The Bank's contacts with the money, repo and stock lending markets

This article looks at the Bank's liaison with the London money markets and in particular at the work of the Sterling Money Markets Liaison Group and the Stock Lending and Repo Committee.

Introduction

In addition to having a regular dealing relationship with participants in its open market operations, the Bank of England also maintains close contact with them in order to discuss market sentiment, expectations, liquidity and trading conditions in unsecured and secured markets. The Gilt-Edged and Money Markets Division also has regular bilateral contact with a wider group of banks, investment banks, financial institutions and brokers as part of its market liaison function. Such liaison contributes to both monetary policy and financial stability goals and to the Bank's interest in maintaining the effectiveness of UK financial services.

In addition to bilateral contacts, the Bank liaises with market participants through two key committees—the Sterling Money Markets Liaison Group (MMLG), chaired by Ian Plenderleith, Executive Director, and the Stock Lending and Repo Committee (SLRC), chaired by Neal Hatch, the Head of Gilt-Edged and Money Markets Division.

MMLG

MMLG, an informal group, was established in the summer of 1999 as a means for the Bank and leading market participants to maintain regular contact with each other on operational matters of common interest. It has met quarterly since then. Meetings usually start with a short presentation by the Bank representatives based on the regular 'markets and operations' article in the *Quarterly Bulletin*. In response, members are invited to give their views on current developments. There is then a discussion on a range of structural developments involving the money markets which can, where necessary, be carried forward by delegated working groups.

Representatives from the market are invited to attend MMLG in their own right, rather than as representatives of a firm or group of firms, and therefore do not generally send alternates when they cannot attend. In addition to market members, who come from a broad range of institutions, there are also members from trade organisations and official bodies. These include the Financial Services Authority (FSA), the UK Debt Management Office (DMO), LIFFE, CRESTCo, the Chartered Institute of Public Finance and Accountancy, the Association of Payment Clearing Services (APACS), the Association of Corporate Treasurers, the London Money Market Association, the Wholesale Markets Brokers' Association, and the London Investment Banking Association. On occasion others are invited to the meetings to discuss items of particular interest: the British Bankers Association (BBA) were recently invited, as discussed below.

The first few MMLG meetings proved invaluable as opportunities to share views on the millennium date change and its impact on money market activity and liquidity. The Group discussed plans to cope with a possible sharp increase in notes in circulation and, in mid-1999, the expansion of eligible collateral in the Bank's money market operations to include euro-denominated debt. This expansion of eligible collateral proved useful over the millennium date change and has been maintained since. The article now turns to some of the areas worked on by MMLG over the past year or so.

MMLG has discussed and contributed to the preparation of the non-investment products (NIPS) code in conjunction with the Foreign Exchange Joint Standing Committee and the London Bullion Market Association; this new code, successor to the London Code of Conduct in respect of non-investment products, will come into effect in December this year. The Code provides guidance on what is currently good practice in the sterling, foreign exchange and bullion wholesale deposit markets, and in the spot and forward foreign exchange and bullion markets.(1)

A working group set up by MMLG contributed to the work led by the Bank and CRESTCo on the review of money market instruments and plans for their dematerialisation so that they can be settled in the CREST system: it is hoped that this change, which will no longer require instruments to be issued initially in paper form, will be introduced in the second half of 2002. Most sterling money market instruments are currently issued in bearer, paper form as negotiable instruments; they may be transferred through the Central Moneymarkets Office (CMO) system run by CRESTCo, with the physical paper immobilised. Certificates of deposit can already be issued in dematerialised form.

At the suggestion of MMLG, the Bank undertook a review of the main legal agreements used by members of the London Money Markets Association, including repo, secured lending and stock lending agreements, and sought views on whether any changes were needed, for example to achieve greater harmonisation of approach in the agreements. The general response suggested that most concerns about legal agreements had been addressed in the groups working on updating The Bond Market Association (TBMA)/International Securities Market Association (ISMA) Global Master Repurchase Agreement and the new Global Master Securities Lending Agreement (consolidating existing securities lending agreements). Indications from the market also suggested that there was no demand for new institutional arrangements for reviewing legal agreements and that it was sufficient to rely on existing legal and market fora, as well as on discussions in the MMLG and SLRC.

The Bank recently presented a report to MMLG and BBA on BBA Libor settlement rates, having established that both foreign and domestic banks in London were content that these rates were representative of market rates with normal dispersion patterns. At the July meeting of MMLG, members' views were sought on the then new overnight deposit facility introduced as part of the Bank's open market operations in order to make the operations symmetrical towards the close of the dealing day and reduce undue volatility and softness in the overnight interest rate. The deposit facility was explained in the box on page 281 of the Autumn 2001 *Quarterly Bulletin*.

More recently, following occasional comment in the market, the Bank asked MMLG if there was a consensus in favour of refining the calculation of the sterling overnight interbank average (SONIA) rate, which is used as the floating-rate leg for the purpose of SONIA swaps, now a widely used derivative. MMLG members agreed that the cut-off time for the daily calculations be extended from 3.30pm to 4.15pm, which change was implemented on 1 November.

Other topics debated recently by the Group have been the outlook for the global economy and the extent to which the United Kingdom would be influenced by any further weakness elsewhere. Regular domestic topics are the growth and use made of the various money markets in London, such as interbank deposits, certificates of deposit, commercial paper and repo.

SLRC

SLRC was established, initially as the Stock Borrowing and Lending Committee, in 1990. It provides a forum for the Bank, securities lending and repo practitioners and for the DMO, FSA, CRESTCo, BBA, APACS, London Stock Exchange, London Clearing House and others to discuss developments in sterling repo and lending markets. European Repo Council and US bond market representatives attend to discuss areas of common interest relating to structural, legal and other developments. It has also considered the work on the proposed EU Collateral Directive and the Hague Conference work on reducing legal risks associated with taking as collateral securities held through multiple tiers of intermediaries.

The Committee has recently debated the potential effect on stock lending and repo of the proposed Basel capital rules. The new regulatory framework now coming into force has been discussed and in particular how the provisions on market abuse in the Financial Services and Markets Act will apply. CRESTCo has briefed on the impact of delivery versus payment and London Clearing House on the progress of the Repoclear project, which will greatly facilitate netting.

SLRC is involved in providing good practice guidelines for the repo and stock lending markets. It produced the Gilt Repo and Equity Repo Codes and more recently a revised Stock Borrowing and Lending Code. Work is in progress on producing a UK annex to the latter code, and it is envisaged that other country-specific annexes

(1) See 'The London Foreign Exchange Joint Standing Committee: a review of 2000', *Quarterly Bulletin*, Summer 2001.

will be produced subsequently. A sub-group is working with legal advisers in obtaining and reviewing legal opinions on stock lending agreements in various jurisdictions.

The SLRC seeks to keep under review work on changes to the main legal agreements used in the markets; and was instrumental in producing the revised Gilts Annex in 2000 to accompany the revised TBMA/ISMA Global Master Repurchase Agreement (GMRA 2000).

Most recently the Committee considered the performance of the market following 11 September and the lessons arising. It also considered the concerns expressed by a few individuals about short selling and stock lending, noting that both activities were a normal and accepted part of developed financial markets, and already well recognised as such by the authorities. Short selling facilitates orderly settlement and the avoidance of fails, and helps to improve the liquidity of securities markets. These concerns have now subsided.

Minutes of the MMLG and SLRC meetings are posted on the markets area of the Bank's web site at http://www.bankofengland.co.uk/markets/index.htm