

STOCK LENDING AND REPO COMMITTEE

TUESDAY 11 DECEMBER 2001

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Present:	Neal Hatch	Chairman
	Dagmar Banton	LSE
	Krystyna Beck	LIBA
	Toby Davies	CRESTCo
	Hugh Gibson	APACS
	Tony Hibbitt	Intermediaries
	Simon Hills	BBA
	Mark Hutchings	ISLA
	Graham Jones	Intermediaries
	Mike Ness	DMO
	Philip Reichardt	Euroclear
	John Serocold	LIBA
	David Sly	Inland Revenue
	James Tomkinson	ERC
	Tim Westover	MMLG
	Rory Cunningham	LCH
	Merope Sylvester	FSA
	Charles McSwiggan	Investec
	Steve Russell	IEMRC
	Geoffrey Goffinet	Bank of France
	John Rippon	Bank of England
	Caroline Pitt	Bank of England
	Stephen Priddle	Bank of England
	Howard Jones	Bank of England, Acting Secretary

The chairman welcomed a visitor from the Bank of France, Geoffrey Goffinet.

MINUTES OF MEETINGS HELD ON 11 SEPTEMBER AND 9 OCTOBER

1. The Chairman asked if there were any comments on the minutes of the previous two meetings. Ms Banton said that paragraph 32 of the October minutes should reflect that there is no need for CREST to provide the functionality for these deadlines.

Previous meetings' minutes are available at:

<http://www.bankofengland.co.uk/markets/slrc.htm>

FOLLOW UP TO 11 SEPTEMBER

2. The Chairman drew the Committees attention to an extract from the Bank Quarterly Bulletin and asked for any comments from The Committee on the specific references to stock lending/repo market following 11 September developments. Members were content with what had been said. He said that the forthcoming Financial Stability Review would cover some of the ground in more detail.

3. He then turned to a short briefing/Q&A document from the BBA about stock lending. He said he hoped this brief document would be a useful educational tool. Mr Hills said that there was a mis-understanding about stock lending in some quarters and that such briefings were certainly needed. It was agreed that the document, with some amendment, would be a valuable introduction to stock lending, and could be placed on websites with links to more detailed resources. The Chairman encouraged members to submit comments to the BBA.

4. Mr Gibson drew attention to the new IOSCO paper, which appeared to define the practice of acceptable stock lending more narrowly than previous versions. He was particularly concerned that the definition specified that lending was to expedite the settlement of transactions, when he estimated that only 20 to 30% of stock lending was for settlement purposes. The Chairman acknowledged that this issue would have to be returned to in the future.

5. Mr Reichardt noted the recent coverage of stock lending by a newspaper, which he felt had chosen to focus only on the perceived negative aspects. He believed that a higher profile stance by the FSA might be valuable and would dispel the impression that this is an unregulated activity. He noted that an article on this subject had earlier made its way into another newspaper and felt this issue was likely to be a recurrent one.

6. Ms Sylvester replied that the FSA had written an article in Market Watch supporting securities lending (a copy of which had been circulated at the meeting) and there was likely to be a follow-up article.

7. Mr Russell said that despite the negative press, pension funds were increasingly taking advantage of the stock lending and repo market.

8. The Chairman asked if the committee had any views on a suggestion that a lower interest environment might lead to greater fails or other distortions in the repo market. Mr Hibbitt suggested that negative real rates of interest were a possibility in the U.S. Mr Reichardt drew attention to the Yen as a precedent. He suggested that the low return on Yen meant that it was increasingly difficult to repo overnight because of the risks involved. He said that the Belgian regulators made them (Euroclear) report and adequately cover their exposure to Yen and make adequate capital provision.

9. Mr Tomkinson suggested that the Yen demonstrated the potential dangers of low interest rates in that interest earned may be lower than the service costs of transactions. He added that there were implications of posting minus rates on dealer screens. People might be motivated to fail on a transaction. He cited a recent case where the provider of securities had chosen not to deliver on a transaction and in which the proposed receiver had sought compensation for the interest that they should have received. As repo rates approached zero he feared that we might see an increasing incidence of fails.

10. The Chairman briefed the Committee on the discussion about contingency planning led by Ian Plenderleith in the Money Market Liaison Group. Mr Plenderleith had suggested there were four strands to be pursued. Individual firms looking at their own businesses (under FSA auspices); the security of the financial infrastructure and payment systems (under tripartite committee auspices); the physical infrastructure including transport and communications (under City of London auspices), and consideration of needs of that various markets operating in London such as foreign exchange, repo, inter-bank deposits (under Bank auspices). The last strand might include the flow and availability of information, communications between firms' back-up sites and with the authorities, liquidity needs, and what communications and settlement systems might be needed to allow trading to continue.

11. For the sterling money markets it was envisaged that the Chairman would meet with general smaller groups, whose work over the next few months would feed into the broader MMLG work. The Chairman sought volunteers for this new group.

12. Mr Serocold wondered if the stock lending and repo markets had any unique requirements given that the markets generally functioned on the back of other securities systems.

13. Mr Tomkinson said that the European Repo Council had met the ECB last Thursday and that the BMA, ISMA and ACI are working with the ERC on the issue of contingency, and that we might wish to coordinate with this forum.

