

SECURITIES LENDING AND REPO COMMITTEE

Tuesday 9 December 2008

Bank of England

MINUTES

Attendees

Michael Cross	Bank of England, Chairman
John Hale	ABI
Andre De Roy	APACS
Nick Baker	Bank of England, Secretary
Cassandra Kenny	BBA
Rahim Nanji	Deutsche
Tony Baldwin	ERC/ Daiwa Securities
Heather Pilley	Financial Services Authority
David Roberts	Fortis
Ian Fox	HBOS
Lisa Cleary	ICMA
Liz Murrall	IMA
David Rule	ISLA
Hugh Gibson	ISLA
Nigel Bradley	LCH.Clearnet
John Serocold	London Investment Banking Association
Dagmar Banton	London Stock Exchange
Joyce Martindale	Railpen Investments
Reuben Levermore	SIFMA

Also Present:

Sumita Ghosh	Bank of England
Christian Hawkesby	Bank of England
John Rippon	Bank of England
Gareth Hughes	Deutsche
Monica Sharma	Financial Services Authority
Johann de Silva	Freshfields
Rupert Macey-Dare	Freshfields

1 **Introductions**

Mr Cross welcomed Members to the December SLRC, and noted that this would be John Rippon's last SLRC following his retirement from the Bank of England. Mr Cross thanked Mr Rippon for his contributions to the work of the Committee.

2 **Minutes of the previous meeting**

The minutes of the previous meeting were agreed.

3 **Matters Arising**

There were no matters arising as all items are picked up in the agenda.

4 **Update on market conditions**

Prior to inviting Committee members to discuss market conditions, Mr Cross updated the Committee on the progress of the Bank's consultation on the development of the Bank of England's market operations. Mr Cross reported that the consultation period had formally closed and thanked Committee members for their comments. There had been very broad support for the facilities the Bank had implemented over the course of the market turbulence. The Bank would give feedback to the market in a paper to be published in the New Year.

Tony Baldwin (ERC/Daiwa) updated the Committee on developments in repo markets. US Treasuries had resumed trading in the vicinity of the zero-rate bound, which could lead to an increase in the number of settlement fails. The Treasury Market Practice Group (TPMG) had recommended a number of measures designed to address the problem of fails¹. ERC is monitoring the development of measures in the US and considering the implications in the event that European markets approach the zero-rate bound.

¹ <http://www.newyorkfed.org/tmpg/PR081112.pdf>

Tri-party repo is now concentrated in the shorter dates, often overnight, with little liquidity seen for term tri-party into the New Year. Liquidity/cash providers in tri-party repo had pulled back significantly, and there had been a general tightening of collateral requirements as participants moved away from structured collateral and ABS toward high grade and liquid securities. Haircut levels had also been tightened up to provide additional security for cash providers as the market looked deeper into methods of protection against counterparty credit risk in potentially illiquid/volatile market conditions. Volumes appear to have reduced further since October. Data for the ICMA survey on repo markets for December is being compiled and results are likely to be available in March.

David Rule (ISLA) updated the Committee on developments in the securities lending market. Demand for borrowed securities was being reduced by the ongoing deleveraging in financial markets. Supply had also fallen as some institutions reconsidered the risks in lending securities following the Lehman default but the expectation was that in most cases any suspension of lending would be temporary. Haircuts were increasing, and becoming more variable, and collateral had tightened. There was increased focus on counterparty risk and daylight exposures.

Mr Rule noted that financing was still available from Central Banks, but this excluded equities and convertible bonds for which financing conditions had tightened noticeably. Mr Baldwin said that eligibility of convertibles for Central Bank operations had been raised at ERC as they are trading like conventional bonds given option values were zero. It was noted that some banks had arranged structures to issue commercial paper backed by convertible bonds for sale to the Federal Reserve.

5 Regulatory developments

Heather Pilley (FSA) updated the committee on regulatory developments. The FSA had established initiatives to consider a number of matters in light of recent events and Miss Pilley described, in particular, work in the Markets Division relating to transparency, infrastructure and cross-border cooperation.

Miss Pilley introduced Monica Sharma to the Committee. Miss Sharma would be focussing on the securities lending and repo markets, and was currently preparing a paper highlighting the risks in stock lending.

6 Revision of the Securities Borrowing and Lending Code

John Rippon (Bank of England) reported that the Securities Borrowing and Lending Code had been revised to reflect regulatory changes. The draft revised Code had been circulated to Members on 28 November for comment. It is envisaged that a working group will be established by the SLRC to review other provisions in the Code with a view to making further amendments in 2009. The aim is to make the Code a living document that may be updated as and when needed.

Hugh Gibson (ISLA) noted that provisions on best execution had been approved by the SLRC in March. Mr Gibson would shortly be meeting with a securities lender and a custodian to review other parts of the Code, with an outcome to be taken to the March 2009 SLRC meeting.

