

## SECURITIES LENDING AND REPO COMMITTEE

MONDAY 6 DECEMBER 2004

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Members present:	David Rule	Bank of England, Chairman
	Nicola Stead	Bank of England, Secretary
	Mark Hutchings	International Securities Lending Association/ AIG
	Hugh Gibson	International Securities Lending Association
	Richard Steele	International Securities Lending Association/ JP Morgan Chase
	Cameron Dunn	European Repo Council/Merrill Lynch
	Ian Fox	London Money Markets Association/ HBOS
	Barbara Pung	International Securities Market Association
	Dagmar Banton	London Stock Exchange
	John Serocold	London Investment Banking Association/ Chair, SLRC Netting Sub-group
	Steve Russell	London Investment Banking Association/ HSBC
	Joyce Martindale	National Association for Pension Funds/ Railpen Investments
	David Roberts	ACI/ Royal Bank of Scotland
	Alex Merriman	British Bankers' Association
	Anthony Littleton	Association for Payment Clearing Services
	Jason Waight	CRESTCo
	Tony Hibbitt	Cater Allen International
	Mark Weeks	London Investment Banking Association/Goldman Sachs
	Markus Sgouridis	The Bond Markets Association

Also present:

John Rippon	Bank of England
David Sheppard	Bank of England
Lilia Tira	LCH.Clearnet
Diego Escanero	Financial Services Authority
Richard Murley	Takeover Panel
John Dovey	Takeover Panel
Tony Pullinger	Takeover Panel

Elaine Graham	Freshfields Bruckhaus Deringer/ SLRC netting sub group
Chris Grant	Freshfields Bruckhaus Deringer/ SLRC netting sub group
Jamie Masters	UBS/ SLRC netting sub group
Karen Painter	Goldman Sachs/ SLRC netting sub group

1. The minutes of the meeting held on 22 September 2004 were agreed. Minutes of previous SLRC meetings are available at:  
[www.bankofengland.co.uk/markets/slrc.htm](http://www.bankofengland.co.uk/markets/slrc.htm)
2. The Chairman noted that a summary of the ECB meeting on 29 July 2004, to discuss standard market documentation (discussed at the September SLRC meeting) was available on the ACI's website at:  
<http://www.aciforex.com/docs04/StandardMarketDocumentationrevised121004.PDF>
3. The Chairman introduced the new members of SLRC: David Roberts, representing the ACI; and Joyce Martindale, representing the NAPF.

#### TRANSPARENCY DIRECTIVE

4. Geraldine Levy (FSA) had been unable to attend the meeting but the Chairman reported on her behalf that CESR had been finalising its views on the Directive for consultation. A consultation paper regarding dissemination and storage of all regulated information had been published on the 28th October. On the issue of major shareholding notifications, the area of most interest to the Committee, a consultation paper was to be published the following week. This can be accessed through CESR's website at [www.cesr-eu.org/](http://www.cesr-eu.org/) and going to Consultations.
5. Geraldine Levy had said that she was available for questions and encouraged members to review and respond to the consultations.

