7601 5700

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