

STOCK LENDING AND REPO COMMITTEE

WEDNESDAY 11 DECEMBER 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)
	Toby Davies	CRESTCo
	Cameron Dunn	Merrill Lynch (European Repo Council)
	Hugh Gibson	HSBC (Association for Payment Clearing Services)
	Tony Hibbitt	Cater Allen International
	Mark Hutchings	ISLA
	Graham Jones	SLRC Netting Sub Group
	Philip Reichhardt	Euroclear
	Alan Storey	Investec
	Tim Westover	Dresdner Kleinwort Wasserstein
	Steve Whiting	Debt Management Office
	John Whitmore	Financial Services Authority
	Simon Ainsworth	Bank of England, Secretary
Also in attendance:	Alistair Defriez	UBS Warburg
	Adrian Hilton	Bank of England
	Howard Jones	Bank of England
	David Sheppard	Bank of England
	Stephen Kirby	Bank of England
	Martin Thomas	Financial Markets Law Committee
	Margot Marshall	Financial Services Authority

SUMMARY OF MEETING HELD ON 9 OCTOBER 2002

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

Matters Arising

1. ISLA reported that they still awaited a letter from John Rippon (Bank of England) on prospective wording of the Gilt annex to the ISMA/TBMA Global Master Repurchase Agreement (GMRA).

Stock borrowing and voting recent cases.

2. Alistair Defriez, a Managing Director of UBS Warburg, addressed the committee on the subject of voting of lent stock, referring to the two recent cases of P&O Princess and British Land. He felt that both highlighted that the normal process of lending and borrowing stock may be misused.

3. The British Land case had been discussed in previous meetings. In the P&O Princess case Mr Defriez had identified a risk that voting of borrowed stock at an extraordinary general meeting to approve the merger with Carnival under a dual listed company structure could potentially lead to an outcome against the wishes of the long-term shareholders. Also he had reason to believe that some borrowers of P&O Princess stock might be planning to tender it into Carnival's partial share offer, which is for up to 20% of the shares in P&O Princess, potentially crowding out long-term shareholders. He believed this so-called 'short tendering' would be a violation of US securities law but not of UK law.

4. Mr Defriez said that he did not wish to restrict stock lending but wanted to discuss whether there were ways of preventing the deliberate borrowing of stock to interfere with corporate governance. He wondered whether clauses might be inserted into stock lending contracts that would prohibit the voting of stock by a borrower without reference to the lender. One suggestion was a kind of 'reverse' purpose test by which stock lending would be prohibited for the purpose of obtaining the voting rights.

5. Members agreed that borrowing stock for the purpose of influencing corporate governance was undesirable but most doubted it could be addressed through changes to standard legal agreements. Members noted that voting rights were irrevocably passed to the registered owner and cannot be separated because lent stock may be needed, for example, to settle sales to end-investors. There were concerns that any watering down of the full transfer of ownership in a stock loan (eg by including a requirement to consult the

lender on voting) might have unintended consequences, such as perhaps affecting the legal robustness of the transaction with a risk of re-characterisation.

6. Most members believed that the appropriate way to resolve such issues was via the existing contractual terms that allow for the recall of lent stock so that ‘long term’ shareholders should be able to vote. Members noted that a significant increase in the recalling of stock might affect market liquidity, with the risk falling mainly on intermediaries, but they would take this into account in their willingness to provide liquidity to borrowers. One issue was that those responsible for stock lending amongst trustees, custodians or fund managers did not always coordinate effectively with those responsible for corporate governance, so that stock was not often recalled to vote. However, custodians did see it as a key part of their role to alert lenders to such events.

7. Other members thought that changes to regulation or even UK securities legislation might provide a solution. This was for the FSA and government to consider. Another possibility was to include a reference in the Stock Borrowing and Lending Code of Guidance (the Code). The Code was, of course, not binding but such a reference would send a clear message to market participants that such strategies were not regarded as acceptable market practice.

8. The Chairman concluded that there seemed little appetite to change the industry standard legal agreements. But that it appeared more might be done to encourage shareholders and their agents to coordinate stock lending with corporate governance, including recalling stock – this was also a conclusion of the meeting with the shareholder voting working group (see next item). ISLA was considering what it could do in this area. The Bank would also consider possible amendments to the Code, in consultation with members, ahead of the next SLRC meeting.

Meeting with Shareholder Voting Working Group

9. The Chairman presented a summary of the joint meeting of the Stock Lending and Repo Committee and Shareholder Working Group on 1 November, which is attached to these minutes.

