SECURITIES LENDING AND REPO COMMITTEE

WEDNESDAY 31 AUGUST 2005

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Members present:	David Rule	Bank of England, Chairman
	Nicola Stead	Bank of England, Secretary
	Richard Steele	International Securities Lending Association/ JP Morgan Chase
	Mark Hutchings	International Securities Lending Association/ AIG
	Sarah Nicholson	International Securities Lending Association/ Morley Fund Management
	Godfried de Vidts	European Repo Council/Fortis Bank
	Ian Fox	London Money Markets Association/ HBOS
	John Whitmore	Financial Services Authority
	John Serocold	London Investment Banking Association
	Bryan Kilpatrick	National Association of Pension Funds
	Alex Merriman	British Bankers' Association
	Anthony Littleton	Association for Payment Clearing Services
	Neil Atkinson	CRESTCo
	Nick Fisher	UK Debt Management Office
	Nick Maggs	LCH
	Tony Hibbitt	Cater Allen International
	Barbara Pung	International Securities Market Association
	Markus Sgouridis	The Bond Markets Association
	Also present:	
	Paul Tucker	Bank of England
	John Rippon	Bank of England
	Stephen Hanks	HM Treasury
	Elaine Graham	Freshfields Bruckhaus Deringer
	Adebayo Adesina	Freshfields Bruckhaus Deringer
	Brian Reddy	Freshfields Bruckhaus Deringer

1. The minutes of the meeting held on 22 April 2005 were agreed. Minutes of previous SLRC meetings are available at: www.bankofengland.co.uk/markets/slrc.htm

MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)

1. Stephen Hanks updated the Committee on progress on MiFID. The deadline for the implementation of MiFID was confirmed as April 2007 (extended from the original deadline of April 2006).

2. HMT and the FSA were both due to issue in November or December consultation papers on MiFID's implementation. The HMT paper would focus particularly on changes to the Regulated Activities Order and the Financial Services and Markets Act. The FSA paper would contain more of the detailed provisions of the implementation paper and the issues facing the market.

3. The Commission was due to publish a formal draft of the implementation measures on 31 October [now likely to be some time in November], which would then be put to the European Parliament for its opinion and the European Securities Committee for its recommendations.

4. The main issues affecting the stock lending and repo markets were associated with the reporting of transactions. There were two proposed requirements here:

   - Reporting transactions to the regulators, which would include gilt repo transactions (and therefore prospectively Bank of England open market operations). The UK was against this proposal [since confirmed by the FSA and HMT that this requirement has been dropped from the latest version of the text].

   - Publication of transactions (post-trade transparency), which would include equity stock lending; although this was likely to be defeated as only a few countries were in favour and France, Germany and the UK were against [since confirmed by the FSA and HMT that this requirement had been dropped from the latest version of the text].

5. Mr Hanks said HMT would be discussing the proposals with the relevant trade associations, but also that HMT would send papers produced on MiFID to a circulation list, which members were welcome to join by contacting him.

6. John Whitmore (FSA) also updated the Committee. As part of its consultation on MiFID Level 2 measures, CESR had recommended that stock borrowing and lending transactions should be exempt from post-trade transparency requirements. This had generally been supported by consultees. The Commission had nonetheless included a post-trade transparency requirement for stock borrowing and lending in its draft implementing measures, largely, it appears, because of its concerns over a lack of

transparency in respect of short selling. [As noted above, in subsequent drafts of the regulations, the Commission has withdrawn its proposal].

7. It was suggested that SLRC could send the relevant people in the Commission the *Introduction to Securities Lending* paper, to help them understand the market.

8. John Serocold noted that the reporting requirements of MiFID would mean changes were necessary for companies' IT systems, and that these changes could not be scoped until the likely outcome of the legislative process was known– this was concerning as they were not likely to be small-scale. The technical ability of the regulators to receive the data was also an issue.

