

STOCK LENDING AND REPO COMMITTEE

TUESDAY 12 MARCH 2002

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Present:	Neal Hatch	Chairman
	Dagmar Banton	LSE
	Krystyna Beck	LIBA
	Andy Clayton	ISLA
	Andrew Gavin	CRESTCo
	Hugh Gibson	APACS
	Jens Pöhland	The Bond Market Association
	Simon Hills	BBA
	Malcom Ewen	Intermediaries
	Nick Fisher	DMO
	John Serocold	LIBA
	David Sly	Inland Revenue
	Cameron Dunn	ERC
	John Burke	LCH
	John Whitmore	FSA
	Antony Beaves	Bank of England
	Alison Emblow	Bank of England
	David Rule	Bank of England
	David Sheppard	Bank of England
	Jon Carr	Bank of England
	Caroline Pitt	Bank of England
	Howard Jones	Bank of England
	Simon Ainsworth	Bank of England, Secretary

Mr Hatch announced that this would be his last SLRC meeting as Chairman as he was moving to become the Governor's Private secretary. He introduced Mr Rule who will replace him as the Head of the Gilt Edged and Money Markets Division and as Chairman of the SLRC.

MINUTES OF MEETING HELD ON 11 DECEMBER

The minutes of the previous meeting were agreed. Previous meetings' minutes are available at: <http://www.bankofengland.co.uk/markets/slr.htm>

The BBA guidelines on stock lending prepared for their website have now been agreed and are attached as an appendix to these minutes.

CONTINGENCY PLANNING

1. Ms Emblow informed the committee about a meeting the previous day (11 March) convened by the Bank/HMT/FSA standing committee. This was the second such meeting to include infrastructure providers, market participants and the City Corporation. The meeting discussed the response of City institutions to contingency issues in the light of terrorist atrocities of 11 September. One of the key themes was the importance of communication. In order to facilitate this, the authorities had established a private website to provide information on the role of the authorities in a crisis, guidance on best practice in contingency arrangements and briefing on the work of the various market committees. Ms Emblow said that this should be treated as a pilot scheme and that feedback on coverage was required.
2. Mr Hatch added that he had had 6 or 7 meetings with participants and will draw together the conclusions at the next meeting of the Money Market Liaison Group which will be held on 4 April and then revert to SLRC. In response to a comment Mr Hatch agreed that a main issue that had been highlighted was one of communication. He stressed that if others wished to be involved in these consultations that they could still contact the Bank.
3. Mr Hills reported that in his view the authorities had made progress and were promising to ensure the functioning of transport, utilities and communication in the event of terrorist act. Mr Hills added that the FSA planned a series of visits to large firms to discuss their business continuity plans
4. Mr Burke asked if any US participants had taken part in the meeting of 11 March. Ms Emblow confirmed that representatives from US firms and AFSA had attended but she was aware of the need for more international co-ordination. Mr Burke stressed the issue of adequate communication mediums, mentioning the problems it caused with real time matching and lack of intra-day novation in New York. Mr Pohland said

that The Bond Market Association had submitted a written submission to the Bank of England on the lessons of 11 September.

5. Ms Emblow reported that the Bank had liaised with the Federal Reserve about contingency planning and that HM Government's Civil Contingency Committee will be looking at telecommunication issues. Mr Gibson mentioned that it would be useful to disseminate contact names for each association to help prevent overlap. He expressed worries about excessive privacy in co-ordinating this planning.

ISSUES RELATING TO THE EURO

6. Mr Carr said that developments since December included the reaching of a Common Position on the Collateral Directive which was now close to adoption. Second, the City Euro Group, chaired by John Townend, had met on 25 January and minutes had been circulated to its members. The group's next meeting would be on 30 May. Third, the Bank planned to circulate its next Practical Issues report in late May, which would focus on the first wave countries' changeover to the euro including lessons from it. He would be in contact soon with firms in the euro money market so as to be able to report on structural developments in this market. The ERC's repo questionnaire and the recently introduced Eurepo reference rates for euro GC were clearly relevant in this context.

EU COLLATERAL DIRECTIVE

7. Mr Beaves briefed the committee on progress with the European Collateral Directive. Although Ecofin had adopted a Presidency text at the end of December 2001, the final text is still subject to the approval of the European Parliament in its second reading.

8. The Collateral Directive is part of the Financial Services Action Plan. The EU Commission proposal was made in February 2001, and remained the only formal proposal on the table until the Council adopted the Presidency text in December. The Council made few substantive changes to the Commission proposal, although a lot of the detail was stripped out to enhance its clarity. The Directive reduces formalities for

the creation and enforcement of collateral arrangements covering repo, pledges, charges and transfer of title. For example, it abolishes the requirements for formal notice periods, registration arrangements and court orders. In addition, the enforcement of collateral will be unaffected by the onset of insolvency proceedings, and legal recognition will be given to the right to make free use of pledge collateral. Less importantly for the UK, it gives legal recognition under member state law to repo agreements and the operation of close out netting in the event of insolvency. Top up and substitution agreements for collateral will no longer be subject to certain insolvency impediments (such as automatic “zero-hour rules”), although this protection is limited to market risk. The Directive also recognises the identification of location and governing law for indirectly held securities (ie held through financial intermediaries and clearing systems) under the so-called “PRIMA” approach.

