BANK OF ENGLAND

Minutes

Money Markets Committee

4 July 2017

Location: Bank of England, Threadneedle Street

Attendees: **ACT**: Michelle Price
Aviva Investors: Mick Chadwick
BAML: Cameron Dunn
Barclays: Michael Manna
BBA: Andrew Rogan*
Blackrock: James Templeman
Credit Suisse: Romain Dumas
DMO (Observer): Jessica Pulay*
Euroclear: John Trundle
FCA (Observer): Helen Boyd
Goldman Sachs: Mathew McDermott
HSBC: Jon Wood
The Investment Association: Ross Barrett
LCH Paul Elkins
LGIM: John Wherton*
Lloyds Bank: Ian Fox
Mizuho Bank: Robert Thurlow
Nationwide: Andy Townsend
PruCap: Nina Moylett
RBS: Robert Begbie
Santander: Paul Barnes
Société Generale: Romain Sinclair
Standard Life: Gordon Lowson
Tesco: Lynda Heywood
Virgin Money: Peter Bole

Bank of England: Chris Salmon (Chair), Sarah John (Head of Sterling Markets Division), Iain Ramsay (Secretary), Aakash Mankodi, Jon Pyzer, Hannah Reynolds (Sterling Markets Division), Jan Lasik (Legal Directorate)

Apologies: **BBA**: Ronald Kent
DMO: Jo Whelan
GLA: Luke Webster
J.P. Morgan: Paul Wilson
LGIM: Jennifer Gillespie

*Alternate

Minute no.	Minute
1.	**Agree minutes from previous meeting**

The minutes from the previous meeting (23 March 2017) were agreed by the Committee.

2. Agree Money Markets Committee forward agenda for 2017

The Chair sought comments on the draft forward agenda that had been drawn up based on discussion at the previous MMC meeting.

One member asked why the issue of Brexit was absent from the forward agenda. The Chair set out that agenda items should be focused on and targeted at issues with specific relevance to UK money markets in order to ensure that the discussion is in line with the objectives of the Committee. As the date of the UK's withdrawal from the EU drew closer it would perhaps be clearer whether trading or regulatory arrangements had the potential to impact upon, for example, the functioning of UK money markets; at which point it could be appropriate for such discussions to take place.

Another member suggested that the MMC forward agenda should feature a discussion on intraday liquidity, which it was felt could become a growing source of concern in markets. Whilst, for the moment, excess cash in the system meant intraday liquidity was less of an issue, it may warrant the MMC's consideration if the Bank were to move towards policy normalisation. The Bank agreed to meet the Committee member bilaterally to discuss the matter further, ahead of its possible addition to the forward agenda.

3. Market Update

Sarah John provided a high-level market update to the Committee. UK and European politics had been a key theme in markets; measures of political risk had receded, particularly in the Euro area, following the French presidential election. And markets looked to have coped well with the unexpected UK election result in June, with most of the market reaction confined to sterling FX, rather than broader UK assets. The more recent theme in markets had been central bank communications. Monetary policy expectations as a result had adjusted in the UK as well as the Eurozone. It was also noted that the FPC had opted to increase the countercyclical buffer back to 0.5%, and had begun their consultation on a proposed change to the leverage ratio.

Iain Ramsay set out the findings of recent analysis undertaken by the Bank focused on the stabilisation in functioning in the UK gilt repo market. That stabilisation followed a period of reduction in repo market volumes and deterioration in market functioning over the previous 12-18 months. The Bank's market intelligence contacts had suggested that there were four structural factors explaining the stabilisation in repo market functioning: (i) counterparty diversification partly resulting from new entrants to the gilt repo market, (ii) the increased use of 'nettable' repo packages, particularly by more sophisticated counterparties, which acted to reduce the 'capital intensity' of trading repo, (iii) a growth in use of 'synthetic' structures such as total return swaps rather than trading the underlying cash instrument, freeing up more bank balance sheet for cash repo, and (iv) behavioural changes – in particular, better preparation ahead of regulatory reporting dates. Contacts had also identified transitory factors including the delayed implementation of the NSFR, as well as a general fall in the level of short positioning by leveraged investors which had built up around political risk events earlier in 2017.

Members were in broad agreement with the Bank's summary of developments in repo market functioning which were based on conversations with market intelligence contacts. Other relevant factors suggested by Committee members included the increased willingness of LDI to shorten the tenor of their repo trades due to perceived lower 'rollover risk', a growing concentration of delivery-by-value repo (as opposed to specifics/specials) in LCH, and the growing presence of non-bank players in the repo market.

Some questioned whether the increased balance sheet allocated to repo by some banks (particularly overseas banks) over the past 6-12 months was a structural and permanent change to the repo landscape, or whether it was more linked to the business cycle and therefore transitory. Repo spreads to the OIS rate had widened, attracting these new players, so some on the Committee expected that a narrowing of the spread could equally dissuade some from continuing to intermediate the market.

Members also discussed the leverage ratio treatment of HQLA which affected banks' balance sheet allocation to repo. It was agreed by the UK bank members present that the change to the exposures measure of the UK leverage ratio had had very little effect, particularly since they also reported to the EBA leverage ratio. This restricted the scope to make balance sheet allocation adjustments, as the European regime had not changed its treatment of reserves.

Buyside representatives on the Committee generally agreed that functioning in the unsecured market had also stabilised although characterised that stabilisation as 'no longer getting worse' rather than an identifiable improvement in functioning. It was noted that increased balance sheet availability in the repo market had taken some of the pressure off the unsecured market over the more recent regulatory reporting dates.

