

SECURITIES LENDING AND REPO COMMITTEE

Tuesday 8 December 2009

Bank of England

MINUTES

Attendees

Chris Salmon	Bank of England, Chairman
Christian Hawkesby	Bank of England
Ronan Hodge	Bank of England, Secretary
Michael McKersie	ABI
John Serocold	AFME
Dasha Kazakova	Bank of America-Merrill Lynch
Cassandra Kenny	BBA
Antony Baldwin	ERC / Daiwa Securities
Robert Fair	Euroclear
Johann Desilva	Freshfields
Heather Pilley	Financial Services Authority
Toby Wallis	Financial Services Authority
Julie Elbourne	Financial Services Authority
Bronwyn Bayne	Financial Services Authority
Geoff Heaton	HM R&C
Lisa Cleary	ICMA
Liz Murrall	IMA
Kevin McNulty	ISLA
Hugh Gibson	ISLA
James Templeman	ISLA
Jamie Smith	Lloyds Banking Group
Dagmar Banton	London Stock Exchange
Joyce Martindale	NAPF
Julian Le Fanu	NAPF
David Hopton	Santander

1 Introductions

Chris Salmon (Bank) greeted Members to the December meeting of the SLRC and welcomed **Toby Wallis, Julie Elbourne** and **Bronwyn Bayne** from the FSA.

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 were picked up in the agenda.

4 Market developments

i) Update on market conditions

Antony Baldwin (ERC) reported limited impact on repo markets from the recent Dubai World debt standstill. Tiering in government bond repo markets had increased with better quality collateral trading through EONIA (e.g. Bunds at -5bps) whereas less creditworthy names had widened out (e.g. Greece +17bps).

Some negative repo rates were reported though these had not resulted in the need to invoke a fails policy as market convention that trades are settled continued. The ERC were looking at the issue of failed trades and the possibility that if negative repo rates persist, fails could become an issue in the market.

Demand for term funding in repo markets remained strong, in part due to forthcoming FSA liquidity regulations, though there was reportedly limited liquidity with transactions typically arranged on a bilateral basis. Questions remained over banks' balance sheets as deleveraging continued to impact on repo market liquidity.

The Miller-Moore amendment to the US Financial Stability Improvement Act that could require secured lenders to take a 20% haircut was discussed. Most thought it was potentially damaging to the repo market encouraging a shift to short term unsecured funding. A carve out

for certain securities was thought likely and most expected it to be amended. A transaction tax of 2-25bps proposed on 3 December was said to add another dimension to the debate.

Mr Baldwin thought central banks were trying to give the market notice of a change in policy stance and the ECB's proposed repo operations were well received as providing sufficient flexibility should liquidity be needed whilst signalling that they intend to remove 'excess' liquidity. **David Hopton (Santander)** noted there was little price reaction to the ECB announcement.

James Templeman (ISLA) provided an update on securities lending market conditions. He noted securities available for lending had fallen about 35% during the latter part of 2008 and early 2009 (skewed towards a fall in equities) but about 50% of this had since returned. Hedge funds were seeing inflows again and assets under management had risen to about \$2trn from a low of \$1.7trn, though well below their peak of \$3trn. Low leverage levels remained and continued to restrain demand to borrow securities. Despite the lower volumes, spreads remained high for a larger number of securities and so provided a boost to lending revenue.

Margins on equity collateral were reported to have fallen back to 7-8% from around 10% earlier this year) as risk appetite tentatively returns. Whilst some lenders were said to still only accept government bonds as collateral, the importance of collateral liquidity has meant more counterparties were willing to accept equities as collateral.

Competition amongst custodians and agent lenders had focused on minimising risk (e.g. indemnity coverage) as lenders had not been looking to raise their risk profile to increase returns.

Jamie Smith (Lloyds) reported that 60-70% of lenders were actively reviewing their collateral requirements and haircuts and that a fall in haircuts would help increase lending volumes. Meanwhile **Joyce Martindale (NAPF)** confirmed that lenders were taking a conservative approach.

ii) **Update on Euroclear term DBV product**

Robert Fair (Euroclear) reported that delivery of the full term DBV product was now expected in 2012. However, CREST were revisiting amending the current DBV product to include term funding. This work was said to be at a feasibility stage but may allow for delivery in 2010 and would represent 80-90% of the functionality of the full product. The

amendment would involve merging the DBV functionality with the repo functionality allowing for a return date beyond overnight to be specified – Euroclear would automatically allocate securities. Substitution of collateral by the collateral giver would also be possible. They had not yet had a full discussion with the market though they intend to do so. A full consultation paper was unlikely given the interim nature of the product and small user base.

