

# SECURITIES LENDING AND REPO COMMITTEE

Wednesday 5 December 2007

Bank of England

## MINUTES

### Attendees

Michael Cross	Bank of England, Chairman
John Hale	ABI
Anthony Littleton	APACS
Nick Baker	Bank of England, Secretary
Alex Merriman	BBA
Rob Fair	Euroclear
Rahim Nanji	Deutsche
Charlotte Hannavy	Deutsche
Godfried de Vidts	European Repo Council
James Woodley	Financial Services Authority
Richard Rogers	HMRC
Steve Russell	HSBC
Christian Hellmund	ICMA
David Rule	ISLA
Hugh Gibson	ISLA
Nigel Bradley	LCH.Clearnet
John Serocold	London Investment Banking Association
Stephen Ong	London Money Markets Association/Kaupthing
Dagmar Banton	London Stock Exchange
Joyce Martindale	RPMI
Reuben Levermore	SIFMA
Chris Ryan	UK Debt Management Office

Also Present:

John Rippon	Bank of England
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## 1 **Introductions**

Mr Cross welcomed new members to the Committee, Reuben Levermore (SIFMA), who was replacing Volinka Reina, and Chris Ryan (DMO), who was replacing Nick Fisher. Stephen Ong (LMMA/Kaupthing Singer Friedlander) attending in place of Ian Fox, and Charlotte Hannavy (Deutsche) were welcomed as special guests.

## 2 **Minutes of the previous meeting on 5 September 2007**

The minutes of the previous meeting were agreed.

## 3 **Matters Arising**

John Rippon (Bank of England) updated the Committee on the UNCITRAL draft legislative guide on secured lending. At the last SLRC, Mr Rippon had noted that a carve-out in the guide for securities repo and lending had been recommended by UNCITRAL, although subject to the caveat that there should be further work on the position of securities. The UNCITRAL group is meeting again in December, and it is expected that the Guide to be finalised then with the carve out intact. But decisions will have to be taken on further work which will be reflected in annexes to the Guide: likely subjects would be intellectual property and financial contracts, and the latter could cover, *inter alia*, repo and securities lending. There could be some possibility of attempts to undermine or chip away at the carve out. The Insolvency Service will lead the UK team at the UNCITRAL meetings and will strongly defend the carve out. This work and negotiations will continue next year, and the Insolvency Service will keep the Bank in the picture so that developments may be reported to the SLRC.

Rob Fair (Euroclear) updated the Committee on Euroclear's work on term DBVs. A consultation paper would be published on January. Euroclear will invite members of the SLRC to comment, and the item will be picked up again at the next SLRC.

## 4 **LCH.Clearnet sterling GC service**

Nigel Bradley (LCH.Clearnet) summarised developments regarding the sterling GC service. Since September the product had been developing well and there had been no settlement

failures since launch. Mid-September saw record volumes of £25bn, with volumes in November and December running at around £10-15bn per day. A €GC service will be launched in Q2 2008, based around the tri-party settlement models of Euroclear and Clearstream.

## **5 Progress report of the revision of the Gilt Repo Code**

Mr Rippon provided the Committee with an interim report on the revision of the Gilt Repo Code. The Working Group on the updating of the Code had met again on 3 December to discuss the 4<sup>th</sup> draft. The Working Group was content with the draft subject to a few minor changes and some slight pruning. The FSA had commented separately on the section on regulation and offered some words on the role of market codes. The aim is to produce a 5<sup>th</sup> draft and cover note in January; and once the Working Group had approved the texts they would be circulated to members of MMLG and SLRC, with a view to finalisation by March. Alex Merriman (BBA) and Godfried de Vidts (ERC) requested that their members were granted sight of the work in progress, in addition to operations groups. Mr Rippon said that the 5<sup>th</sup> version, aimed to be completed in January, would be available for these groups. The Code will be published under the auspices of the MMLG and the SLRC. The aim was to keep the Code under regular review thereafter, and Mr Rippon suggested that annual discussions are held at the SLRC and changes are made as and when necessary on the website version.

