A response by UK Finance to the Bank of England's Discussion Paper

on Transitioning to a repo-led operating framework

January | 2025

Introduction

UK Finance[1] is pleased to respond to the Bank of England's (the Bank) **Discussion Paper** on transitioning to a repo-led operating framework. It:

- *proposes that a demand-led framework is a more appropriate mechanism to supply reserves as the Bank of England's balance sheet normalises*
- *sees a greater role for repo operations, particularly Indexed Long-Term Repo (ILTR) operations in the Sterling Monetary Framework*
- *suggests that firms should ensure that are operationally ready for increased usage of the Bank's short- and longer-term repo operations*

Key Messages

Support for the proposals

Our members are fully supportive of the Bank of England's proposal to move to a more demand-led approach to the supply of central bank reserves. It represents a sensible and practical re-focussing of the Sterling Monetary Framework (SMF), in the light of the ongoing normalisation of the Bank of England's balance sheet. The proposed framework should be operationalisable for most firms with little change to exiting processes and procedures although, as the Bank recognises, there may be challenges for our smaller members as they prepare for it.

More tenor flexibility would be welcome

We note and agree with the Bank's observation that banks tend to roll over existing drawings under the Short-Term Repo (STR) and that utilising the STR facility is now seen as business as usual. We also agree that it does not make operational sense either for users of the STR or the Bank to keep rolling over relatively large amounts every week, which introduces the possibility of operational error and risk, however remote.

We welcome the addition of a longer, 6-month, tenor to the repo armoury but suggest the Bank should consider offering other maturities, perhaps one and three month also, at least during

[1] *UK Finance is the collective voice for the banking and finance industry. Representing 300 firms, we are a centre of trust, expertise and collaboration at the heart of financial services, championing a thriving sector and building a better society.*

the period that firms build familiarity with the new approach, to give firms greater flexibility in responding to unexpected changes in their maturity ladder and thus demand for central bank reserves as their balance sheets evolve.

An alternative to our 'more tenors' suggestion would be to allow firms to prepay their drawings, after a short, two-day, period of notice, as is permitted on other SMF facilities.

The auction process

Members understand the Bank' preference is for a competitive 'Dutch' auction at which all bidders above the clearing spread pay the same price. Our members believe that there is scope to increase the regularity of such auctions to enable bidders to access the facility more regularly. This will be particularly important as the capacity of the Bank's repo facilities increases, while embedding its role as a business-as-usual facility that does not signal any distress on the part of participating firms.

Our members would also welcome the opportunity to place bilateral bids on a reverse enquiry basis at any time outside the regular auction window.

This would help SMF participants that have been unsuccessful in their auction bids or need to roll a repo at other times.

Encumbrance reporting

Members fully support the need to pre-position adequate quantities of collateral with the Bank to supply the reserves that banks demand for payment and precautionary purposes.

However, members note that they report to the PRA as encumbered the entirety of the collateral posted at the Bank, even if these assets have not been drawn down. Our members, recognising that is an issue for the PRA to address, would clearly prefer to report the actual encumbered amount which will assist with clarity in engagement with investors and other stake holders such as rating agencies. The current approach creates trapped collateral and therefore liquidity.

On a related note, the drawn balances under the facilities should be treated favourably in regulatory metrics such as the leverage ratio.

Prepositioning 'new' collateral

We recognise and welcome the Bank's willingness to be ready to lend to participants in the SMF against a wide range of eligible collateral, including loan pools, and the importance of the Bank understanding their credit profile in advance of it lending against them.

Some of our smaller members in particular may be more reliant on Level C collateral. They and larger members too, tell us that the process for seeking Bank approval for tortuous. faster top-ups is the long drawn-out process for the Bank is the drip-feeding of questions over a period of many weeks. Bank should have an SLA in place of for instance 3 months to come to a decision about Level C collateral.