9. Also raised were questions about how information could be collected on bundles of collateral e.g. DBV in CREST, and whether intra-day repos associated with liquidity provision in RTGS payment systems would fall within the scope of the reporting– it was difficult to see how this would have any value.

10. Mr Whitmore said that the most relevant conduct of business provision that MiFID will impose on securities lending will be the "best execution" requirements in Article 21 of the Level 1 measures. He reported that the FSA had collected data showing that over 90% of securities lending transactions involved 'eligible' counterparties, which would be exempt from the obligations. Furthermore, the latest draft of the proposed MiFID Level 2 measures allowed all professional clients to opt for treatment as eligible counterparties.

11. This figure was supported by ISLA, who asked whether prime broker lending to hedge funds would fall under the requirements; this highlighted that a company could be an eligible counterparty for some trades and not others. HMT had indicated that the requirements would operate on a trade-by-trade basis. Mr Whitmore said he would circulate additional clarification on this once the final Level 2 provisions became clearer.

ESCB/CESR STANDARDS ON CLEARING AND SETTLEMENT

12. Godfried de Vidts updated the committee. A copy of his slides is attached. The standards that affected the securities lending and repo markets were Standard 4: Central Counterparty, Standard 9: Credit and Liquidity Controls and Standard 18: Regulation, supervision and oversight.

13. Standard 9, which detailed the obligations of CSD operators, had been delayed until the publication of the CPSS/ IOSCO paper on Recommendations for Central Counterparties. This topic will also be covered at an ECB/ Chicago Fed conference in April 2006.

14. At present the proposal from the banking sector was that CSDs should be treated separately from banks, i.e. that the standard should not apply to banks. (If it did, then the banks agreed that broker-dealers should also be included.) The banks also argued that they should be supervised by banking supervisors rather than the ECB or CESR. The requirement that CSDs should not be allowed to take credit or liquidity risk could affect securities lending transactions e.g. Euroclear's securities lending programme.

15. Work on the methodology for Standard 18 had started in early May with a meeting of an ECB /CESR taskforce which had requested that the role of home vs host regulators should be defined.

16. One of the main issues for repo and securities lending was the definition of 'significant' and 'non-significant' custodians. The Brussels meeting had tried to clarify how 'significant' custodians would be defined– at present those with greater than €500bn of euro assets under custody would be included but this raised a question about whether the size of assets or the level of turnover was more relevant.

17. There would be a consultation on the revised standards from October to December and members were urged to respond.

SEPTEMBER MEETING OF THE EUROPEAN REPO COMMITTEE

18. Godfried de Vidts reported on the agenda for the meeting on 21 September. The main item of interest was the settlement between the ICSDs and the German CSD. At present there was a lack of harmonisation between the operating times of the CSDs, but it was hoped that this would be addressed following the meeting. [A solution has been found; Clearstream is preparing a press release].

UK INSURANCE REGULATIONS

19. John Whitmore spoke. The FSA's consultation on the rule amendment for securities lending through Euroclear had been positive and the FSA would be going ahead with a rule change (proposed in its April consultation), once it had been formally approved at

the FSA board on 15 September. For the purposes of the rule, Euroclear Bank would be the counterparty. [The change has now been approved. See Handbook Notice 47 at www.fsa.gov.uk/publications].

20. The FSA were also considering whether to make a similar rule change in respect of Clearstream, and whether stock lending through Euroclear should be 'permitted' stock lending for collective investment schemes.

21. Stock lending by insurers directly to US broker dealers and banks (supervised by the federal authorities with the appropriate permissions) and the use of letters of credit as collateral had been consulted on as part of the FSA's July quarterly consultation. That consultation had closed on September 8 and the intention would be to implement the proposed changes in November or December unless the consultation responses raised further issues.

22. Sarah Nicholson said that ISLA had responded to the July consultation and welcomed the changes in relation to Euroclear. They had also supported the recommendation that letters of credit would continue to be allowed as collateral in stock lending transactions if they were issued by EEA and US banks.