ISSUES RELATING TO THE EURO

14. Mr Carr said that the latest report on Practical Issues Arising from the Euro had been published on 7 December. The focus was predominantly on the final changeover to the euro, including its economic impact (eg on Eurosystem monetary operations). The second part of the report included material on inter alia monetary policy operations more generally, as well as on the foreign exchange, money (including repo) and capital markets. He noted that the European Repo Council's second survey of the repo market in Europe was scheduled to be undertaken on 12 December and that this would helpfully provide an indication of the growth of the overall euro repo market. The internet, as opposed to the paper, version of Practical Issues included some additional material, in particular on issues relating to any changeover for the sterling financial markets and outstanding payment issues.

15. Second, the Giovannini report on EU cross-border clearing and settlement arrangements had been published in November. This described the current arrangements and highlighted barriers to integration. A follow-up report was envisaged in 2002, which would be more forward looking and have a particular emphasis on public policy aspects. The European Commission are also planning to issue a Communication on this topic.

16. Finally, he reported that the Belgian Presidency hoped to secure adoption of the draft Collateral Directive, including its scope, by end-2001.

FSMA MARKET ABUSE PROVISIONS

17. Ms Sylvester said that since the Act had come into force there had been lots of questions, although none about stock lending and repo, and that the website contained an area for frequently asked questions and answers. She also drew attention to the FSA's Market Watch, which, she said, they were keen to promote.

18. Mr Hills said that no market guidelines from the FSA on the pre-hedging of convertible bonds were likely until January.

PROGRESS ON UK ANNEX TO THE STOCK BORROWING AND REPO CODE

19. Mr Rippon explained that the annex had been held up by the task of establishing suitable notification deadlines for handling equity stock events, in particular as they relate to dividends with scrip/cash alternatives. The problem related to interaction between the legal position and the LSE rules. He said that following a number of very helpful meetings it seemed likely there would be changes to Stock Exchange rules.

20. Ms Banton reinforced this by saying that the consultation process was finished. In which they had received three responses from the lending community strongly supporting the changes. She said that a paper would go out at the end of this week or next.

21. Mr Rippon felt it would be appropriate to re-convene the sub-group perhaps in January.

SLRC NETTING SUB-GROUP

22. Mr Jones said there had been two sides to the netting meeting. The GMSLA update had been delayed. Also they had held discussions with ISMA and sought an opinion from Freshfields.

23. Mr Tomkinson said that he believed the European Master Agreement included stock lending transactions and he wondered why, in aiming to reduce the number of

legal documents covering this issue, there had not been some discussion of this agreement.

24. Mr Jones replied that they had focused on OSLA/GESLA and the GMSLA due to the pressures of work and market demand. Mr Serocold and Mr Russell added that the nature of the discussion was driven by market participants demands and that there was no market appetite for the EMA.

UNCERTIFICATED SECURITIES REGULATIONS

25. Mrs Pitt described the passage through Parliament of the Uncertificated Securities Regulations 2001, which revoked and re-enacted with modifications the 1995 USRs which had set up the legislative structure for CREST. The 2001 Regulations were signed into law on 23 November and came into force on 26 November (copies available from HMSO or its website - SI 2001 No 3755). The Regulations introduce "Electronic Transfer of Title"; the CREST record becomes the register of legal title to both gilts and corporate securities, providing immediate legal title to securities upon settlement in CREST. The Regulations also make a small amendment to allow self-collateralisation for delivery-versus-payment in central bank money in CREST. Both these changes reduce risk and increase international competitiveness in the CREST system.

26. Mr Serocold asked about the barriers to cross-border securities transfers mentioned in the Giovannini report. Mrs Pitt and Mr Davies agreed that the latest legislative changes improved the position of CREST in this respect.

27. Mr Reichardt said that the changes had improved the environment for the transfer of cross-border collateral and suggested that other factors were more important in limiting such transactions, notably settlement cycles and the particular nature of the UK market with respect to withholding tax and stamp duty. Mr Serocold responded that from his reading of the Giovannini report there was an onus on the authorities to deal with such tax issues.

UPDATE FROM ERC

28. Mr Tomkinson informed the committee that the results of the most recent survey were due out on 12 December and that the results would reinforce the underlying message that arose out of the last survey, which had perhaps been overshadowed by the tragic events of 11 September.

29. He went on to say that a new repo fixing interest rate would be established from 4 March 2002, from which the average value would be taken, leaving the highest and lowest 15% out of the fixing. Thirty-eight institutions had agreed to participate.

30. He notified the Committee that for those interested in applying elections for the ERC steering Committee would be held at the Madrid general meeting.

NEXT YEAR'S WORK PROGRAMME

31. The Chairman asked if anyone had any additional suggestions for next years work programme. He added that the EU Collateral Directive would probably be discussed in the next meeting and said that after previous discussion about the timing of meetings a quarterly meeting in March appeared appropriate.

32. Mr Gibson said that money market instrument reform was desperately important and he expressed great concern that it appeared that this was to be delayed due to a bottlenecks on legal work. He said the present CMO system was old and relatively costly and that potentially business might move to European settlement systems.

33. Mr Ness asked who was in charge of the project. Mr Davies responded that the project was being directed by the Bank and CREST jointly. He believed that getting the suitable legislation was the possible stop-jam, although he was optimistic that there would be movement on this front.

34. Mrs Pitt reminded the Committee that Treasury had only just finished with DvP and FSMA and Mr Rippon added that he believed the Treasury did now recognise the importance of money market reform and that the Bank, CREST and Treasury Solicitors would be meeting about this issue shortly.

The Chairman suggested that the next meeting would be on 12 March.