

## STOCK LENDING AND REPO COMMITTEE

THURSDAY 15 AUGUST 2002

SUMMARY OF MEETING HELD

AT THE BANK OF ENGLAND

Members present:	David Rule	Bank of England, Chair
	Dagmar Banton	London Stock Exchange
	Krystyna Beck	Deutsche Bank (London Investment Bank Association)
	John Burke	London Clearing House
	Andy Clayton	Northern Trust (International Securities Lenders Association)
	Toby Davies	CRESTCo
	Cameron Dunn	Merrill Lynch (European Repo Council)
	Hugh Gibson	HSBC (Association for Payment Clearing Services)
	Simon Hills	British Bankers Association
	Mike Jameson-Till	Investec
	Tammy Phillips	Morgan Stanley
	Steve Russell	HSBC
	David Sly	Inland Revenue
	Alan Spargo	GNI
	John Rippon	Bank of England
	Steve Whiting	Debt Management Office
	John Whitmore	Financial Services Authority
	Simon Ainsworth	Bank of England, Secretary
Also in attendance:	Howard Jones	Bank of England
	Will Kerry	Bank of England
	Margot Marshall	Financial Services Authority
	Tammy Phillips	Morgan Stanley
	Stephen Priddle	Bank of England
	Jon Relleen	Bank of England
	Emlyn Scott	London Clearing House
	Guy Simkin	London Clearing House
	Julian Wiseman	Bank of England

### SUMMARY OF MEETING HELD ON 11 JUNE 2002

The minutes of the previous meeting were agreed. Previous meetings' minutes are available at: <http://www.bankofengland.co.uk/markets/slrc.htm>

## **VIEWS ON RECENT TRADING**

1. The Chairman asked the Committee for views on the pattern of trading seen in the past four months as equity indices had fallen. Members reported that there had been no marked increase in stock lending over the period. Those attendees with prime brokerage businesses said that short positions of hedge funds had not been unusually large either. Indeed, many had reduced positions. CREST figures on aggregate stock lending of FTSE-100 UK equities suggested that over the past four months the amount of stock on loan continued to account for round 2% of market capitalisation, although proportions had edged slightly higher over the past six weeks.

## **FSA UPDATE ON SHORT SELLING/STOCK LENDING WORK**

2. The FSA representatives set out the background to their current work programme on short selling.
- Last summer a few companies expressed concern to the FSA that they believed they had been targeted by short sellers. Before hearing of these concerns the FSA had already planned to review its approach to short selling since it had most recently been reviewed in 1996 and markets had developed since then;
  - This process had been given added impetus when further claims about short selling were made following the 11 September terrorist attacks; the work had been made a priority for end Q2/Q3 of this year but was superseded by higher priorities in Q2.
  - The current research phase of the project would last a further 6 weeks, which would then be followed by the publication of a discussion paper sometime in October. The FSA was talking with a wide range of interested parties in the markets. The review was focusing on equity rather than fixed income markets. The FSA had stated that it was aiming to produce a discussion paper in October. The FSA was planning a round-table on short selling in September.
  - The FSA viewed short selling as a valid investment practice.
  - The FSA was prepared to listen to arguments for greater regulation of short selling but had so far not been convinced that regulation of the trading process was the answer. However, the FSA stated that some form of disclosure of

short selling or securities lending might be appropriate. In its research to date, the FSA had found no conclusive evidence that ‘tick’ regimes, utilised by some overseas jurisdictions, had resulted in better market outcomes or lower equity price volatility.

- The FSA reported that they were researching ways of improving disclosure, if that was appropriate, either through the publication of data on short selling or through the publication of stock lending figures.

3. The FSA outlined international factors that should be considered.

- A project was being undertaken by IOSCO on transparency and short selling forms a part of that project; conclusions not expected until 2003.
- In Europe there existed little specific regulation of short selling, although some jurisdictions had rules on disclosure of stock lending and/or short positions or required short sellers to borrow stock almost immediately.
- North American and Asian authorities were more prescriptive about market practice, with requirements that included ‘tick’ rules and disclosure regimes. In the US aggregate market short positions were published monthly; in Canada bi-weekly; in Australia daily and in Hong Kong twice daily.