## **6 Equity Repo Market**

At the June SLRC it was agreed that the growth of the equity repo market would be monitored, and if it seemed that the market could become materially larger the possibility of introducing a new Equity Repo Code should be considered. Mr Rule noted that the equity repo market had been discussed at the ISLA Board. The use of equities as collateral in financial markets was said to be growing, although not necessarily equity repo. Borrowers' reduced willingness to give cash collateral, given current market conditions, and lenders amending their guidelines to avoid e.g. ABS, was expected to lead to an increase in the use of equities as collateral in stock borrowing.

Mr Cross noted that the increased use of equity as collateral was something that is being picked up by the Bank's Market Intelligence, although this may be a product of extraordinary

times. Mr Rippon noted that if it were concluded that some new market guidance were desirable this did not necessarily imply that a full blown code covering all the ground in the previous code should be produced ; it was possible that more limited guidance would suffice. Mr de Vidts suggested that it would be helpful to have a discussion on tri-party with the main providers. Mr Merriman noted that there was a need for ‘UK plc’ to have a view on the equity repo market, and noted that this should be used to counterbalance other codes such as that from the International Corporate Governance Network. Mr Merriman also noted that the follow up to the Shareholder Rights Directive might also include proposals on securities lending and repo and again the UK’s best practice should be upheld. Mr Rippon suggested that work on the Securities Borrowing and Lending Code could reflect this.

## 7 **Regulatory developments:**

### *MiFID implementation overview*

James Woodley (FSA) gave the Committee an overview of MiFID implementation and its impacts since implementation. The switchovers for non-equity transparency and transaction reporting had occurred on the 1<sup>st</sup> and 5<sup>th</sup> November respectively, with systems changes taking place midweek and over the weekend, and had been relatively straightforward, with the rest of Europe experiencing few issues either. Since implementation there had been four notable impacts. The number of bilateral, over-the counter, trades had increased, many now being reported to other mechanisms, such as BOAT. Mr Woodley noted that this was as a result of not only the MiFID changes, but the Government’s modernisation of the stamp duty intermediary relief, which took place on 1 November. Some trade data has become more fragmented since MiFID implementation, despite the FSA’s efforts to promote consolidation (e.g. the Trade Data Monitor regime). The number of transactions being reported had increased significantly, and Mr Woodley noted that he would give a more detailed analysis at the next SLRC. Around nine or ten firms were now publishing pre-trade quotes, some of which are acting as systematic internalisers. John Serocold (LIBA) asked whether the FSA had a clear view of the breadth and depth of the changes when it seemed that the FSA’s review had only covered the largest systematic internalisers at this stage. Mr Woodley confirmed that in the longer term a more widespread review would be carried out, and added that the FSA would be interested to hear feedback from Committee members and the market on which areas this more comprehensive review should cover.

Overall, the level of competition had increased across the market. In the short term the FSA is concentrating on ironing out any issues, and will do a comprehensive review in the longer term.

*a) Markets in Financial Instruments Directive (MiFID): best execution*

There is currently one outstanding question with the European Commission regarding best execution and whether this will apply to securities lending. Members of the Committee will be informed as soon as a decision is reached.

*Markets in Financial Instruments Directive (MiFID): non-equity transparency*

The Commission's report on non-equity transparency is anticipated to be published in the next quarter. Mr Woodley noted that Charlie McCreevy had suggested in a recent speech that it was unlikely that the Commission would take any regulatory action.

*Markets in Financial Instruments Directive (MiFID): transaction reporting*

The FSA's new Sabre transaction reporting system is now live. Securities lending and repo remains out of scope of the MiFID transaction reporting regime. (A list of relevant MiFID transaction reporting documents can be downloaded from: [www.fsa.gov.uk/transactionreporting](http://www.fsa.gov.uk/transactionreporting)).

