

# SECURITIES LENDING AND REPO COMMITTEE

Tuesday 2 June 2009

Bank of England

## MINUTES

### Attendees

Chris Salmon	Bank of England, Chairman
Graham Young	Bank of England
Ronan Hodge	Bank of England, Secretary
Hamish Pritchard	Bank of America-Merrill Lynch
Antony Baldwin	ERC / Daiwa Securities
Heather Pilley	Financial Services Authority
David Roberts	Fortis
Lisa Cleary	ICMA
David Rule	ISLA
James Templeman	ISLA
Nigel Bradley	LCH Clearnet
Ian Fox	Lloyds Banking Group
Karen Wu	London Stock Exchange
Joyce Martindale	NAPF
David Hopton	Santander

## 1 **Introductions**

Mr Salmon welcomed Members to the June SLRC as the new Chair 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**

**Mr Baldwin (ERC)** updated the Committee on developments in repo markets. Markets were said to be functioning well, especially for sovereign and supranational paper, with spreads continuing to contract (e.g. peripherals to Bunds, and credit to government). Haircuts were typically falling with the maximum level generally the ECB level, with some trades between market participants remaining without haircut. Nevertheless, participants remain cautious of the recent perceived improvement in conditions as without authority interventions globally they would be in a far worse situation.

The Japanese Central Bank recently began accepting foreign currency government debt as collateral, moving closer to the stance of the Fed and Bank of England.

The DMO Special Repo Facility was re-introduced allowing for gilts to be created for a period of one week. The facility was reported to be having the desired effect in easing conditions for some gilts.

**Ms Martindale (NAPF)** noted that in general pension schemes support stock lending and see it as essential for the proper functioning of the market. Furthermore, securities lending can provide schemes with a useful, but not huge, additional source of income. Nevertheless, the events of the past 12 months have caused schemes to reassess stock lending and reduced the willingness of some schemes to lend. Concerns about what borrowers do with the stock and the greater emphasis on voting may have also caused some schemes to reduce their stock lending. The NAPF are looking for the FSA to express its support for stock lending.

**Mr Hopton (Santander)** reported a marked improvement in three month liquidity in unsecured markets with some volume out to twelve months. There is also more liquidity in repo markets out to three months with the Bank of England's minimum bid in repo operations (0.60%) encouraging more term repo market activity below this level. This was a positive sign that the market was able to recycle liquidity using the Bank of England as a backstop. Investors were said to have a bit more confidence at longer maturities and for lower quality credits. Investor demand remained strong for government guaranteed issuance.

**Mr Fox (Lloyds)** noted that there were now a small number of banks that could issue unguaranteed bonds, though at high spreads, and this was seen as a positive development. There had been relatively sporadic and modestly sized issues by the best names but sentiment remained fragile. Subordinated debt issuance was thought to be less likely except for some Tier 1 issues.

As lending had compressed to shorter maturities, the amount of churn in the inter-bank market was said to have caused some issues. Whilst credit departments were extending their credit lines, non-banks, e.g. money market funds, were keeping their lending very short term.

**Mr Young (Bank)** noted the Bank of England's expansion of its quantitative easing programme to £125bn by August MPC and that they were still considering lending out purchased gilts to alleviate some scarcity in the market.

## 5 U.S. Treasury Securities Fails

**Mr Rule (ISLA)** reported that implementation of the new fails penalty had gone smoothly and most counterparties had agreed to the practice. Settlement fails were said to have fallen to levels as low as in the late 1990s. The restrictions on 'dealer time' had also been removed.

**Mr Baldwin (ERC)** reported the ten year US Treasury bond had recently been trading at -300bps in repo markets and that fails had increased marginally over recent days.

**Mr Bradley (LCH Clearnet)** noted that whilst fails were not a problem in sterling markets, LCH were considering what they might do if the situation changed. They plan to consult on what is an acceptable level of failure and have already put a 'safety net' in place should this become an issue.

## 6 Regulatory developments

**Ms Pilley (FSA)** gave an update on the FSA's work. The discussion period for the Turner Review would close on 18 June. The review is focused on prudential capital and liquidity issues covering areas including clearing, settlement, transparency and credit rating aspects. Responses were requested to the Discussion Paper.

The Treasury published a paper on issues arising from the Lehman Brothers bankruptcy. In particular, how client assets were held at the clearing house and firm level. They are also looking at the OTC derivatives market and the use of central counterparties for CDS transactions.

**Mr Rule (ISLA)** noted that an issue had arisen after Lehman Brothers bankruptcy as to whether some loans of UK equities should be closed out under LSE rules rather than as part of a lender's overall portfolio. ISLA members were keen to avoid any segmentation of their outstanding loans governed by a single master agreement. Ms Pilley noted that HM Treasury was consulting on the closing of market positions as part of its consultation on the winding down of investment banks.

## 7 **Publishing the Revised Securities Borrowing and Lending Code**

**Mr Hodge (Bank)** noted there had been no feedback on the revised code and wanted to check members were happy for the Bank of England to publish the code in its present form. There were no objections. Subsequently, some members expressed a desire to have more time to review the code before it was published.

He further noted that whilst **Mr Gibson (ISLA)** had been unable to attend this meeting, he had expressed a desire that the code be published on a more ad hoc and regular basis going forward reacting to market developments. Current issues included default risk management in the post-Lehman environment; investment management risk related to cash collateral aspects; and short-selling restrictions that may impact the wording or references in the code.

## 8 **Review of the GMSLA**

**Mr Rule (ISLA)** circulated a near final draft of the GMSLA prior to the meeting. Whilst substantially complete he was keen to elicit feedback by 12 June. The main changes were said

to include amended post-default procedures, modelled on the GMRA and including lessons from the Lehman default, and tax-related points.

He further noted that ISLA had published a set-off protocol to enable firms to update outstanding agreements to include the new post-default procedures. Take-up had been slow so far but most recognised it as desirable.

## 9 **Recent share issues by Liberty and DSG: implications for securities lending**

**Mr Rule (ISLA)** noted Liberty and DSG had raised new capital in recent months using a new approach that involved contacting large shareholders ahead of the announcement and offering them an underwriting role at a discounted price if the issue was not fully subscribed. The problem was that large holders that had lent shares might not be contacted because their names would not show up on the register. Whilst there was no obvious solution, it was something for the group to be mindful of. **Ms Martindale (NAPF)** suggested it might be a temporary issue given the recent spate of ‘rescue rights’ issues.

## 10 **Any other business**

### Netting Opinions Exercise

**Mr Rule (ISLA)** noted that the netting opinions exercise had been completed in March.

### Central counterparty in the securities lending market

**Mr Rule (ISLA)** welcomed comments on a recently published initial report of an ISLA working group on central counterparty (CCP) in the securities lending market.

### ERC Update

**Mr Baldwin (ERC)** noted an ERC survey was due for release in early July and mentioned the on-going work on credit claims after the recent Cogesi meeting where there was a summary of work so far. In this regard, progress was made in respect of steps towards an annex to GMRA for Credit Claims. Notably:

- a high level framework to be given to the ERC later in June, and
- a target for implementation within 18 months

Mr Baldwin also mentioned a document was likely to be published in the coming weeks by the ECB regarding lessons from the turmoil.

The ERC AGM is scheduled for October 15 and will be held in London.

#### David Rule

**Mr Salmon (Bank)** noted it was Mr Rule's last meeting and thanked him for his valuable contribution to the committee.

#### Next Meeting

The next SLRC meeting is due to be held at the Bank of England on Tuesday 8 September 2009.