

STOCK LENDING AND REPO COMMITTEE

TUESDAY 13 MARCH 2001

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Present:	Neal Hatch	Chairman
	Dagmar Banton	LSE
	John Burke	LCH
	Deborah Chesworth	LIBA
	Andy Clayton	ISLA
	Malcolm Ewen	Intermediaries
	Simon Hills	BBA
	Sarah Hobbs	LIBA
	Graham Jones	ISLA
	Neil McCann	CRESTCo
	Mike Ness	DMO
	Alan Storey	Intermediaries
	Tim Westover	MMSG
	David Wyatt	CRESTCo
	Alison Emblow	Bank of England
	Barry Harrison	Bank of England
	Caroline Pitt	Bank of England
	Stephen Priddle	Bank of England
	John Rippon	Bank of England
	Nick Talbot	Bank of England, Secretary

1. The chairman noted apologies for absence from Krystyna Beck, Hugh Gibson, Tony Hibbitt, Philip Reichardt, James Tomkinson and John Whitmore.
2. He welcomed to the meeting Mike Ness (DMO and attending in place of Jo Whelan/Allison Holland), David Wyatt (CRESTCo and invited as a specialist speaker on DvP), Alison Emblow (BoE and invited as a specialist on the BASEL Accord) and Barry Harrison (BoE and attending in place of Jon Carr).

MINUTES OF 13 FEBRUARY MEETING

3. These were agreed as final and have been posted on the Bank of England's Markets website as agreed at: <http://www.bankofengland.co.uk/markets/slr.htm>

DvP against CENTRAL BANK MONEY

4. Mr Wyatt of CRESTCo briefed the committee on this topic. DvP against central bank money represents the simultaneous exchange of central bank money for securities (gilts, equities and money market instruments).
5. CREST currently operates an Assured Payment System (APS). Each CREST member is required to have a relationship with a settlement bank who guarantees the payment obligations of their customers from the point they are created until the point the payments are discharged between settlement banks at the end of the day. However this system does not entirely eliminate payment risk. The seller's settlement bank generally does not guarantee payment to their customer in the event of insolvency of the purchaser's settlement bank before inter-bank settlement has occurred. DvP against central bank money aims to eliminate this payment risk.
6. Full details are available on CRESTCo's website at http://www.crestco.co.uk/news/index_home5.html including the trialling strategy.
7. Following a meeting of the Steering Group, a target date has been set for the end of November for implementation with testing and trialling scheduled for late summer. Risks to this date exist, in particular should there be any slippage in the implementation timetable for new CHAPS (scheduled late summer) and the CLS bank (scheduled for October). As such a contingency timetable has been considered with a back-up implementation date of mid-December. Everyone is keen that there should be no slippage of the timetable past 2001, as there are a number of market initiatives already planned to go live in 2002 such as netting.
8. A substantial amount of additional collateral will be required – estimated to be around £40bn – to allow the system to function. The Bank has now defined eligible collateral to be the same as that used in OMOs – i.e. principally gilts, and certainly not equities. The proposal is that settlement banks' principal customers (principal in the form of dealing (i.e. opposite of agency) rather than "main") will allow the banks to use their stock to generate this extra collateral. The customers would simply have to indicate a willingness to allow their collateral to be used; the CREST system would automatically move the collateral and ensure it was returned when the customer required it. Mr Davies of CRESTCo has been discussing this with settlement bank customers and leading intermediaries.

9. In addition, the timing of gilt settlement is being reviewed. It currently begins later than equities settlement at 8.00am and a project team is examining the advantages and disadvantages of this and whether the two should begin together at 6.00am. A formal consultation with the market will take place in the Spring.

10. Legal discussions between CRESTCo, the settlement banks and the Bank of England are on going in order to create a legal structure to underpin the DvP arrangements including self-collateralisation.

ISSUES RELATING TO THE EURO

11. Mr Harrison said that the Bank is planning to publish the next *Practical Issues* in early June.

12. The final report by Baron Lamfalussy's Committee of Wise Men on the regulation of European securities markets was published on 15 February and is available from the Commission's website:

http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussy.htm.

13. The report seeks to improve the regulatory process in order to speed the development of an open, secure and integrated European securities market. It was discussed at ECOFIN on 12 March and a European Council Resolution may be agreed at the Stockholm European Council meeting on 23-24 March.

14. The European Parliament was to debate the report on 14 March, including a motion from the Economic and Monetary Affairs Committee calling for greater parliamentary safeguards over the proposed European Securities Regulators Committee.