Kevin McNulty (ISLA) confirmed that ISLA could act as a point of contact to provide feedback on behalf of ISLA members.

Jamie Smith (Lloyds) noted that from an inventory management perspective, it would be desirable to manage substitutions on a daily basis as repo desks would not want to tie up their collateral for longer than overnight.

Chris Salmon (Bank) said the Bank of England saw merits in such a product as it would reduce churn in the overnight DBV market and encouraged other participants to engage constructively in relation to the initiative.

5 Regulatory developments

i) FSA Update

Heather Pilley (FSA) updated the committee on the FSA's recent work.

The second of three papers produced by HMT on issues arising from Lehmans is due for publication on the 16 December. This will cover a number of topics relating to markets, client assets and how investment bank resolution could be framed. The release of an FSA companion paper on client assets has been moved back to Q1 2010.

Work is ongoing on OTC derivatives following a communication from the EC on 20 October. The FSA will publish a paper shortly on reforming OTC derivatives markets, together with HMT. As a hint as to its contents, regard could be had to their August/September communication. Ms Pilley reported the pace of developments in this area were quite fast.

ii) Informal Review of Stock Lending

Toby Wallis (FSA) reported that following a request from Lords Myners, the FSA's primary markets policy team had been conducting an informal review of the stock lending market focusing on risk management, governance and investor engagement.

The review highlighted a range of understanding of securities lending amongst beneficial owners and whilst they recognised there has been increased focus on the risks around securities lending since the Lehman bankruptcy, an inadequate understanding by some meant they were not in a position to manage these risks effectively or engage with their agent lenders adequately.

The FSA proposed that more comprehensive guidance material on best practice should be provided to beneficial owners and this could benefit the market by improving the understanding and perception of securities lending. They suggested the SLRC consider establishing an Education and Documentation subcommittee to produce and distribute such guidance materials. Representatives of ISLA, NAPF, IMA and the ABI gave their support to the formation of the subcommittee. On that basis, **Chris Salmon (Bank)** agreed a subcommittee should be established with the aim of producing a report in time for the June meeting of the SLRC. He asked SLRC members to indicate to **Ronan Hodge (Bank)** whether they wished to be represented on the subcommittee. Whilst no formal response had been received from HMT relating to their review, they thought it would be appropriate to aim to distribute the new materials by Q3 2010.

The FSA also proposed independent research is commissioned about the prevalence of borrowing to vote. **Kevin McNulty (ISLA)** noted that previous attempts to do such research had led to weak conclusions given the lack of available data but that they would explore a new commission. **John Serocold (AFME)** suggested the research would need to get coverage in relevant trade magazines. **Liz Murrall (IMA)** thought the research should also cover the issue of recalling stock to vote.

6 Work Programme Updates

i) ISLA Update

Kevin McNulty (ISLA) reported sign-up to the GMSLA 2009 remained limited and that there were a couple of issues that once resolved, along with guidance notes, should improve take up.

Other workstreams related to agent-lender disclosure with respect to Basel II and FSA requirements and a response to a recent paper on new pension arrangements.

ii) ERC Update

Antony Baldwin (ERC) reported that work on inter-operability (relating to LCH and the tri-party repo market) was ongoing. **Godfried de Vidts (ERC)** had done some recent work on LCH margining; a write-up was available on the ICMA website.

Lisa Cleary (ICMA) reported that work on repo of bilateral corporate loans was at a preliminary stage. There was no planned expansion of counterparty/jurisdiction coverage in the legal opinions exercise. The review of the GMRA was progressing well and is taking into account aspects of the GMSLA 2009 and harmonising where appropriate. Once all suggestions are received, they will look at drafting in Q1 2010.

7 Any other business

Work programme 2010/11

Chris Salmon (Bank) requested comments from committee members on the 2010/11 work programme be sent to **Ronan Hodge (Bank)**. A revised document will be produced for the March meeting.

Next Meeting

The next SLRC meeting is due to be held at the Bank of England on Tuesday 9 March 2009.