

SECURITIES LENDING AND REPO COMMITTEE

Wednesday 6 December 2006

Bank of England

MINUTES

Attendees

David Rule	Bank of England, Chairman
Anthony Littleton	APACS
Alex Merriman	BBA
Nick Fisher	DMO
Warren Alsop	Euroclear
Cameron Dunn	European Repo Council/Merrill Lynch
Christian Krohn	Financial Services Authority
James Woodley	Financial Services Authority
Matthew Cherrill	Financial Services Authority
Steve Russell	HSBC
Gregor Pozniak	ICMA
Christian Hellmund	ICMA
Hugh Gibson	ISLA
Laurence Marshall	ISLA/UBS
Nigel Bradley	LCH.Clearnet
John Serocold	London Investment Banking Association
Ian Fox	London Money Markets Association/ HBOS
Dagmar Banton	London Stock Exchange
Joyce Martindale	National Association of Pension Funds/Railpen
John Richmond-Scott	Bank of England, Secretary
Chris Yeates	Bank of England
Netting subgroup:	
Elaine Graham	Freshfields
Michelle Skipper	Freshfields
Rahim Nanji	Deutsche Bank
Also present:	
Chris Becher	Bank of England

1 **Introduction**

Mr Rule welcomed representatives from the SLRC netting subgroup attending, as normal, the final meeting of the year.

2 **Minutes of the previous meeting on 28 September 2006.**

The minutes of the previous meeting were agreed.

3 **LCH.Clearnet Gilts DBV service.**

Nigel Bradley (LCH.Clearnet) updated the group on development regarding the RepoClear Sterling GC service since the last meeting. In mid-October member testing had been successfully carried out with 18 participants. A further 7 participants had expressed a strong interest in using the Sterling GC service. Among these two groups there were a total of 5 new entrants into the Gilt DBV market. It was expected that the live date would be mid-to-late January and additional testing could still be offered to participants.

Warren Alsop (Euroclear) noted that no significant changes to DBV functionality were expected on CREST's Single Settlement Engine (SSE) before the implementation of the RepoClear Sterling GC. Mr Alsop said that the DBV processing had been stable over the past few weeks, although a member commented that DBV settlement still did not take place as efficiently as before the SSE implementation. Mr Alsop said that a minor technical change to the version of the SSE software used by CREST was provisionally scheduled for the weekend of 16 and 17 December, in preparation for the launch of the SSE in Euroclear Bank in early 2007. Dollar DBV settlement had been de-coupled from the Euro timetable and CREST would continue to explore areas for improving the processing of DBV settlement in the new year.

4 **Range of collateral taken against gilt stock loans**

The chairman said that following meetings with market contacts to discuss the very low level that gilt GC repo rates had reached on the 31 July, it had emerged that gilt lenders were taking

a wider range of collateral than in the past. There seemed to have been an increase in gilt lending against cash (as opposed to against CDs), as was common already in the dollar market as well as against corporate bonds, asset-backed securities and equities. Mr Rule said that the acceptance of cash as collateral to gilt lending could potentially allow gilts to be released into the overnight repo market later in the day, provided lenders had opportunities to reinvest the cash. The Bank was keen to understand the constraints securities lenders faced when accepting cash collateral. One member commented that they had not experienced great demand from securities lenders for cash because of reinvestment constraints. Another member commented that they had been borrowing gilts against equities.

5 Updating the Gilt Repo Code

Mr Rule said that the Bank had written to all OMO counterparties to ask for their views on updating the gilt repo code. Opinions had varied but, on balance, most of the counterparties that had responded were not in favour of updating the code as it was thought that the market was sufficiently developed not to require a code of conduct and that guidance was also provided by the European Repo Council (ERC).

However, at a recent meeting of the LMMA, members had generally been in favour of a code, in particular it was thought useful as a guide for new entrants to the repo market and for issues specific to the Gilt market. Mr Rule therefore proposed that a group be set up to look at the issues an updated code would cover, drawing on the existing ERC guidance. John Rippon (Bank of England) would chair this group and several volunteers had already come forward, Cameron Dunn (ERC/Merrill Lynch) also volunteered to take part.

6 Transparency Directive

Christian Krohn (FSA) reported that the Transparency Directive was in the final stages of implementation. The FSA had published a policy statement in October containing near final rules. The rules were expected to be finalised once the final level 2 requirements had been approved and published by the European Commission and European Parliament. Royal assent had now been given to the Companies Bill, from which the statutory powers to derive the new rules were derived.

Transitional provisions would require issuers to publish a notice, by the 31 December, detailing the number of their shares admitted to trading, which shareholders should use to check their holdings against notification thresholds.

As previously discussed, the rules defined lenders as exempt from making major shareholding disclosures, by allowing them to treat their right to recall lent stock as an 'acquisition' to be set-off against their lending/'disposal' of the stock. These issues had been resolved and the near final policy statement would reflect that agreement had been reached on this approach.