*b) FSA work on CFDs*

A consultation paper (CP0720) on disclosure had been issued, with a closing date for comment of 12 February 2008. Mr Woodley noted that securities lending and repo were outside the scope of the consultation, although securities lending issues were being considered by the Takeover Panel and the Commission. If any members of the SLRC had any questions on the CP, Mr Woodley suggested they contact Simon Cottee or Toby Wallace on the FSA's Primary Market Policy Team (e-mail: [cp07\\_20@fsa.gov.uk](mailto:cp07_20@fsa.gov.uk)).

*c) Agent/lender disclosure and Basel II*

Mr Woodley and Mr Rule updated the Committee on agent/lender disclosure and Basel II. Mr Rule said that the FSA had produced a draft paper on how borrowers of securities through agency lending programmes can calculate their regulatory capital requirements. The FSA has stated that the industry should move to full daily disclosure of underlying principals within two years from January 2008. In this two year window, ISLA has produced recommendations for, at a minimum, monthly disclosure, piggybacking on the US solution by using US data formats and DTC's system for allocating unique identifiers to underlying principals. The scope so far was only to include securities lending, but agency repo would be included in the long-term solution.

Mr Woodley noted that the FSA was meeting shortly with ISLA and LIBA to further discuss proposals regarding the calculation of regulatory capital requirements.

Mr Rule said that, notwithstanding the continued uncertainty about whether MiFID best execution requirements applied to agent lending, ISLA was looking to extend the Stock Borrowing and Lending Code in that area, including the contents of a typical execution policy and disclosures to clients. Mr Rule noted that the proposed text would be available to share with the Committee at its next meeting.

## **8 EU work on shareholder voting and implications for securities lending**

Hugh Gibson (ISLA) updated the Committee on EU work on shareholder voting and implications for securities lending. Mr Gibson reported that the European Commission response to the comments on its consultative paper was due soon. Mr Merriman noted that the BBA expected a proposal for a Recommendation on harmonised treatment for voting rights on borrowed securities, although no political decision had been taken yet. Mr Hale said that the ABI had heard that the Commission planned to press for the separation of record and dividend dates. Mr Rule suggested the Securities Borrowing and Lending Code might need to be changed to ensure that it is consistent with the recommendation made by the Commission on borrowing to vote.

## 9 **New tax legislation for repo**

Richard Rogers (HMRC) gave a presentation on new corporation tax legislation for repo to the Committee. Previous corporation tax rules encouraged artificial attempts to generate tax deductions or shelter income. The new rules follow a general move toward the use of UK Generally Accepted Accounting Practice (GAAP) as a basis for taxing financial instruments. The new tax rules generally follow GAAP with the result that profits are recognised if, and only if, there is a corresponding accounting profit. The new repo rules also have the ability to accommodate complex financial transactions, and the whole arrangement of a repo is treated as a loan. The new tax legislation for repo was introduced on 1 October 2007, with transactions entered into before the date of introduction taxed under the old rules.

Mr Serocold asked whether other countries were following this route. Mr Rogers replied that he believes the US taxes repo in a similar way, but he is not aware that other EU countries do.

## 10 **Review of the GMSLA**

Mr Rule noted that, following the consultative paper from ISLA issued in June, a working group had now been set up to update the GMSLA. Deloitte will be writing a new tax addendum. Freshfields will cover the legal aspects. The new version is expected to be completed in H1 2008.

## 11 **Report on status of harmonisation of legal opinions for repo and securities lending agreements**

Mr Cross noted that at the last SLRC, it was agreed that the Bank would hold a meeting with members of SIFMA, LIBA, ICMA, ISLA and others to help review progress, but given events in the market the Bank was unable to hold the meeting. Mr Cross thanked the members of the respective organisations for pressing ahead with the meeting on 11 October in the Bank's absence.

At the 11 October meeting between ICMA, ISLA, LIBA, SIFMA and in-house lawyers of these associations' members and a subsequent meeting on October 19 between the associations, agreement in principle was reached on the combination of the opinion

seeking/updating exercises which have to date been conducted separately by the associations for the GMRA and the securities lending agreements, respectively.