7 Review of the GMSLA

Mr Rule reported that the proposals received on the draft version of the new GMSLA circulated by ISLA in April had been discussed in light of the lessons learned following the bankruptcy of Lehman Brothers. The proposals were broadly supported, and additional minor improvements had been suggested. It was hoped that the new agreement would be finalised in time for the start of the netting opinion gathering exercise.

Mr Rule noted that ISLA was proposing a protocol process whereby counterparties can write to ISLA agreeing for the post-default procedures in existing documentation (e.g. OSLAs) with all other firms signing up to the protocol to be replaced with the new procedures, using the same approach taken by ISDA for derivatives documentation.

8 Report on progress of combination of legal opinions for repo and securities lending agreements

Reuben Levermore (SIFMA) reported that, as of mid-October, SIFMA had withdrawn from funding GMRA legal opinions. This meant that SIFMA would not be involved in updating the GMRA legal opinions for 2009. This work would be handled and funded by ICMA.

SIFMA had sought to avoid duplication between the trade associations and had decided that the funding for GMRA legal opinions could be better directed elsewhere in its Members' interests. Reuben Levermore said that SIFMA did not expect this decision to have any significant effect on the market as those SIFMA Members that rely on the GMRA opinions are generally also Members of ICMA and therefore can access the full range of GMRA legal opinions offered by ICMA. He noted that the GMRA opinions currently available to SIFMA Members, most of which are valid until early April 2009, would remain on the SIFMA website.

SIFMA would retain its IPR rights in the GMRA itself and had an interest in promoting the GMRA as a template for repo. It therefore had every intention of remaining engaged as an SLRC member, however in practical terms SIFMA would now concentrate its repo activities on its US and Asian divisions. Reuben Levermore thanked Lisa Cleary, David Rule and John Serocold for having worked with SIFMA on GMRA matters.

Lisa Cleary (ICMA) reported that the legal opinions exercise for 2008/09 is now underway, with ICMA co-ordinating the exercise on the GMRA side, as well as the stock lending side. ICMA have now contacted counsel in all 68 jurisdictions in which opinions were obtained in March 2008 to request preliminary fee cap proposals for the updating of these legal opinions. Over the coming weeks ICMA will liaise with the SLRC in order to review the collated figures and agree on the format of instruction letters. A more detailed report on the 2009 opinion set would be provided at the March 2009 SLRC.

ICMA have completed an audit of counterparty coverage of the current legal opinions. The results are intended to be used as a guide only and in all cases, coverage should be verified by the opinion user. The document will be circulated to the SLRC shortly.

ICMA have revised the FAQ document published with regard to Lehman Brothers and have produced an enhanced document which is available on the ICMA website. The revised

document has been extended to encompass more general questions fielded in the past months of market turbulence.

John Serocold (LIBA) noted that he had handed over the Chairmanship of the SLRC subgroup to Mr Rule. Mr Cross thanked Mr Serocold on behalf of the Committee.

9 **2009/10 Work programme**

Mr Cross asked members to consider a revised SLRC work programme for 2009/10. The Committee was invited to send amendments to the 2008/9 work programme to the SLRC secretary. A new work programme could then be agreed at the March SLRC meeting.

10 **Any other business**

Mr Cross reported that the Bank, DMO, Treasury and CREST had agreed that Bank of England sterling bills would be eligible in the CREST UBG DBV category from 11 December. The measure should considerably enhance liquidity of the bills, which could now be traded through Brokertec and settled via LCH.Clearnet².

Liz Murrall (Investment Management Association) reported on the work of the Shareholder Voting Working Group (SVWG). The SVWG was currently investigating why votes were not getting through the voting chain. A tracing exercise for five issuers determined that 10.9% of votes went missing, one half of which could be attributed to over-voting. The issue appears to be that voting instructions have to be initiated so far in advance that entitlements can change by the meeting date and if this is due to sales or stock being lent then the related stock can be over-voted.

Mr Rule reported that market interest in the CREST DBV process had increased in light of the bankruptcy of Lehman Brothers and recent equity and gilt price volatility. Some had suggested that the market standard haircut on gilt DBV collateral is now too low. It was confirmed that counterparties can agree haircuts rather than those being set centrally by CREST. Counterparties had also focussed on the fact that Lehman had entered administration after DBVs had unwound, highlighting that DBV collateral is cash during the day and

² <http://www.bankofengland.co.uk/markets/marketnotice081210.pdf>

securities lenders need to ensure they take a haircut on that cash as well as the overnight delivery of gilts.

Mr Cross updated the Committee on work on non-standard CREST closure (NSCC). CREST had produced a White Book which was currently with the Bank for final comment. It was anticipated that CREST would publish the NSCC White Book in the New Year. At the November meeting of the MMLG Operations sub-Group concluded that a series of training sessions would be scheduled in the New Year, aimed at both the wider CREST community as well as the settlement banks.