#### VOTING ON LENT STOCK: TAKEOVER PANEL

6. Mr Murley briefed the Committee on the activities of the Takeover Panel in relation to securities lending and voting.

7. The Panel intended to consult the market on a Code regulating the activity of equities lending during a takeover. A consultative paper would be released in May.
8. The initial proposal for the Code had been that lending should not count as 'transfer' or 'dealing' and should therefore not be discloseable under the Code. But it was agreed that it would be useful to know when securities were being borrowed for the purposes of the offer.
9. Responses to this initial proposal had been mixed. Some participants thought that 'borrowing for offer' (noting the difficulty in defining this) constituted market abuse; some thought that this practice was entirely innocent, and other respondents had opinions between these two extremes. The associated difficulty was how one could determine the state of knowledge of the agents undertaking the transaction.
10. The Panel had reassessed its approach (in the light of the feedback) and now asked whether stock lending should count as dealing, if it crossed the 1% threshold<sup>1</sup>. The basic premise was that lenders would recall their stocks ahead of a vote, but in practice this was affected by:
  - Lenders (or their fund managers) not knowing when their shares had been lent by their agents
  - The loss of lending revenue not making it profitable to recall, especially when the number of votes gained (the number of shares owned) is small
  - The various ways lenders might define whether a vote is 'important' enough to warrant a recall
  - Lenders intending to recall not succeeding in taking receipt of the securities in time for the vote.
11. If stock lending were to count as dealing for the purposes of disclosure, there would be an exemption, under rule 8(3)(d), for intermediaries, which would mean that e.g. prime brokerage arms of banks would not have to disclose (although the proprietary trading desk of the bank would). Also, at present borrowers holding only a derivative, rather than the underlying stock, would not have to disclose their holding, but the Panel was considering whether this should be changed so that, for the purposes of disclosure, derivatives would count as if they were shares.

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<sup>1</sup> The lender owning more than 1% of the stock on issue

Mr Murley reiterated that the purpose was not to stop the practice of lending, but to improve transparency.

12. There was some concern that overnight collateral through Delivery by Value (DBV) in CREST would be included in the disclosure requirements, which would be difficult to achieve in practice. The borrower of overnight DBVs in CREST does appear on the register of owners, meaning that the vote would in principle pass to them. But in practice, DBVs unwind, with the equities returning to the securities lender before a vote could be cast. Moreover, most borrowers are unaware of the nature of the securities in the DBV basket so would be unlikely to vote them. In any case, a lender would be able to exclude specific shares from the basket if it wished to do so; i.e. ahead of a vote.
13. Ms Martindale said that many pension funds would not know whether their securities had been lent, as custodians were often permitted to do this without informing the lender. Mr Steele said that custodians could provide information on securities lent on request from lenders, but that there was likely to be a time lag in reporting.
14. Mr Serocold noted it would be useful at an early stage to review EU strategy on stock lending and voting to avoid the risk of enforced changes to UK strategy by EU supervisors in the future. Mr Murley said he would investigate this, and noted that this issue and others that had been raised in this meeting were likely to be discussed in the consultation in the spring.

#### UPDATE OF THE SECURITIES BORROWING AND LENDING CODE OF GUIDANCE

15. Mr Rippon said that a near final version of the Code had been agreed by the members of the Committee's Code sub group and that, subject to the agreement of the main Committee at this meeting, the intention was to publish the revised Code and UK Annex very soon. The draft Code and UK Annex had been circulated to all members of the SLRC and a few additional comments had been received. In the light of these, the draft Code had been amended to indicate that, rather than suggesting that trustees themselves should necessarily be familiar with the Code, their agents and advisors should be. The hope was that trustees would build up familiarity with the Code over time. Apart from this, there had been no change to the substance since the final draft was agreed by the sub group.

16. The Chairman said he was keen to raise awareness of the Code in the market, and with this in mind, it was agreed that the Bank would publish the Code with a Press Release [done on 16 December]. ISLA said they would do the same.

#### REPOCLEAR DBV CLEARING PROJECT

17. Ms Tira gave a presentation on LCH.Clearnet's gilt DBV repo clearing project. The presentation slides are attached to these minutes.
18. The project, initiated in response to requests from the market, would extend the benefits of a central counterparty clearing to DBV participants, e.g. anonymous trading; balance sheet netting, reduced workload and settlement costs.
19. It was thought that as much as £30bn of interbank DBV per day could be cleared through the new system, with a netting potential of 50%- 70%- although this was uncertain. It was planned to go live at some point in 2005.