Mr Serocold noted that the first joint opinion gathering exercise was now underway with Freshfields, ICMA and SIFMA who were working towards a completion by 31 March 2008. One outstanding issue remained: a number of opinions were due to expire in Q1 next year (including Kuwait and Luxembourg). The FSA had been asked to agree that its requirements would be met notwithstanding the fact that a number of opinions were more than a year old.

Reuben Levermore (SIFMA) noted that SIFMA were pleased to have agreed the funding structure, and thanked Mr Hellmund for his efforts in preparing instructions for the common legal opinions. He added that there seemed to be strong interest from Members in further increasing the types of counterparties covered by those opinions and SIFMA would be keen to respond to Members' needs.

Mr Serocold noted that while the SLRC sub-group would continue to exist, meetings would be arranged in such a way as to take account of the substantial overlap of membership between the subscribers to the netting sub-group and the members of SIFMA and ICMA with an interest.

Mr de Vidts noted that the ERC had discussed the GMRA with the ECB. The ERC were keen for a meeting with the ECB and Bank to be organised shortly after the completion of the first exercise.

## **12 Country report on legal opinions**

Mr Hellmund updated the Committee on new legal opinions. Mr Hellmund noted the efforts were being made to combine the process for new opinions. On October 16 and December 4 ICMA notified the entire membership about the publication on its website of a new legal opinion for Israel and Croatia respectively. As requested by the ERC committee, ICMA commissioned new legal opinions for Anguilla and India (at the suggestion of SIFMA) and Oman and the jurisdictions of the United Arab Emirates (other than Abu Dhabi for which an opinion already exists).

The ERC confirmed that there is sufficient market interest to obtain legal opinions for Barbados, Iceland and Indonesia. On the condition that clean opinions can be obtained for a reasonable price ICMA will commission opinions for these jurisdictions. ICMA. SIFMA recently confirmed to ICMA that they are willing to join ICMA in seeking these opinions.

ICMA is in the process of establishing with local counsel whether clean legal opinions can be obtained for Bulgaria and Qatar. ICMA continues to monitor legal developments in Malaysia, Romania and Russia with a view to ascertaining at what stage a clean opinion can reasonably be expected for each of these jurisdictions.

Mr Serocold noted that it was his role to approve legal opinions and report back to the SLRC sub-group. He thought that there were no concerns on the machinery to bring opinions to the sub-group in light of the harmonisation of legal opinions.

### **13 Terms of reference and 2008/09 work programme**

Mr Rippon noted that the Terms of Reference, available at <http://www.bankofengland.co.uk/markets/gilts/slrcterms.pdf>, needed to be reviewed and required some updating. The current reference to the Equity Repo Code could be deleted and the objective of considering whether a new Code may be needed depending on developments in the equity repo market could be added. Some other updating may also be required, such as on 'legal netting', given progress on harmonisation, and the change in name of the Stock Borrowing and Lending Code of Guidance to the Securities Borrowing and Lending Code of Guidance and also some of the names of the member organisations. The Bank would prepare and circulate for comment a draft of some revised Terms of Reference.

Mr Cross noted that a revised work programme, available at <http://www.bankofengland.co.uk/markets/gilts/slrcwork20072008.pdf>, should be agreed for 2008/09. Mr Cross suggested that members send suggestions to the SLRC Secretary.

### **14 Any other business**

Mr de Vidts noted that a meeting had been held 6 weeks ago to discuss CCBMII, and a consultation with banks who obtained money from central banks was discussed. Mr de Vidts

has championed a working group for the project, and he noted that the ECB will consult the market in February. Mr de Vidts noted that CCBMII aims to simplify collateral management, and it is something for the SLRC to keep an eye on. Mr Cross agreed.

Mr Merriman noted that he was moving to a different role and a replacement from the BBA would attend from the next meeting. Mr Cross thanked Mr Merriman for his contributions to the SLRC.