

SECURITIES LENDING AND REPO COMMITTEE

TUESDAY 8 JUNE 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
	Richard Steele	International Securities Lending Association/ JP Morgan Chase
	Hugh Gibson	International Securities Lending Association
	Godfried de Vidts	European Repo Council/ Fortis Bank
	Ian Fox	London Money Markets Association/ HBOS
	Mark Wharton	Financial Services Authority
	Nick Fisher	UK Debt Management Office
	Adrian Tgetgel	International Securities Market Association
	Simon Hills	British Bankers' Association
	John Serocold	London Investment Banking Association/ Chair, SLRC Netting Sub-group
	Steve Russell	London Investment Banking Association/ HSBC
	Anthony Littleton	Association for Payment Clearing Services
	Tony Hibbitt	Cater Allen International
	Also present:	
	Rob Fair	CRESTCo
	Paul Blanchard	London Clearing House
	John Rippon	Bank of England
	David Sheppard	Bank of England
	Jon Carr	Bank of England

MINUTES OF MEETING HELD ON 9 MARCH 2004

1. With regard to item 13, the problems with the Italian settlement system, Monte Titoli, Mr de Vidts said that no compensation would be paid by Monte Titoli, and that if banks had claims they should approach their correspondent bank.

SLRC/ISLA/BBA/LSE/LIBA/ACT PUBLICATION ON SECURITIES LENDING

2. This had been published on 11 March. Mr Rule informed members of the committee of the following figures for access and downloads of the publication from the websites of the sponsoring organisations:

- BBA: 333 hits
- Spitalfields Advisors: 150 downloads
- ACT: 583 downloads
- ISLA: 8765 hits, 2750 downloads
- Bank of England: 1824 hits

EU TRANSPARENCY DIRECTIVE

4. Mr Wharton reported on the status of the EU Transparency Directive. The text of Level 1 had been agreed in principle by ECOFIN on 11 May, and was due to be adopted in the autumn. It was now in the process of being translated. There were no proposed changes to the text on notification requirements for disposal/acquisition of bonds, discussed at previous SLRC meetings.

5. Work was now beginning on Level 2, which sets out the detailed measures beneath the Directive. A draft mandate for technical advice was needed from the European Commission before the Committee for European Securities Regulators (CESR) could begin their work, which would include consultation on a provisional version of its advice. The mandate would be published on the CESR website: www.cesr-eu.org and members should review it to see how CESR would be approaching the work. There may also be an open hearing in Paris in the early autumn once the first consultation paper is published. Mr Wharton said he would update the Committee further at its next meeting.

ESCB-CESR DRAFT STANDARDS FOR SECURITIES SETTLEMENT SYSTEMS

6. Mr Sheppard reported on the draft standards. There had been a public hearing at CESR on 25 May. The deadline for written responses to the current draft was 21 June, whereafter there would be a further meeting of the working group to produce a final draft. This would then be presented to the CESR chairman and the ECB Governing Council for approval. Some market participants

remained concerned about the scope and application of the standards, but the standard relating to securities lending (Standard 5) was not thought to be contentious. Mr Hills said that the draft standards appeared to permit national discretion as to whether Central Securities Depositories (CSDs) should be allowed to provide centralised securities lending facilities. He was opposed to this in principle (except in a crisis situation), as national CSDs have a monopoly position.

CREST/EUROCLEAR HARMONISATION PROGRAMME

7. Mr Fair gave an update from CRESTCo. Consultation with the market was currently taking place on the ESES/RGV project and on the long term harmonisation of settlement and the Single Application Platform (SAP). Mr Fair dealt with each issue in turn.

8. **ESES-RGV:** The aim was to create a single settlement solution for the Euronext markets, by migrating the Belgian and Dutch markets onto the French RGV settlement system. This was being investigated by Euroclear to see if it can be implemented as a step on the path to the SAP. A Euroclear PLC board meeting on 8 July would decide whether the plan was workable and whether to go ahead. The provisional timetable was for the implementation of the Single Settlement Engine by 2006, and implementation of the RGV-ESES project by 2007. The intention was that the ESES-RGV solution would use the SSE as settlement engine, and bring forward the delivery of certain parts of the SAP to avoid throwaway investments.

9. **SAP:** Post ESES-RGV, harmonisation would bring together all the Euroclear Group markets for all Securities Settlement System functions:
 - Settlement
 - Corporate actions
 - Single payments model
 - Tax/ legal aspects.