## **DISCUSSION**

4. The Chairman asked whether, from the perspective of the stock borrowing and repo market, attendees saw merit in any of the options for further regulation of short selling. Nobody spoke in favour of further regulation.

5. The Chairman asked members whether, from the same perspective, greater disclosure of aggregate stock lending or short selling positions by stock would help practitioners. Most attendees believed that the publication of such stock lending data would be of limited value to market practitioners but could perhaps be helpful to retail investors and company managers. However, a number stressed that guidance would be needed as to how to interpret any data. For example, CREST stock lending data included positions related to securities settlement and financing transactions as well as short positions. Company managers could obtain some data from their share register.

6. The Chairman asked how useful CREST data would be in providing transparency. The CREST representative reported that while CREST had no data on short selling, it did produce comprehensive data on stock loans, which were often used, amongst other things, to finance short positions. Trade-by-trade data had always been made available to the FSA and LSE as part of the transaction reporting regime and more recently CREST has provided the FSA with aggregate data by stock. The CREST representative reported that CREST was in discussions with a third party vendor with the intention of publishing more detailed analysis on a subscription basis. The intention was to provide different levels of service, including a breakdown by individual security and, for a CREST member, a comparison of its stock loan activity relative to the rest of the market (while maintaining strict levels of confidentiality). The product should be ready to trial in the autumn, after work had been done to strip out intermediation and value effects. Committee members welcomed this move, although it was noted that the pricing policy should not deter potential users and some thought a core level of data should be published free-of-charge. Some attendees also felt that publishing data on less liquid stocks could reveal changes in the position of an individual firm – for example, if the stock had one large market maker only – leaving it open to a squeeze. It was pointed out that CREST stock lending data would be only a rough proxy for the scale of short selling, given other possible motivations for stock borrowing and the possibility of going short without borrowing the stock eg via derivatives.

7. The Chairman asked the committee how easy would it be to collect meaningful aggregate data on short selling in cash and derivatives markets directly from intermediaries. The consensus among members was that it would be difficult to define short positions in a satisfactory way (eg in relation to options positions), to judge what range of intermediaries should be included and to produce timely data. In all likelihood, results would have little meaning. This was the view taken of such statistics in other countries. Compliance costs might be significant depending on what data was collected and how. Members agreed that that CREST data on stock lending would be much easier to obtain than any survey data on short selling, potentially more comprehensive, and perhaps just as good a broad measure of short selling in spite of the limitations mentioned earlier.

8. The Chairman asked committee members for views on what, if anything, the SLRC could usefully do next. Members thought the minutes of the meeting should be published as normal but otherwise the Committee should wait to respond to the proposed FSA consultative paper. Some also thought that the Committee should do more to explain stock lending market to the public: for example, through a one-off publication. The Chairman concluded that further thought should be given to this and the Bank would put forward some possible ideas at the next meeting. The SLRC had previously endorsed a brief explanation of stock lending which is available on the BBA's website at <http://www.bba.org.uk/public/corporate/35471/53291>.

### **GILT SETTLEMENT THROUGH REPOCLEAR**

9. The LCH representatives reported that in the 8 business days since gilts have been added to the securities settled through RepoClear a daily average of £6.5bn had been settled, at an average maturity of 10 days. Automated trading systems and voice brokers both had significant proportions of the business, with a greater proportion of business executed via voice brokers than had been the case with the other European government securities cleared through LCH. It was reported that gilt repo trading was more concentrated than other markets between 8 and 10.30am. LCH did not yet have a power of attorney to allow it to instruct settlement on behalf of its members in CREST. While this was a concern, there had so far been a 100% settlement success rate.

### **NEXT MEETING**

11. The next meeting was scheduled for 10 September but would have to be rearranged for later that month.