#### RECENT PRESS ARTICLES ON SHORT SELLING AND SECURITIES LENDING

20. The Chairman drew the attention of the Committee to recent press articles suggesting possible changes to LSE rules or CRESTCo data publication in the light of the FSA's decision on the Room Service case.
21. Ms Banton said that reports that the LSE was considering tightening rules on short selling to require firms to disclose short positions (as they must currently do for long positions) were exaggerated. The LSE had no formal consultation in place but were debating the issues and possible responses to make.
22. Mr Grainger said that reports that CRESTCo intended to provide more stock lending data to help detect short selling were also too strong. CRESTCo would be writing to ISLA to suggest how improvements could be made to the CREST data service; e.g. shortening the time lag before publication and providing data on different securities. They also intended to speak to current subscribers to the data to ascertain what was needed.
23. There was some discussion on the implications of the press coverage for the market. Mr Serocold said that over-reporting by the media risked premature introduction of new regulations. Another risk was that scare stories would cause trustees to become nervous and cease lending. In order to help ensure proper

reporting of the issue in the market, the FSA's final notice on Evolution is attached with these minutes.

#### ESCB/CESR STANDARDS ON CLEARING AND SETTLEMENT

24. Mr Sheppard reported on the Standards. These had been published in late October and would be applied after some further work on assessment methodology, which was being carried out by working groups of market participants with the aim of reaching a conclusion in the late autumn. Some of the standards relating to Central Securities Depositories and securities lending would be particularly relevant to the Committee.

#### IMPLICATIONS OF MiFID FOR SECURITIES LENDING

25. Mr Escanero reported on the requirements of the Markets in Financial Instruments Directive (MiFID) for repo and stock lending. MiFID had now been adopted and the deadline for implementing its main provisions was 30 April 2006. The main elements of the Directive that had implications for securities lending and repo were as follows:

- Article 19.2 & 19.3: Information to clients
- Article 19 .5: Know Your Customer
- Article 19.7: Client Agreement
- Article 19.8: Reporting to clients
- Article 21: Best Execution obligations
- Article 22: Client order handling rules
- Article 24.1: Measures for eligible counterparties.

26. Articles 19, 21, and 22 of MiFID will not apply to stock lending or repo activities conducted with eligible counterparties.

27. CESR intended to publish a consultation document on Level 2 in February 2005 with a four week feedback period. One member thought that 4 weeks would not be long enough especially in relation to Best Execution obligations.

28. Mr Hutchings asked whether a summary of implications of MiFID for securities lending could be circulated to ISLA and SLRC members [attached with these minutes].

## TAKE UP OF THE GLOBAL MASTER SECURITIES LENDING AGREEMENT (GMSLA)

29. After concerns had been raised at a recent meeting of the Committee's Netting sub group, Mr Rippon asked the members of the main Committee whether, in their view, there had been relatively poor take-up of the GMSLA since its inception in 2000, and what the reasons might be for market participants choosing to continue using the Overseas Lending Agreement.
30. Members thought that the GMSLA was being widely adopted for new lending agreements, although most (but not all) members thought that the OSLA was not being replaced for existing contracts. Netting opinions will continue to be provided in a combined form, covering both the GMSLA and the OSLA. Members did not think that the continued use of OSLA raised any significant concerns.

## REVIEW OF 2004 WORK PROGRAMME AND DISCUSSION OF 2005 WORK PROGRAMME

31. The Chairman and members discussed the 2004 work programme. Many items had been completed. Items which should be carried forward to the 2005 work programme included
- Monitoring the impact of Basel 2 on securities lending and repo markets
  - Monitoring developments in G30
  - Monitoring Giovannini developments, especially the EU Commission Communication on clearing and settlement, which will be given priority of its own.
32. Mr Hutchings said that the *Introduction to Securities Lending* document had had over 1000 downloads from the ISLA website, with a similar number for the summary. He asked whether SLRC would support a publication on securities lending and voting, which Spitalfields Advisors (authors of *Introduction to Securities Lending*) were willing to write.
33. Members generally thought that a descriptive publication, which made reference to practical examples, was a good idea. A definite proposal would be produced for the next meeting of SLRC, after a sub group had met to discuss it in the New Year. [Sub group since arranged to meet 17 January.]