One mechanism would accommodate all markets, based around internationally agreed standards, including an ISO15022 compliant interface (and compliance with any successor standards, for example the proposed ISO20022 XML

standard). This would simplify settlement not only for existing market participants but should also make it possible for new markets to come on board in the future. Working groups were currently in place; each of the functions above included a representative from each domestic market as well as representatives from trade associations. Various options for the best way to migrate from the legacy systems to a single settlement engine with minimal costs and risks were being discussed.

10. Two publications on these projects were to be released in June. 'Harmonisation Fundamentals' would review the barriers to single settlement that exist today; for example, there are tax barriers that make it uneconomic for non-French banks to be members of Euroclear France. 'Harmonisation Proposals' would be an indicative text for the future of the SAP, forming the basis of the consultation process going forward. The ESES-RGV blueprint would give details of how this project would work in practical terms, but would only be published if the Euroclear board give approval for the project to proceed. If approval were granted, this document would be published in July.
11. Detailed proposals relating to stock lending and repo were still to be defined at this point, as most of the focus by Euroclear to date had been on settlement and corporate actions, but a harmonisation of repo functionality was proposed. Stock lending, self-collateralising repo, DBV and tri-party repo were all issues to be covered by the settlement and payments working groups. Mr Fair said that SLRC would be consulted as part of this process.
12. Mr Gibson said that, contrary to the timetable that Mr Fair had previously laid out, according to the UK Markets Advisory Committee Flash Report on the CREST website the UK MAC had not been confident that the SSE would be completed by 2006. Mr Fair said that the MAC may well have expressed that view, but as far as he was aware, development was on schedule and 2006 was still the target. Mr Tgetgel asked whether CRESTCo would be approaching TBMA and ISMA with respect to repo harmonisation. Mr Fair said that Euroclear would be approaching everyone with an interest when the documents were published later that month.

REFORM OF THE BANK OF ENGLAND'S OPERATIONS IN THE STERLING MONEY MARKETS

13. Mr Rule reported on the Bank's reform of its money market operations. The Bank had released a consultation paper at the end of May, with the consultation period due to finish on 11 June. The paper set out the Bank's objectives for its operations. The Bank still intended to use reverse repo for its open market operations, and was not intending to make changes to the range of collateral it accepted. However, the Bank no longer wished to lend at a fixed rate beyond the next MPC meeting, and was considering implementing indexed repos to avoid this.

14. Mr Rule said that some contacts had suggested that greater stability in short dated interest rates might encourage sterling securities lenders to take cash collateral rather than other sterling securities, moving sterling market practice towards US market practice. Mr Hibbitt said that balance sheet considerations were actually causing some in the US market to move from cash to securities collateral.

HMT/FSA/BANK OF ENGLAND PAPERS ON EU FINANCIAL SERVICES ACTION PLAN (FSAP)

15. Mr Carr said that HMT, FSA and Bank had recently published two documents on the FSAP, entitled 'The EU FSAP: Delivering the FSAP in the UK' and 'After the EU FSAP: A new strategic approach'. (They are available on the respective websites and hard copies can be obtained from HMT [7270 4558.]) A key aim of the first paper was to set out the implementation issues for UK-based firms relating to the FSAP, given that over 20 of the measures would be implemented in the UK and other Member States over the next three years or so. It identified the work that needed to be done to meet this challenge, differentiating between what the authorities, and market firms, would have to do. It also included a useful summary of those EU measures affecting the financial sector which had yet to be implemented.

16. The second paper considered how the Single Market in financial services could be enhanced in future. It highlighted five priorities: better implementation and

enforcement of EU measures; alternatives to regulation, better EU regulation where it was required, with proper analysis of the evidence on costs and benefits beforehand; making the Lamfalussy process work well; and recognition of the global nature of financial services and thus, for example, the impact of EU legislation on the competitive position of EU firms and markets.

17. Mr Carr said that several of the particular issues currently being progressed or discussed at EU level were relevant to SLRC members, e.g. capital adequacy (CAD3), clearing and settlement, Hague Convention. In addition, members of the European Commission group of securities market experts had recently suggested that an EU approach might be taken to other issues, in particular the greater harmonisation of netting regimes at EU level.
18. The Commission had invited comments on the four reports (available on the Commission's [DG MARKT] website) before 10 September. This provided an opportunity for market firms to influence the Commission's future work programme. The Commission's work plan for 2005-9 was likely to be announced in early 2005.
19. Members thought it would be useful for them to liaise on EU issues of particular relevance to the securities lending and repo markets, perhaps via an email group involving LIBA, BBA, ISLA, ERC, ISMA and TBMA. Mr Gibson highlighted the need for regular updates on EU work in this area (Mr Carr will brief the SLRC at its September meeting).