UPDATING THE GILT AND EQUITY REPO CODES OF BEST PRACTICE

23. John Rippon said that the Bank of England was aiming to have drafts of the preliminary updated Codes ready for internal circulation in October. The new Codes would reflect recent changes in regulation, lessons from the Securities Lending Code of Guidance and market developments.

PUBLICATION OF SECURITIES LENDING AND CORPORATE GOVERNANCE DOCUMENT

24. Mark Hutchings thanked the endorsing bodies of the publication, which had been published during the summer. Feedback had shown that the publication had been welcomed.

25. The IGCN paper on voting had not yet been published in its final form. Another draft had been produced, which ISLA had seen.

SLRC NETTING SUB GROUP AND ISLA DUE DILIGENCE PROJECT

26. Richard Steele outlined ISLA's proposal to co-ordinate offering advice from legal counsel to subscribers, e.g. to help them meet legal, regulatory or tax requirements in different jurisdictions. The aim would be to add these additional services to the netting opinion gathering service provided by Freshfields.

27. John Serocold supported the idea but said that it was important to commit to a firm proposal and timetable. ISLA, ICMA and LIBA should speak to agree.

28. Regarding the opinion gathering exercise, members agreed that it made sense to have a co-ordinated approach to obtaining opinions on the master securities lending and repo agreements in order to avoid the same work being done by different counsels (and sometimes by the same counsel for two fees) to produce opinions which then needed to be checked against each other. The Chairman said that the Bank, with Freshfields, would organise a group from LIBA, ISLA, TBMA and ICMA to discuss how to achieve a co-ordinated approach.

GMRA: UPDATE OF LEGAL OPINIONS

29. Barbara Pung updated the committee. Subject to acceptable costs, ICMA was considering extending the scope of updates and new opinions to cover insurance companies, hedge funds and mutual funds (in addition to companies, banks and securities dealers already covered by the current opinions) as parties to the GMRA. This exercise would be considered in the context of the securities lending agreements opinion-gathering exercise.

30. The appendix to these minutes details the status of new and revised opinions for the various jurisdictions.

ANY OTHER BUSINESS

31. John Serocold said that the problems with obtaining the US opinion on the securities lending agreements had been resolved and efforts were now being made to ensure there was no repetition for the 2006 opinion.

32. John Whitmore said that the FSA were due to issue a paper on bond market transparency.

33. The Chairman said that the Bank of England had published a paper consulting on the transitional arrangements to be put in place ahead of Money Market Reform, which included the possibility of the Bank lending money via repos at maturities of 6-12 months at market rates.

DATE OF NEXT MEETING

2. The next meeting will be held on 30 November 2005 at 11am, at the Bank of England. It will be followed by a buffet lunch.

BANK OF ENGLAND
3 OCTOBER 2005

Appendix: ICMA's update on the GMRA opinion gathering exercise

Following the review of a revised draft of a new opinion for the People's Republic of China by a working group of the ICMA/TBMA Joint Opinion Committee (JOC) the opinion should be available by the beginning of September 2005.

ICMA was currently reviewing a revised draft of a new opinion for Brazil. The opinion should be available by the beginning of September 2005.

For Scotland, South Korea and Taiwan, local counsel were currently preparing revised draft opinions for ICMA's review.

An initial draft of a new opinion for Mexico and the Philippines was currently being reviewed by ICMA.

Since it should be possible to obtain clear opinions for Guernsey and Slovenia, ICMA had recently instructed counsel for each of these jurisdictions to prepare a draft opinion for ICMA's review.

With regard to Jersey, subject to acceptable costs ICMA would be instructing counsel to produce an opinion for this jurisdiction for the first time.

In relation to Croatia, Malaysia and Romania, ICMA was currently clarifying whether a clean opinion for these jurisdictions could indeed be obtained. In the affirmative and subject to acceptable costs, ICMA would consider seeking an opinion for these jurisdictions.

In relation to the Czech Republic and Slovakia, ICMA was continuing to monitor legal developments with a view to ascertaining at what stage a clean opinion could reasonably be expected.