34. Members of the Committee were invited to send suggestions for the 2005 Work Programme to the Secretary. A draft version is attached with these minutes.

## ISMA'S UPDATE REPORT ON GMRA RELATED MATTERS

### Legal opinions

35. Ms Pung reported. ISMA had recently initiated the 2005 updating exercise of the GMRA legal opinions in 36 jurisdictions. As in previous years, it was intended to publish the updated opinions by the end of March 2005.
36. Opinions for Greece and Poland had been published on ISMA's website on 27 October.
37. Draft opinions for Hungary and Norway were under review by the ISMA/TBMA Joint Opinion Committee. The initial draft of the opinion for Cyprus would now be submitted to the relevant JOC committee for review.
38. In relation to Brazil, Estonia, Latvia, Lithuania, China, the Philippines, South Korea, Taiwan and Malta, ISMA had recently instructed local counsel from these jurisdictions to produce a draft opinion for ISMA's review.
39. Regarding Croatia, the Czech Republic, Slovakia and Slovenia: ISMA continued to monitor legal developments to ascertain at what stage a clean opinion might reasonably be obtained.
40. Regarding Mexico and Scotland: ISMA was currently clarifying whether clean legal opinions could be obtained for these two jurisdictions.
41. Based on the recommendation of the European repo committee that there was not sufficient market interest for a Malaysian legal opinion, ISMA had decided not to pursue obtaining an opinion for this jurisdiction.
42. The legal situation in Russia remained unclear: ISMA was currently examining the possibility to support new legislation to allow the GMRA to be adopted as the cross-border repo standard document for Russia.

### Integration of core provision opinions (CPOs) into ISMA's opinions on the GMRA

43. Ms Pung said that the German Financial supervisory authority (BaFin) required the provision of netting opinions for the GMRA. Together with each netting opinion, the BaFin also required a 'core provision opinion' (CPO) in order to

ensure that conclusions reached in the netting opinion for the relevant jurisdiction would not be affected by alterations to the other provisions of the GMRA.

44. With a view to supporting its German members to comply with the BaFin's requirements and promoting the use of the GMRA within Germany, ISMA was currently holding discussions with the Association of German Banks to establish whether the existing and future CPOs could be integrated into ISMA's opinions on the GMRA, and in particular for those jurisdictions for which the Association had already obtained CPOs to date. Subject to acceptable costs, ISMA would also consider integrating CPOs into all the other opinions on the GMRA.

#### NETTING SUB GROUP

45. Mr Serocold said there was nothing to report on the opinion updates, which were available to subscribers on the Freshfields website. Examining the scope to rationalise the opinion gathering process was an ongoing project, not likely to be completed before the second half of 2005.

#### ANY OTHER BUSINESS

46. Mr Dunn raised an issue regarding EONIA based repos, for which cash and securities instructions must be input and matched one day before settlement. As the EONIA fixing is only known late in the day adjustments sometimes needed to be made to the transaction after the actual EONIA rate is known, which had been more of a problem recently as EONIA has been more volatile at times. In the light of this, the possibility of intra-day settlement of EONIA repos was being discussed by the European Repo Council.
47. Although transactions with negative interest rates (discussed at the June meeting) were rare outside Japan, a recommendation had been made by the Investment Managers' Association that in the event of a borrower failing to deliver securities the buyer has a right to terminate the transaction, or the interest rate would be adjusted to zero for every day of the fail. This issue has arisen in the International Emerging Markets (IEM) and Credit repo market.
48. The ISMA repo market survey was to be conducted on Wednesday 8 December. The number of participants in the survey continued to grow.

49. The Chairman drew the attention of the Committee to the Bank of England's second Consultative Paper on sterling money market reform, which was available on the Bank's website.

DATE OF NEXT MEETING

50. The next meeting will be held on 9 March 2005 at 11am, at the Bank of England.

BANK OF ENGLAND

6 JANUARY 2005