BANK OF ENGLAND

Minutes

Money Markets Committee
25 September 2017

Location: Bank of England Offices, Moorgate

Attendees:
ACT Michelle Price
Aviva Mick Chadwick
BAML Cameron Dunn
Barclays Michael Manna
Blackrock James Templeman
Credit Suisse Romain Dumas
DMO Jessica Pulay* (alternate: observer)
Euroclear Angus Scott* (alternate: in place of John Trundle)
FCA Helen Boyd (Observer)
GLA Luke Webster
HSBC Jon Wood
ICAP Andrew Berry
Investment Association Ross Barrett
LCH Paul Elkins
Lloyds Ian Fox
Mizuho Rob Thurlow
Prudential Nina Moylett
RBS Donal Quaid
Santander Paul Barnes
SGCIB Romain Sinclair
Standard Life Gordon Lowson
Tesco Lynda Heywood
UK Finance Andrew Rogan* (alternate: in place of Ronald Kent)
Virgin Money Peter Bole

Bank of England
Chris Salmon
Sarah John
Jonathan Pyzer
Aakash Mankodi (Secretary)
Iain Ramsay
Rebecca Maher
Imane Bakkar (Item 4 only)
Ed Ocampo (Item 4 only)
Jan Lasik

Apologies:
Goldman Sachs Mathew McDermott
LGIM Jennifer Gillespie
Nationwide Andy Townsend

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1. **Introductions and Minutes**
The Chair welcomed Donal Quaid from RBS to the Committee. Members were informed that Donal will be attending in place of Robert Begbie going forward.

There were no comments on the July committee minutes, and they will be published on the Bank's website. The Chair informed the committee that in the interests of efficiency, the minutes from future meetings will be finalised and circulated to the committee for comments within 10 working days of each meeting. Members will have a further 10 working days to provide comments. The minutes will be published on the Bank's website thereafter.

2. **Market Conditions**
Sarah John provided an update on market conditions since the July meeting. The Bank's market contacts had highlighted that gilt repo market functioning continued to improve in recent months, with spreads tightening and more balance sheet capacity becoming available in the UK. A fall in demand for leverage from highs earlier in the year and an increased use of instruments such as total return swaps was thought to be leading to further balance sheet optimisation. While it was not clear whether the market had moved to a new steady state, current conditions were expected to lead to a more benign quarter and potentially year-end in the UK than in previous years.

It was further noted that these developments had occurred against the backdrop of some notable monetary policy news over the period in the UK and overseas. The Bank had not heard of any specific market functioning or liquidity issues on the back of these developments over the period. The floor was opened for thoughts from members.

Members agreed with the summary of market conditions. One member noted that spreads in gilt repo markets had narrowed notably over the period. And whilst there was more capital being deployed, it was not certain how much further excess capacity was left across major banks. It was also noted that there were a number of new bank entrants, which were contributing to the increase in repo supply this year. Overall, these developments were thought to be beneficial for users (such as LDI investors) in the market. An increase in yield pick-up activity against the backdrop of lower repo spreads was also observed, with market participants more willing to bid for higher yielding paper.

Another member highlighted that financing markets were seen as just another tool to facilitate bank revenues following somewhat disappointing quarterly earnings for major investment banks this year. Other members concurred, noting that the major driving factor for greater repo supply had been the increased capacity from large investment banks. Therefore, it was possible that more cyclical rather than structural factors were leading to market improvements in repo currently.

Other market trends were discussed, including the continued widening in gilt asset swap spreads in recent months, and the recent narrowing of the 3-month LIBOR-OIS spread.

3. **Developments in Market Infrastructure**
Jonathan Pyzer provided an update on recent developments in market infrastructure in securities financing markets. Announcements from LCH and Eurex over the period regarding the take-up from two separate buy-side firms of their repo and securities lending clearing solutions respectively were noted. Elsewhere, peer-to-peer (P2P) platforms such as Elixium and DBVx were also beginning to gain some industry traction. The Bank's conversations with market contacts had highlighted that these were being seen as welcome developments amongst those seeking new ways to access liquidity and considering relative cost efficiencies of trading through such platforms. There were however a number of outstanding questions with regard to the viability and outlook for these solutions. The floor was opened for thoughts from the committee.

Nina Moylett provided an update from the July Securities Lending Committee meeting, which focussed on market infrastructure. Three external participants – Gross Short Arbitrage Value (GSAV Ltd.), Equilend and Pirum were invited to present their views on developments in market structure to the committee. Committee members identified market transparency and CCP clearing as areas that needed further consideration. On CCP clearing, members noted that market participants continued to be reluctant to adopt existing central clearing infrastructure for securities lending. Participants debated on: i) the appropriate cost of clearing, ii) benefits from a credit, collateral and term perspective, iii) its impact on underlying market liquidity and market fragmentation and iv) the implications of CCP failure. Committee members had also questioned whether the increasing numbers of platforms being introduced could co-exist in a new market structure.

One member provided their perspective on CCP clearing. It was noted that non-cash collateral clearing had so far been perceived as relatively difficult to engage with from market participants' (particularly buy-side) perspective. Continued challenges included: mutualisation of risk, eligibility of trading through a CCP, clearing costs and legal hurdles. While greater price transparency was being encouraged by regulation, it was not clear yet if market participants were willing to absorb clearing costs to achieve this. It was also highlighted that CCP clearing was not designed around the necessity for bank disintermediation, so relevant new models needed engagement from all market participants.