FAILURE OF REPO TRANSACTIONS WITH NEGATIVE INTEREST RATES

20. Mr de Vidts briefed the Committee on this issue. It is current practice, where the borrower fails to deliver securities in a repo transaction, that interest should still be paid to the counterparty, from the value date of the transaction. In the case of repo transactions with negative interest rates, this results in the borrower receiving interest even though they have failed to deliver the securities. The question had been referred to the ISMA Market Practices Committee. Mr de Vidts was keen that the market should be able to solve the problem for itself.

21. The implication of 'guaranteed delivery' transactions was discussed. One option would be for the lender not to conduct future business with that counterparty. However, it was thought this might not always be possible, and Mr Blanchard noted that some transactions take place between anonymous counterparties. Mr Blanchard also said that this issue meant that users might need to decide whether they wished to use the autobuy mechanism introduced by LCH. Mr Fisher noted that the DMO offers an automatic non-discretionary standing facility to all regular dealing counterparties of the DMO and will issue gilts on a repo basis into the market as part of its Debt Management responsibilities to prevent market dislocation or disruption - for example, in the event of delivery fails in the repo market.

CESSATION OF ANONYMOUS TRADING THROUGH THE CENTRAL COUNTERPARTY

22. Mr de Vidts reported that an ATS had decided to cease anonymous trading in cash bonds through LCH.Clearnet. The European Repo Committee had discussed this and held bilateral meetings with the market.

NETTING SUB GROUP

23. Mr Serocold reported on the activities of the netting sub group. Good progress had been made on the opinion updates. He said he planned to talk to TBMA and ISMA with a view to potentially issuing combined opinions, to reduce the number of parallel processes and lawyers involved. Members generally thought this was a good proposal, and Mr Serocold said he would provide an update at the next meeting. Mr Serocold also said that the netting sub group was working on the feasibility of having a single, annual date for all opinion updates.

24. It was noted that although SLRC commissions opinions for the Overseas Securities Lending Agreement (OSLA) this has now been superseded by the GMSLA. ISMA no longer provides opinions on the OSLA, and it was thought that market participants should be using the GMSLA.

GMRA: UPDATE OF LEGAL OPINIONS

25. Mr Tgetgel said that ISMA had completed its annual GRMA opinion exercise on 2 April. The main points are summarised below.

- ISMA is aware of prospective changes in law in certain jurisdictions that are due to take effect in 2004. New insolvency laws are expected to come into effect in Japan, Portugal and Spain and the banking statute is expected to be amended in Switzerland. When the relevant change in law takes effect, ISMA will ask counsel to confirm that the change in law does not have an adverse effect on the 2004 update opinion. Counsel have confirmed that the implementation of the Collateral Directive has had no adverse effect on the 2004 opinion update in Germany.
- New legislation in Norway will shortly be enacted to substantially reduce the level of qualifications in a legal opinion. Once the legislation has been enacted, ISMA will seek a legal opinion with TBMA.
- Final opinions for Greece and Poland should be available for members within the next few weeks. First opinions are being sought for Estonia, Lithuania, Malta, Czech Republic, Slovakia, Slovenia, Cyprus and Latvia.
- It has been confirmed that it is possible to obtain satisfactory legal opinions in South Korea and Taiwan. In Russia and Croatia, ISMA continues to monitor legal developments in order to establish when a clean legal opinion can be expected, and the situation in China, Brazil, Mexico and the Philippines will be clarified.

UPDATE OF THE STOCK BORROWING AND LENDING CODE OF GUIDANCE

26. Mr Rippon said a draft update of the Code would be circulated to SLRC members ahead of the September meeting, for comments or additional items. The aim was to have the text finally approved at the December meeting of SLRC. Mr Gibson suggested that a working group of SLRC members (in which ISLA would want to be involved) should be formed to take the update forward. ISLA had a number of substantive comments.

ANY OTHER BUSINESS

27. There were concerns that there were no representatives from pension funds or investment managers on SLRC. To address this, the Chairman said he would invite a representative from the National Association of Pension Funds onto the Committee.

28. Mr de Vidts announced that the ERC semi-annual repo market survey would take place shortly, to be published in October.

DATE OF NEXT MEETING

29. The next meeting will be on 22 September 2004 at 11am, at the Bank of England.

BANK OF ENGLAND

2 JULY 2004