We also question the significantly large sample number of loans the bank needs to audit in relation to Level C collateral but welcome that Bank has now moved away from using a single law firm to oversee the legal audits to a panel of 3 law firms as legal audits have been another source of significant delay.

The current eligibility criteria for Level C Loan collateral is solely UK focused. For lenders with loan portfolios that include a significant number of multi-jurisdictional borrower groups, it would be beneficial to consider expanding the scope of eligible obligor jurisdictions and currencies. This expansion would enhance access to the ILTR facility.

On collateral eligibility, a further point is that the eligible collateral profile for Equity collateral is very strict, with restrictive concentration limits. We would encourage the Bank to consider the possibility to widen it to main equity indices and reduce the concentration limits. We would also encourage the BOE to make equity collateral part of their standing collateral profile as it is today only discretionary.

Not only is it lengthy, taking many months, but the information required of firms, via data tapes, is extremely comprehensive, with mortgages requiring the reporting of 100 different attributes, we understand.

Our members would be pleased to work with Bank staff to distil these attributes down to a narrower range, drawing on their own lending practices and the Bank's experience of using the data they currently receive for probability of default analysis purposes. We except that by focussing on the most relevant attributes this would also decrease the approval time. Ideally, the Bank should consider moving to an automated process where collateral eligibility can be checked digitally / electronically and haircuts are clearly set out against the corresponding ISIN number.

Our members note that, in the case of publicly traded securities, eligibility of an individual asset for use as collateral in Eurosystem operations can be easily determined by a daily-updated data base referencing ISIN numbers. We encourage the Bank to develop such a mechanism too.

Triparty repo

Our members recommend that the Bank considers moving to a delivery vs payment (DvP) tri-party repo approach to collateral positioning and management. Our members are very familiar with the tri-party approach, which is used by the ECB in its Eurosystem operations and Federal Reserve in its open market transactions. Tri-party repo outsources post trade collateral management to a third-party agent. This facilitates routine activities such as collateral selection, payments and deliveries, custody of collateral securities, collateral management and substitution, settlement and other operations during the life of the transaction.

Triparty repo is the mechanism behind the Federal Reserve's Overnight Reverse Repo Facility (ORRP), and the Standing Repo Facility (SRF). The SRF, for instance, is available daily with a capacity of $500 billion, with bids still awarded via auction. As such, the Bank could continue its preferred method of awarding bids, while benefitting from operational efficiencies. The operation of such a platform by a third party means the central bank is exposed to less operational and settlement risk, while benefitting from market-leading operational efficiencies. It would also reduce the intraday liquidity risk and associated costs vs current operating framework of prepositioning.

Our members find that a tri-party approach is much more transparent and efficient allowing them to better optimise use of collateral against a pre-agreed basket of collateral with substitution rights agreed in advance in line with the criteria of the basket. Specifically, participating firms can not only check collateral eligibility digitally – decreasing burden on both firms and the central bank – but triparty also allow firms to see the haircut applied by ISIN number. This allows firms to make clear, fully informed, decisions in advance. Failure to do so could have deleterious consequences during a period of volatility where firms only realise they are unable or unwilling to access Bank facilities, once collateral eligibility and haircuts become clear.

As triparty is already used for the Federal Reserve facilities, it can be compatible with T + 1 settlement. Given the expected move to T + 1 in the UK, possibly in 2027, triparty repo would prove an ideal way of future-proofing the Bank's facilities for future market changes, without any substantial increase in operational risk or settlement failures.

Challenges for smaller members

Our smaller members have been active users of the TFSME which they fully appreciate is being unwound and have been actively making plans to repay these funds. The ILTR may well be an important future source of funding for them. But some may need help and support from the Bank as they transition away from TFSME. UK Finance would be pleased to facilitate workshops with such members and the Bank if needed.

Of course, UK Finance would be pleased to facilitate discussion with members on the issues we have raised in this response. We are content that the fact that UK Finance has responded to this consultation be published by the Bank of England on its website.

Responsible Executive

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