9. The second reading of the Directive remains to take place in the European Parliament, and although no date has yet been fixed, it is still hoped that final adoption will be possible by July, with an 18-month implementation period to follow.

10. Mr Beaves added two caveats to the protections available under the Directive. First, the scope of the persons covered by the Directive. In its current form, the Directive will apply to dealings between financial institutions and all legal entities other than natural persons. However, there is an opt-out for those member states that wish the scope to remain more restrictive and only apply to dealings between financial institutions. Secondly, there is an opt-out on the protection of “appropriation” as a method of the enforcement of collateral, where this would be problematic under national law.

11. Mr Beaves explained that the Hague Convention/Conference has also been seeking to clarify what is the meaning of the ‘location’ of indirectly-held securities. It has proceeded on the basis that an interest in indirectly-held securities should be located where the parties have agreed that the account which represents the entitlement to those securities is maintained. Agreement on the final wording of the Hague text had not yet been reached, although this might be concluded by the

Summer. It would then be up to national authorities to decide whether and how to adopt the Hague text.

SLRC NETTING SUB-GROUP

12. Mr Ainsworth briefed the committee on the most recent meeting of the netting sub-group. The GMSLA opinions for all jurisdictions bar Italy are now complete. The committee is still examining the implications for next year's timetable in the light of the EU's new rules on insolvency. The committee also discussed what the FSA's definition of continuous assessment entails, although it is awaiting the result of discussions between the US Bond Market Association, ISLA and the FSA.

13. In future the Netting Sub-Group intends to meet on a six weekly basis with its meetings scheduled so that they do not coincide with SLRC meeting days.

UPDATE FROM REPOCLEAR

14. Mr Burke updated the committee on recent and future developments. Repoclear has gone live with the General Clearing Member/NCM 3rd party clearing services, but noted that volumes will be limited because of balance sheet requirements. The Forward Start GC baskets will go live on 26 March, with principal interest likely to be in the German government bond under 10-year basket. LCH is also going live with a Euro12 GC basket under 10-year. The basket will initially comprise 4 of the Euro zone markets but others will be added in due course. Gilts will be added to RepoClear on 24 June. This is expected to be popular with the majority of current RepoClear participants likely to use the service. Currently RepoClear's turnover is around £100 billion per day or £2 trillion a month, but the addition of Gilts is likely to cause a further step change in volumes traded. Mr Burke said that additional 7 or 8 banks are currently in the process of implementing RepoClear.

UPDATE FROM ERC

15. Mr Dunn reported back to the committee on the general meeting of the ERC held in Madrid. An Asian repo council is to be created, as is an equity sub-committee that will be chaired by Barbara Ferry. The ERC best practice guide for repo margining has been published on the ERC website.

16. Mr Dunn then went on to talk about the launch of the 'Eurepo' reference rate. 38 Banks are involved in submitting electronic mid points to two decimal places. The top and bottom 15% quotes are excluded and the remainder averaged. The rate is felt to have a large potential for derivative transactions reducing the basis risk between repo and cash. This new fixing is thought to provide more representative benchmark from which interest rate swaps may be priced off, which in turn should help deepen term liquidity. The reference rate is based on repos that involve government bonds and bills issued by all Eurozone states.

17. The 2nd ERC semi-annual repo survey has been published. With 55 participants it has now reached critical mass. It implies that Euro area repo has grown 13% during the period. The ATS share has nearly doubled from 8% and 15% and significant growth should continue. Electronic trading is heavily used in Italy at the expense of agency brokers, with the proportion of contracts denominated in euros increased at the expense of dollars and yen. The top ten banks accounted for 60% of the market with the top 20 accounting for 82%. Business outside the eurozone rose from 17.5 to 26% of the total, most of this in London.

18. The next meeting of the ERC will take place in Vienna during May. There will be a joint session with the North American Repo Council.

UPDATE FROM THE BOND MARKET ASSOCIATION

19. Mr Pöhland reported that TBMA and ISMA were currently in the process of updating their joint legal opinions to the GMRA for 2002, which should be completed by the end of March. These opinions would be available on TBMA's and ISMA's respective websites.

20. In similar vein, TBMA and ISMA, together with the TBMA/ISMA Joint Opinion Committee, have reviewed their opinion updating procedures in light of the upcoming FSA requirement for a continuous review process, and will shortly submit a joint letter to the FSA to that effect.

21. Furthermore, Mr. Pöhland informed the Committee that TBMA and ISMA are currently in the process of drafting and finalising the Swiss, Canadian and Japanese annexes to the GMRA. The associations are also planning to hold a joint Benelux GMRA workshop shortly, following on from the success of the previous workshops held in London, Frankfurt, Paris and Milan.

SVWG

22. Mrs Pitt reported that the Shareholder Voting Working Group has reconvened and raised again the question of voting on lent stock. There seems to be little reason to change the previous opinion expressed by the SLRC to the SVWG that it is not a significant problem where shareholders who lend out stock lose the right to vote. The technical and legal difficulties involved in giving the lender the right to vote were felt to outweigh any potential benefits.

NEXT MEETING

23. The Chairman said that the next scheduled meeting would be on 11 June, but that scope exists for an interim meeting if required.