FSA Discussion Paper 17 ‘ Short Selling’

10. The FSA noted that they had received no formal responses but that informal feedback suggested opposition in the market to options 1 and 2 viz. the reporting and publishing of short sales in the cash equity market; and the reporting and publishing of short positions in the cash and derivative markets. The consultation period was due to end on 31 January. LIBA and ISLA representatives said their associations were preparing responses. The Chairman asked whether SLRC should respond in its own right but members did not think there were any particular points to make from the Committee’s perspective.

Work of the Financial Markets Law Committee

11. Mr Thomas, secretary to the Financial Markets Law Committee (FMLC) explained the role of the new body to attendees. Following the dissolution of the Financial Law Panel, the Bank formed the FMLC in June 2002, under the leadership of Lord Browne-Wilkinson, to identify issues of legal uncertainty. Mr Thomas requested that SLRC members bear in mind the FMLC’s existence and use it as a resource. Updates of the FMLC’s work would be given via email bulletins and via the body’s website in addition to verbal briefings from its Secretary.

CRESTCo/SFS work on CREST stock lending statistics

12. Mr Davies reported that the CRESTCo/SFS proposal to publish stock lending data required the consent of CREST members. So far there had been a number of objections and CRESTCo had attempted to alleviate concerns by undertaking to conduct all the aggregation of data in-house. CRESTCo was continuing to communicate with interested parties and committed itself to holding an open meeting in January. Members expressed remaining concerns about controls to protect confidentiality of proprietary data and about the terms for subscribing to data, including what data would be available free of charge to the market as a whole. Mr Davies said he expected that CRESTCo would be able to address these concerns satisfactorily when it published amended proposals in January.

13. In response to questions from attendees, the FSA reported that based on feedback thus far the publication of stock lending data was desirable. The FSA would prefer a market solution to additional regulation.

Publication on Stock Lending

14. Discussion of the proposed publication to explain the stock lending process was held over to the next meeting.

Membership of the SLRC

15. Attendees agreed to a request from ISMA for membership of the committee.

Netting Sub-Group

16. Mr Jones updated the committee on a meeting of the sub group held earlier that morning.

17. Freshfields were to request that South African counsel quantify the risk of re-characterisation in relation to collateral.

18. A recent change in Spanish law has made the legal framework more favourable for stock lending and repo transactions. A new opinion was likely to be available in four weeks

19. All opinions are currently being produced to schedule.

20. Freshfields had launched an extranet by which subscribers can view opinions on-line.

STOCK LENDING AND REPO COMMITTEE
and
SHAREHOLDER VOTING WORKING GROUP

FRIDAY 1 NOVEMBER 2002
SUMMARY OF MEETING HELD
AT THE BANK OF ENGLAND

SLRC members present:	David Rule	Bank of England (Chair)
	Dagmar Banton	London Stock Exchange
	Krystyna Beck	Deutsche Bank (London Investment Bank Association)
	Toby Davies	CrestCo.
	Hugh Gibson	HSBC (APACS)
	Philip Reichardt	Euroclear
	John Rippon	Bank of England
	Steve Russell	HSBC
	John Whitmore	FSA
	Adrian Hilton	Bank of England (Acting Secretary)
SVWG members present	Terry Pearson	
	Michael Kempe	
	George Littlejohn	
	Tom Morrisson	
Also in attendance	John Hale	Association of British Insurers
	Ian Hovey	Deutsche Bank (International Securities Lending Association)
	Charles Lowe	M&G (ISLA)
	Sarah Nicholson	Morley Fund Management (ISLA)
	David Sheppard	Bank of England
	Andrew Speers	Barclays Global Advisors (ISLA)

1. Voting on lent stock

- The group was in broad agreement on the legal position of lent stock; that a stock loan is a sale of securities with an agreement to repurchase equivalent securities at an agreed price at some point in the future. A stock borrower may pass back to the lender any material property benefit accruing from the stock whilst it is lent, so long as he can ‘manufacture’ it. A shareholder vote, however, cannot be

manufactured in the same way, and is the sole property of the end purchaser. Most borrowed stock is delivered into a sale obligation so that it, and the vote, transfers to another end investor that has made a purchase in the market. In this sense votes on lent stock are not usually 'lost' even if the stock is not recalled. However some lent stock would be tied up in collateral or in intermediaries' books where the legal owners might be less likely to vote.

- Lenders may recall lent securities in order to exercise voting rights. Since borrowers rarely retain stock, they must find stock in the market so that more recalls could affect market liquidity and spreads might widen.
- There was a general consensus among the group that there can be a need for greater communication, management information and co-ordination between corporate governance departments and lending desks at investment institutions. Those deciding how shares should be voted did not always co-ordinate with those responsible for stock lending. As institutions begin to take a keener interest in corporate governance, so they may think more carefully about their stock lending activities.