4. Key topic discussion: impact of introduction of SFTR on UK money markets

The SLC had held a focused discussion on the impact of the introduction of the SFTR. The SLC Chair gave a brief summary of that discussion. It was expected that the implementation of SFTR could create an imbalance in supply/demand in the securities lending market; supply could fall in light of the transparency requirements and compliance costs, and could therefore lead to higher market rates for securities lending.

Members generally agreed with these observations. There was a view that the costs associated with SFTR compliance could result in a reduction in activity from smaller or less sophisticated market participants. Others noted that some non-regulated beneficial owners would be sensitive to the transparency requirements regarding their market positions being revealed (with hedge funds and sovereign wealth funds mentioned as examples).

It was also noted that there continued to be uncertainty around the exact timing of the phase-in of SFTR reporting requirements which was thought likely to be delayed by 6 or 9 months.

5. SIMEX16 follow-up

The Chair gave an update following the SIMEX16 (Sector Simulation Exercise 2016) exercise which was held in November 2016. The Bank and the Cross Market Operational Resilience Group ('CMORG') used a prolonged RTGS outage as the exercise scenario. Subsequently a document containing 'key learnings and further work' had been published in May 2017. That report had noted a number of actions to be taken forward by the Bank as well as the market.

The March and May SIMEX16 reports' findings fell within three themes: (i) operational contingencies for payments, (ii) sector response arrangements, and (iii) legal and policy challenges. On the second, one Committee member noted surprise at the fact that the MMC contingency call had not been considered as part of the SIMEX16 exercise.

The Chair proposed that a small working group be formed from the MMC to take forward some of the SIMEX16 actions and findings. Members were supportive of the suggestion. The Chair requested that members nominate themselves after the meeting to be part of that working group.

6. Update from *UK Money Markets Code Sub-Committee*

Gordon Lowson provided an update from the Sub-Committee. The Code was published on 26 April and had been well received by the market. Jon Pyzer and Sarah John had attended a number of events arranged by various trade associations to build awareness and understanding of the Code. Questions on the Code since its publication had been focused less around its content and mostly on the jurisdiction of application of the Code – particularly so for market participants based outside the UK who traded in UK money markets.

The Sub-Committee had agreed that a cross-market survey should be circulated as widely as possible across UK money markets to get a clearer idea of what proportion of market participants expected to state their commitment to the Code and progress towards that goal, as well as to understand any issues market participants had faced in committing to the Code. The Sub-Committee would discuss the results in Q4 2017 and report back to the MMC as appropriate. Such a survey would, in the absence of a 'register' of those that had signed up to the Code, be the best means to gauge the level of implementation across the market. The Chair noted the potential benefits of a register of signatories of the statement of commitment as a means of measuring the level of implementation to the Code across the market and encouraged the Sub-Committee to consider its merits further.

As for any cases of substantive non-adherence in UK money markets, the Sub-Committee had felt that reporting this on a no names basis to the MMC would be appropriate, in order that members could then make a decision as to the best way to address any such issues.

The Sub-Committee had discussed the most suitable approach to updating the Code on a regular basis. It was felt that the Sub-Committee should undertake an annual review of the Code, reporting to the MMC if substantive changes needed to be made.

7. Bank of England: Sterling Monetary Framework and SMF Annual Report

Hannah Reynolds presented a summary of the content and conclusions of the 2016/17 SMF Annual Report. The purpose of the review was to help identify where the Bank's sterling operations work well and where further work may be necessary. It draws on discussions with internal and external stakeholders, including calls with a range of SMF participants. The 2016/17 review notably covers the August 2016 policy package, including the TFS and CBPS.

Some high level feedback in the SMF Annual Report included (i) that reserves accounts and the ILTR facility are seen as helpful in managing day-to-day liquidity needs, (ii) that the Bank's communications and actions in the lead up to the 2016 referendum were viewed as appropriate and supportive of the market, and (iii) that the TFS has helped to lower funding costs despite some initial administrative challenges around usage of the scheme.

Key findings included (i) that additional education around the ILTR facility would be welcomed as the allocation mechanism is complex and some firms faced some 'key person risk', (ii) that SMF participants would welcome being designated a main/central contact within the Sterling Markets Division, and (iii) that firms would welcome open channels of communication around the impact of ring-fencing, the future of reserves averaging, and any future changes to collateral eligibility. These findings would be taken forward by the Bank in the coming period.

The Chair additionally noted that the Banks Independent Evaluation Office was undertaking an independent internal review of the Sterling Monetary Framework and the Bank's delivery on its objectives around sterling market operations. The Chair intended to keep the MMC updated on any findings emerging from that review.

8. AOB

The Chair noted that on 28 April 2017 the Working Group on Sterling Risk-Free Reference Rates had announced SONIA as its preferred near risk-free interest rate benchmark. Subsequently a large-scale project on transferring markets to usage of the new benchmark would continue in earnest. The choice of a *secured* near risk-free rate in other jurisdictions, most notably the US, was discussed. The various international working groups had been in general agreement that this 'mismatch' would be dealt with via new basis contracts.

Acronyms

ACT	Association of Corporate Treasurers
BAML	Bank of America Merrill Lynch
BBA	British Bankers Association
CBPS	Corporate Bond Purchase Scheme
DMO	Debt Management Office
FCA	Financial Conduct Authority
GLA	Greater London Authority
ILTR	Indexed Long Term Repo
LDI	Liability Driven Investors
LGIM	Legal & General Investment Management
SFTR	Securities Financing Transactions Regulation
SLC	Securities Lending Committee
SMF	Sterling Monetary Framework
TFS	Term Funding Scheme