

SECURITIES LENDING AND REPO COMMITTEE

Wednesday 8 March 2006

Bank of England

MINUTES

Attendees

David Rule	Bank of England, Chairman
Neil Atkinson	CRESTCo
Mark Austen	TBMA
Dagmar Banton	London Stock Exchange
John Burke	LCH.Clearnet
Cameron Dunn	European Repo Council/Merrill Lynch
Nick Fisher	Debt Management Office
Ian Fox	London Money Markets Association/ HBOS
Hugh Gibson	International Securities Lending Association (ISLA)
Tony Hibbit	Cater Allen
Christian Krohn	Financial Services Authority
Anthony Littleton	APACS
Joyce Martindale	National Association of Pension Funds/Railpen
Margot Marshall	Financial Services Authority
David Roberts	ACI/RBS
Barbara Pung	International Securities Market Association
John Serocold	London Investment Banking Association
Richard Steele	ISLA/JP Morgan
Also present:	
John Richmond-Scott	Bank of England, Secretary
John Rippon	Bank of England
Mike Heather	Bank of England

1 Introduction

The chairman welcomed Mark Austen (TBMA) to his first meeting.

2 Minutes of the previous meeting on 30 November 2005.

The minutes of the previous meeting were agreed. Minutes of previous SLRC meetings are available at www.bankofengland.co.uk/markets/slrc.htm

3 LCH.Clearnet presentation on Gilts DBV service.

John Burke (LCH.Clearnet) presented LCH's new Gilts DBV service that was scheduled to be introduced later this year. The slides of the presentation have been circulated with these minutes.

The Committee discussed the new service. LCH.Clearnet expected a large settlement netting effect (approximately 70% of value netted) for participants that trade both sides of the market and Mr Burke also commented there could be a change in trading patterns ; most likely an increase in trading velocity and smaller trade size. The lack of margin offset (to be introduced in phase two) would be addressed at a later date; priority would be given to the getting the product to market.

LCH.Clearnet had proposed a shape size of £100mn, although Mr Burke emphasised that this should be decided by the market and the value could be smaller or larger or there could be no compulsion. The view was expressed that a compulsory shape size was not desirable, especially as fails were rare in Gilt DBV.

Regarding trialling of the new product, Anthony Littleton (APACS) mentioned the liquidity management trialling exercise CREST were undertaking in the summer in connection with the launch of the SSE. CREST settlement banks could consider incorporating testing the LCH.Clearnet Gilt DBV product into this trialling. David Rule also mentioned the Bank's money market reforms and asked whether firms would want trialling of the LCH.Clearnet product to coincide with the launch of reserve averaging. LCH.Clearnet would follow up any concerns regarding the co-ordination of the Gilt DBV go-live with other projects and resource demands on the market, including front and back offices.

4 Euroclear Consultation Paper – Securities financing and settlement windows on the Single Platform.

Neil Atkinson introduced the Consultation Paper (CP) which addresses harmonising the Euroclear CSDs by 2009.

The vision of the Euroclear Business Model was that the group Central Securities Depository (CSD) services would be migrated to a Single Platform and the harmonisation of CSD processes was an integral part of the consolidation process. Comments on the CP had been

requested by 3 March, but Euroclear was still keen to get further views from the market given the potential magnitude of change. Bilateral meetings had been set-up to get further opinions from the trade associations.

There were two overriding objectives:

- 1) Compliance with ISO standards and market practices
- 2) Upward harmonisation, i.e utilising the best solution in the group for the single platform

The two objectives had been in conflict with each other, as ISO market practice in the bilateral financing instructions area differed from that used in the CSDs currently. Typically this related to return legs, where market practice for stock lending was that members input return legs themselves, whereas CREST and Euroclear France generated them automatically. The CSDs were therefore not currently compliant with international practice.

Committee members emphasised that it was important the Single Platform should not move to the lowest common denominator of the existing platforms and should include the functionality offered by CREST. Regarding DBV, it was agreed that either DBV or something analogous (e.g. possibly triparty repo) would be required in the new platform to enable securities to be financed in a straightforward way. Some also thought it was important to end DVP settlement before DBV settlement began in order to give participants certainty about their securities positions. The Committee was keen that debate continues until a “harmonised upward solution” could be found.

It was agreed that Euroclear (Rob Fair) would give a fuller presentation in April to SLRC and probably MMLG members.

5 Forthcoming review of GMSLA

Richard Steele (ISLA) informed the group that ISLA had started a review of the GMSLA. One proposal was an updating of GMSLA; a more radical option was to amalgamate GMSLA into the GMRA. The review was a long-term process and was still at a very early stage.

6 Transparency Directive

Christian Krohn (FSA) reported on the most recent round-table held at the FSA on Monday 6th March and gave the latest status regarding the implementation of the Transparency Directive. Provisions in the Companies Act could be interpreted to treat right of recall in a securities lending transaction as an acquisition which could therefore be netted against the disposal. This would mean that the lender's level of holding of shares would not change by reason of it entering into a stock-lending agreement, and hence there was no notification triggered by disposal of the stock under the agreement. To address the scenario where borrowers appear to have borrowed stock to exercise the attached voting rights, an alternative implementation solution would be to make the lender's ability to treat its right of recall as an acquisition, conditional on its undertaking (vis-a-vis its client) to exercise that right of recall in every instance where there was a vote. Borrowers however would have to notify under the directive (if a threshold was crossed).

John Serocold (LIBA) raised the issue of double counting – i.e. with lenders exempt but borrowers reporting, it could easily be envisaged that two different “owners” of the same share could report it.

Hugh Gibson (ISLA) said the netting approach would be welcome news to lenders but questioned the value of the reporting given the double counting issue and the fact that notification might not deter borrowing to vote as there was a four day timeframe before notification was required. The directive would also not lead to harmonisation of thresholds across Europe.