15. In addition to recommending a new regulatory structure, the report calls, amongst other things, for the development of a pan-European clearing and settlement system that its authors hope will arise from private sector efforts to consolidate. Mr Burke commented that, following the report, the Giovannini Group is to undertake a study on EU clearing and settlement. Three markets are being considered: bonds, derivatives and equities. The Group's report will provide an assessment of today's environment, how the markets would work under different structures and a set of proposed models. These proposals will take into account feedback from a soon to be

released questionnaire. The group is aiming to report back to the Committee of Wise Men by mid-July.

16. The ECB conducted a survey of cross-border collateral users and the results have now been published on the ECB website:

<http://www.ecb.int/pub/pdf/collateralsurvey.pdf>

The report showed that collateral provided on a cross-border basis has risen significantly over the last 18 months, to just over 20% of all collateral provided to the Eurosystem, with the majority delivered via the CCBM rather than via settlement system links. Users expected an even higher proportion of cross-border collateral would be triggered by the emergence of a large, liquid repo market, rather than by refining the channels used to deliver cross-border collateral.

BASEL ACCORD and CAPITAL ADEQUACY DIRECTIVE (CAD)

17. Ms Chesworth said that LIBA and others were concerned about the potential effect of the proposed new capital rules on the stock lending and repo market.

Specifically:

- It was not clear what the proposals meant, particularly for transactions in the trading book;
- If the proposals were taken as given, then they implied a significant increase in the capital charges for stock lending and repo. This would arise from: restrictions on the eligibility of collateral; the “haircuts” on the value of collateral; and the proposed floor on offset (the so-called “w” factor);
- There were further outstanding questions, regarding triparty for example.

18. Ms Chesworth said that LIBA, the BBA and ISDA were to have a series of meetings in order to formulate a response, the first being next week. She hoped the group would be able to have a reply ready by the end of April and she extended the invitation to join this group to other members of the committee.

19. Ms Emblow said that the proposals were designed for consultation with the market. As such they were not final and indeed the BASEL committee welcomed

constructive and specific comments. The consultative paper is available at <http://www.bis.org/publ/index.htm>

20. Mr Jones noted that the US might be minded to take a different view. Given the different current approach, there seemed a possibility that the US Associations might accept the BASEL proposals in principle and focus more on the detailed numbers involved. Ms Chesworth said that the group would be liaising with the US markets.

MODERNISING SECURITIES SETTLEMENT

21. Mrs Pitt briefed the committee on this. In February, HMT published a consultation document called “Modernising Securities Settlement.” This document includes a new set of the Uncertificated Securities Regulations (USRs). These replace the 1995 Regulations which set up the legal and regulatory structure for CREST. The main aim of the new regulations is to remove the gap between settlement through CREST and registration on the issuer’s register, which conveys legal title. Once passed through Parliament, transfers through CREST will now convey legal title to securities, both for equities and gilts.

22. Copies of the consultation document are available from 020-7270-4345 or on HMT’s website at <http://www.hm-treasury.gov.uk>. The consultation document follows an earlier one in 1999.

23. The document describes the rationale for a completely new set of USRs. Special arrangements apply to transfers from the uncertificated part of the register held by the Operator to the certificated part of the register held by the issuer’s registrars and vice versa. Transitional provisions mean that no action is necessary by issuers to comply with the new Regulations. No new approval of CREST by the FSA is required.

REPOCLEAR

24. Mr Burke said that volumes had again increased through Repoclear. The system had broken through the psychological barrier of €50bn per day in volume,

reaching a record of €53bn per day. The Austrian, Belgium, Dutch and German government bond systems remain operational.

25. Repoclear are enhancing their system to include three strands of non-government bonds from the second week of April. These will be supranationals, agencies and sovereign debt. They will be restricted to being euro denominated issues and of the highest liquidity.

26. In addition, Belgium and Dutch Treasury securities (types of bills issued through an auction mechanism) will be added in the next couple of weeks and will be subject to a market making process.

27. A forward start General Collateral product is being developed. This is currently at the design stage with consultation taking place with a group of corporate banks and expected to last 4-6 weeks. Assembly of the system is scheduled for the summer. The current proposal is for 3 day settlement and for there to be five baskets of securities included.

28. A triparty GC product has not yet been given the go-ahead; the panel of advisory banks felt this should remain on the back burner until a later date when the product was more widely used in the market.

ANY OTHER BUSINESS

29. The Chairman spoke about membership of the committee. He spoke of the need for keeping this under review and the need to keep as many market participants directly involved, while also allowing the committee to function efficiently. He asked members to consider whether there were gaps on the committee that needed to be filled and to send any ideas to him.

DATE OF NEXT MEETING

30. The next meeting will take place on Tuesday 10 April.