BANK OF ENGLAND

Collateral Operations Review (COR) Project: Implementation of a Single Collateral Pool (SCP) Model – Frequently Asked Questions

General

1. What is a Single Collateral Pool?

As the name suggests, the Bank will hold a single pool of collateral for each participant which will be used to offset the exposures that arise as part of the Bank's official operations. This replaces the current model whereby each operation is managed separately using 'repo' transactions.

2. Why is the Bank doing this?

To simplify the process for managing the collateral provided in the Bank's operations, with the aim of enhancing operational efficiency and reducing operational risk – both for the Bank and for participants in its official operations.

3. Why did the Bank choose the SCP approach over another method of achieving these aims?

The Bank consulted several other central banks that have implemented an SCP model *(for ref: Banque de France, Netherlands Bank and Bank of Japan)*. They have seen significant reductions in the volume and frequency of collateral movements relating to their official operations.

The Bank also conducted a full consultation process with its participants before taking this decision and received a high level of support for the proposals. The October 2010 consultation document can be found with other SCP documentation on the Bank's website, on the Markets pages under the 'Sterling Monetary Framework Operations' link.

4. What are the main changes involved for an SCP model?

At present, the Bank's SMF and intraday liquidity operations are 'repo' transactions whereby individual securities are held as collateral against the Bank's exposures to that participant. The proposed SCP model would aggregate a participant's collateral position and lead to a significant reduction in the number of transactions needed to provide collateral to the Bank.

5. Does this mean large-scale changes for the banks participating in the operations?

Not to any great extent. The processes and timing for Open Market Operations will be unaffected by this change. Banks will still participate in open market operations (OMOs) and source intraday liquidity from the Bank. Thus they will still need to collateralise these operations. But the collateralisation process will be more efficient for them as well as for the Bank.

6. Are there any other changes that are happening as a result of this?

Alongside the SCP model the Bank will be adopting market standards for the delivery and receipt of collateral by the participant banks, replacing the current more manual procedures. The ability to straight-through-process these transactions should also improve efficiency and reduce operational risk for the Bank and the participants.

7. Does this change the Bank's method of monetary policy implementation?

No. The structure and frequency of the Bank's operations will be unaffected by these changes. Only the method of collateralising the resulting exposures will change.

8. When will this change be implemented?

The go-live date is expected to fall in the second half of 2014. Further information can be found on the Bank's website – please see the Seminar presentation which is on the Markets pages under Sterling Monetary Framework Operations – Information for Participants – SCP Implementation.

9. Where can we get more information?

Please go to the Bank's website where, on the Markets page under 'Sterling Monetary Framework Operations', there is a link to Single Collateral Pool implementation under 'information for participants'.

Specifics for participants

10. What is the impact for firms that are only signed up to the Operational Standing Facilities (OSF)?

The collateralisation of any cash drawings made under the OSF will be managed within the SCP framework. If the collateral is already held with the Bank, then the operation will settle automatically once the Bank's front office approves the drawing. Alternatively, the participant may deliver the necessary collateral same-day, ideally via the Portal or MT540 series SWIFT messages.

11. What happens if a participant tries to deliver collateral that has not been confirmed as eligible?

The Bank will not accept collateral that it has not confirmed as eligible. Participants will be informed (via SWIFT message or the Portal) of the reason that the delivery has not been successful.

12. Why will the Bank be applying minimum maturity limits?

Under the current repo arrangements, collateral must have a maturity date later than the maturity of the repo under which it is held. The Bank enforces this partly to avoid the complexities of managing any cashflows associated with maturing securities.

This cannot work in a pooled collateral scheme because the length of operations collateralised by the SCP will vary. Instead, a line of collateral in the pool is only used to collateralise exposures if it meets a 'minimum time to maturity' restriction. Thus, once a line of collateral falls within that maturity limit, it will simply be given zero value in the pool. For the Single Collateral Pool we plan to set the limit at 10 days or less (depending on the collateral held), though this is subject to change.

13. Which pools will participants need – is it only for SCP and DWF?

The number of pools will depend on the operations which the Bank conducts. In the event of (for example) a US dollar swap operation, we cannot utilise the SCP because the SCP collateral is valued in a different base currency with a different haircut structure.

We would need to set up a separate 'sub-pool' (for each participating bank) in which collateral is valued in dollars, in order correctly to value the securities being used to collateralise the US dollar loan. It is straightforward for the Bank to set up new pools in the new system.

Please note that 'pre-positioned' DWF collateral will, in future, be held in custody in the participant's SCP and only moved to a separate DWF pool in the event of a DWF drawing.

14. Will IDL collateral be unencumbered at end of business day as currently?

In effect, yes. All participants will be provided with a value of their collateral that is excess to requirements within each collateral class. There will be the flexibility to choose which collateral they wish to report as unencumbered in order to make up this value. Participants will be able to access information on the excess values and on the collateral itself from the Portal or from daily SWIFT statements.

15. Will the increased holdings attract increased custody fees?

It is important to note that the SCP model does not necessarily imply large increases in participants' collateral holdings at the Bank. Only the method of collateralisation will change.

Either way, the Bank's custody fee policy will remain the same. Any fees incurred by the Bank though its holdings of SMF collateral at the central securities depositaries will be passed onto participants on a pro rata basis. This includes fees on any excess collateral. Indeed, given the economies of scale the Bank achieves from the size of its holdings, the rates passed on are often lower than the direct fees that would be incurred by many participants.

16. Will elected items such as MT548 settlement advices come at additional cost?

Participants would not be charged by the Bank for choosing to receive these SWIFT messages.

17. What are the formatting options for statements?

Participants can elect to receive statements as MT535 SWIFT messages or secure emails in a standard format from the Bank's system. Participants that choose to take the Portal can download the available data themselves (including all collateral and operation details) and format accordingly, for example within Excel.

18. How does the new system deal with corporate actions on securities held as collateral? Will it send out notifications?

Participants can elect to receive Corporate Action Notification messages (SWIFT MT564) for any mandatory or voluntary corporate action that applies to collateral held by the Bank in support of its operations.

19. Will prices used to value collateral be available in valuation reports?

The Bank will not provide its prices directly, via the CM Portal or in other reports.

20. *Does the Bank expect the change of legal ownership from pre-positioned securities (owned by the participant but held by the Bank) to a collateralised loan agreement (owned by the Bank) to cause change in behaviour regarding 'pre-positioned' collateral*?

As explained in the seminar presentation and the letters from Toby Davies, we fully expect the encumbrance rule change to remove any disincentive to place collateral with the Bank. Furthermore, we have consulted other central banks which operate the Single Collateral Pool mechanism (including Banque de France and Netherlands Bank) who have reported no disincentives to holding excess collateral in their operations.

21. Does the changed legal status of the collateral affect the way the Bank services the assets held in the SCP?

The changed legal status of the collateral holdings will not affect the way the Bank services the assets held in the SCP. Coupons (and redemptions) paid on participant securities held by the Bank will be manufactured back to the participant, subject to margin calls being met, as is the current process. Participants can elect to receive various SWIFT corporate action notifications including MT564 and MT566 messages.