Mr Krohn acknowledged the outstanding issues and underlined the fact that the FSA had attempted to reduce the impact of disclosure requirements whilst fulfilling the requirements of the Directive. The FSA would issue a Consultation Paper (including clarification of the current interpretation) on 30 March with a three month consultation period. No further consultation was expected unless the level two text was altered by the Commission.

7 **Markets in financial instruments directive (MiFID)**

Margot Marshall (FSA) updated the Committee on the status of MiFID from the FSA's standpoint. There has been no great change since the last SLRC meeting. On 6 February the European Commission's Level 2 recommendations had been published. After consideration by the European Parliament, the European Securities Commission would vote to adopt Level 2 measures on 8/9 June.

The FSA MiFID Consultation Process would be in two parts with a main MiFID consultation paper and a follow-up consultation paper. The FSA had scheduled to finalise the consultation process by the end of 2006 at the latest.

Regarding details of the directive, the FSA had stated that they have no discretion to disapply best execution to securities lending that involves execution of orders by firms on behalf of their clients. In the case of securities lending transactions with no previous comparable transactions, best execution would be linked to the nature of the transaction and a sensible application of the requirement. As regards MiFID requirements for transaction reporting, some form of identification would be required for Counterparty 2 reporting, as appears in transaction reports sent to the FSA.

8 **UK insurance regulation**

Margot Marshall (FSA) informed the group that the FSA had not received requests from insurance companies for similar waivers for Securities Lending via Clearstream as for Euroclear.

9 **GMRA: updated legal opinions**

Barbara Pung (ICMA) updated the SLRC on the GMRA related issues. ICMA was currently updating the legal opinions on the GMRA in 52 jurisdictions, 24 of these jointly with TBMA. As in previous years, ICMA intended to publish the updated opinions by the end of March 2006. Annex 1 contains list of the new opinions.

10 **SLRC Netting sub-group: SLRC Netting legal opinions**

John Serocold updated the Committee on legal opinions on securities lending agreements. All opinions were in place, although the updated opinion for Kuwait had not yet been released to members. All relevant opinions had been made available to members via the SLRC clientnet. Information on specific opinions and potential new jurisdiction is in Annex 2.

11 **2006 Work Programme**

A draft Work Programme for 2006 had been issued to the SLRC. Two targets for 2006 would be a review of the Gilt Repo Code of Best Practice and Equity Repo Code of Best Practice, and further progress on the harmonisation of the legal-opinions gathering exercises for GMRA and the securities lending agreements. Any further comments on the 2006 Work Programme were welcome.

12 **Any other business**

Dagmar Banton (LSE) informed the group of a LSE notification providing guidance on short selling published on 7 February. This has been circulated with these minutes.

Appendix 1- ICMA's update on GMRA legal opinions

1.1 New opinions published for Guernsey, Jersey and the People's Republic of China

On December 20, 2005 ICMA notified its membership by circular that new opinions, jointly obtained with TBMA for Guernsey, Jersey and the People's Republic of China were available to members on ICMA's website.

1.2 New opinions being sought for the Czech Republic, Slovakia and Slovenia

Following confirmation from local counsel that a clean opinion for Czech Republic, Slovakia and Slovenia could indeed be provided, ICMA had now authorised the instruction of local counsel to produce a new opinion for these jurisdictions.

TBMA had not yet confirmed whether it would join ICMA in obtaining these new opinions and share the costs with ICMA on an equal basis.

1.3 New opinions considered for Croatia, Malaysia, and Romania

In relation to Croatia, Malaysia and Romania ICMA was continuing to monitor legal developments with a view to ascertaining at what stage a clean opinion could reasonably be expected for each of these jurisdictions.

Appendix 2 –SLRC Netting Opinions

2.1 Updated opinions

Bahamas, Bahrain, Caymans, Finland and Singapore original counterparty opinions were being negotiated by Freshfields. Japan and Finland additional counterparty opinions were being negotiated by Freshfields. Portugal, Barbados, Ireland, Bermuda and Japan original counterparty opinions had just begun their update processes.

2.2 Potential new jurisdictions.

A Combined OSLA/GESLA/GMSLA opinion for the Czech Republic was now being obtained. Additionally, a subscriber had approached Freshfields to obtain a stocklending opinion from Czech counsel, the scope of which was broader than the SLRC's regulatory netting opinion and closer to that of the stocklending opinions exercise that had been being explored by ISLA.

Poland - early indications were that problems remain for Stocklending. Counsel had indicated that a clean opinion was not, at present, possible; but Freshfields would continue to monitor the position.

2.3 Jurisdictions with current GMRA opinions, on which Freshfields had received enquiries from in house counsel regarding new opinions:

Estonia; Latvia; Lithuania; Malta; Cyprus; South Korea (for which jurisdiction the SLRC had formerly had a stocklending opinion); Norway.

2.4 Jurisdictions without current GMRA opinions, on which Freshfields had received enquiries from in-house counsel regarding the possibility of obtaining new opinions:

Malaysia (for which jurisdiction the SLRC formerly had a stocklending opinion); Israel; India; Russia; Dubai (for which jurisdiction the SLRC had formerly a stocklending opinion); Iceland; Ukraine; Romania.

2.5 The following jurisdictions now had GMRA opinions only, but there had been no specific enquiries from any SLRC members for stocklending opinion coverage:

Mexico; Thailand (for which jurisdiction the SLRC had formerly had a stocklending opinion); Greece (for which jurisdiction the SLRC had formerly had a stocklending opinion).

2.6 ISDA had obtained netting opinions for the following jurisdictions, where there was no current stocklending opinion:

Czech Republic; Iceland; India; Mexico; Malaysia; Norway; Poland; Thailand.