The notification requirements would generally apply to securities borrowers. However, intermediaries that had borrowed securities and on-lent them within one business day and did not intend to (and did not in fact) exercise voting rights would be exempt from notification.

It was noted that the UK seemed to be more at a more advanced stage than other EU countries in their implementation of the Transparency Directive, with many countries yet to clarify how securities lending would be treated. In response to a question from the Chairman, Mr Krohn confirmed that the relevant notification requirements depended on the nationality of the companies whose shares were held.

7 Markets in financial instruments directive (MiFID)

James Woodley (FSA) updated the Committee on MiFID developments. A Consultation Paper (CP) on reforming conduct of business regulation, including proposals for implementing relevant proposal in MiFID, was issued in October 2006. Regarding best execution, the FSA are currently working with CESR to ensure that a harmonised approach would be taken across Europe. CESR intends to produce a CP on best execution in January 2006¹.

¹ Since the SLRC meeting on 6 December 2006, CESR has asked the European Commission to clarify the position on scope of the best execution obligation. At a CESR meeting in Paris on Friday, 15 December it was decided that specialist situations, like stock lending, are impossible to deal with before a view from the Commission on the scope of the best execution obligation is known. The Commission's view is not anticipated before publication of the CESR CP in January 2007, so the CP may have to be followed up subsequently.

8 Proposed amendments to the New Collective Investment Schemes sourcebook

Mr Cherrill provided an overview of the proposed modifications to the rules relating to securities lending from the scheme property of authorised funds. Proposals included: extending the list of permitted counterparties with which securities lending may be undertaken to include US broker dealers and some US banks; permitting the use of Euroclear Bank's Securities Lending and Borrowing Programme; and extending the list of acceptable types of collateral to include commercial paper and liquidity funds subject to certain restrictions.

A new rule was also proposed for the treatment of the income generated from securities lending or from the reinvestment of the collateral. Income would be treated as income property of the fund and any fees or expenses taken from this income would be subject to rules on payment out of scheme property and must be disclosed in the prospectus.

Guidance on re-investment of collateral was also proposed that would bring acceptable collateral for re-investment into line with acceptable collateral for securities lending transactions.

Hugh Gibson (ISLA) commented that most of the new rules were welcome, but the rule on treatment of income could be an area of concern. It was suggested that a workshop would be useful to increase understanding in this area and that treatment of income/breakdown of costs required should take into account, where relevant, how the custodian manage their lending programmes. Mr Gibson also said that the requirement to provide a breakdown of costs should be in line with similar requirements in other markets and questioned whether any existing prospectuses would need to be changed to take account of the new rules.

9 Status on harmonisation of the legal opinion gathering exercise

Mr Rule explained that ICMA had started their opinion-gathering exercise for 2006/7 independently due to time constraints. The Bank agreed to set up a meeting with the relevant trade associations (ICMA, SIFMA, ISLA, and LIBA), as suggested by Mark Austen (SIFMA)² in early 2007 to define further the next steps, in particular funding and governance

² Written comments were provided by Mr Austen in advance of the meeting

arrangements. It was expected that a harmonised process for gathering the opinions would be in place for the 2007/8 round.

10 SLRC Netting sub-group: SLRC Netting legal opinions

John Serocold (LIBA) provided an update from the previous SLRC Netting subgroup that had taken place on 1 December. The group had decided not to proceed with making opinions on securities lending agreements compliant with BaFin (in addition to FSA) requirements because of lack of a common business interest amongst members in this area. The group had also started a review of the jurisdiction and counterparty coverage required by its members.

11 Review of GMSLA

Hugh Gibson (ISLA) provided an update on the review of the GMSLA. A significant review of legal, tax and operational aspects of the GMSLA was under way and it is hoped that a draft version will be available for review by all interested parties in a few months time.

12 GMRA: updated legal opinions

Christian Hellmund (ICMA) updated the SLRC on GMRA-related issues and progress in the current round of opinion updates. It was expected that the updated opinions would be published in March 2007. More details are provided in the Annex.

13 Any other business

Chris Becher (Bank of England) provided a summary of the European Commission's Code of Conduct on clearing and settlement. Unbundling of costs and revenues by central counterparties, exchanges and securities depositories would be required by 2008. The code currently applied to cash equity markets only but it was expected that it would be extended to other products. This code could also be extended to other service providers at a later date.

The DTI had issued a consultation on a proposal by the European Commission for a Directive to establish requirements in relation to the exercise of voting rights by shareholders. Hugh Gibson (ISLA) commented that there were some concerns that the period between the announcement of a meeting and the striking of a record date was too short to enable lenders to recall shares in order to vote themselves. This could result in lenders either withdrawing from lending in order to guarantee being able to vote or running the risk of losing their vote, which Mr Gibson felt would be against the whole initiative of corporate governance policy.