Committee members generally agreed that mutualisation in particular was a difficult issue to address. One member argued that as CCPs rely on a collective of credit-rated banks providing capital to mutualise risk, unrated asset managers who did not hold capital were likely unsuitable to participate in clearing for these reasons. Another member noted that one European CCP had designed an alternative by creating a direct lender class, but it needed further buy-in from the industry. Other challenges that were flagged included: the scalability of CCP trading, CCP failure and related margin requirements through recovery and resolution, and the difficulty in regularly sourcing cash collateral for variation margin. On this final issue regarding cash collateral, there was some discussion on how clearing demand in the UK was largely from cash takers. It was noted that one CCP in the US was attempting to address this issue by incentivising cash providers to participate in their clearing solution. Members further highlighted that the structural challenges required to incorporate alternative agency-style models were significant. The costs and complexity of these structures remained an issue. This was relevant for both repo and securities lending clearing, as well as, to some extent, peer-to-peer solutions.

One member argued that some alternative solutions could be viable for specific institutional needs. They highlighted that agency models were becoming better understood amongst buy-side participants in securities lending markets. Some types of firms, such as insurance companies, seeking better price discovery and transparency, were seen as willing to invest in the infrastructure and skills required, and had sufficient risk appetite to adopt such solutions.

Other members acknowledged that alternative solutions to improve liquidity and transparency in the securities financing markets should be given due thought "while the sun was shining" i.e. given the relatively benign market conditions. Ultimately, it was thought to be beneficial for the market to have diverse sources of liquidity, for example, to deal with times of stress.

In summary, it was noted that this was a useful discussion of developments in market infrastructure. It was highlighted that CCP clearing and P2P solutions did have potential benefits from a balance sheet optimisation and transparency perspective, and could be a useful avenue for particular types of participants in the market. Market-led impetus and continued discussions around the various challenges related to wider adoption of these initiatives were required, and their relative traction across regions and participants was likely to be a slow-drip development in the current conjuncture.

4. **Risk Free Reference Rates – Presentation and Discussion**

Imane Bakkar provided an update on the risk-free reference rates (RFR) workstream, and gave a summary read-out from the July RFR roundtable meeting[1]. The Chair highlighted that it was particularly important that the transition from Libor to new risk-free reference rates received close engagement

[1] http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/rfr/2017/record060717.pdf

from market participants. The Bank was considering the most appropriate means to facilitate this engagement effectively. It was noted by members that the recent speech by the Financial Conduct Authority's CEO[2] had highlighted the urgency of this issue and generated more industry conversations regarding engagement with Libor reform groups going forward. This was seen as a welcome development.

There was some discussion around the design of future term fixings, which was acknowledged as an important issue for consideration. Some members observed that the transition was not intended to lead to instruments that would replicate Libor, but would be a step-change in market practice and frameworks altogether. It was noted that the Bank would set up a working group to consider the issue.

The Chair re-iterated that new RFRs were not intended to replicate libor. But it was important to understand market requirements and facilitate appropriate market-led solutions. All of this would require continued engagement and action from authorities and market participants.

5. **SIMEX Working-Group Update**

Jon Wood provided an update from the SIMEX working group. Members were reminded that an informal discussion group of MMC members, along with Bank representation, had been formed to discuss actions of interest to the MMC following SIMEX16. The working group will provide a further update to the Committee in December.

6. **UK Code Sub-Committee**

Gordon Lowson provided an update on the UK Money Markets Code sub-committee. At their last meeting the Code sub-committee agreed that a survey circulated to relevant market participants would be an effective way to understand awareness of the Code, and the willingness of market participants to sign the statement of commitment. Initial survey responses suggested very high awareness of the Code across UK money market participants, and generally good progress on wider adherence. It was noted that the main areas of clarification amongst participants had been on the geographic scope of the Code. The Sub-Committee would consider whether the FAQs could be updated to clarify this issue.

7. **Securities Lending Committee - BRRD**

Nina Moylett flagged that since the last MMC meeting ISLA had raised an issue with the Bank and other market participants regarding moratorium requirements within the current BRRD framework. The SLC will discuss this issue at their November meeting and report back to the Committee in December.

8. **AOB**

Paul Barnes noted that it might be helpful for the Committee to discuss the impact of the third phase-in of initial margin requirements over the course of next year, as it applied to a wider range of participants. It was agreed that this would be on the forward agenda for 2018.

Another issue raised was with regards to the recent changes in DMO end of day gilt reference pricing, as mentioned in the March Committee minutes[3]. It was noted that a lack of awareness amongst some institutions regarding using Tradeweb's new pricing offering was leading to them using Bloomberg as their pricing source. This in turn was leading to mark-to-market disputes with some banks, all of which had since been resolved appropriately. A few members flagged that the new pricing source should be reflected in appropriate bilateral documentation such as GMRAs (which was not yet reflecting the change in market standards). Other members concurred with this view. The DMO noted that they were not aware of these discrepancies and will follow up on the issue.

[2] https://www.fca.org.uk/news/speeches/the-future-of-libor
[3] http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/mmc0317.PDF