

SECURITIES LENDING AND REPO COMMITTEE

Wednesday 7 March 2007

Bank of England

MINUTES

Attendees

Michael Cross	Bank of England, Chairman
Anthony Littleton	APACS
David Hopton	Abbey
John Hale	ABI
Nick Baker	Bank of England, Secretary
Alex Merriman	BBA
Paul Miles	CRESTCo
Matthew Cherrill	Financial Services Authority
Natasha Powell	Financial Services Authority
James Woodley	Financial Services Authority
Joanna Perkins	FMLC Secretary
Ed Murray	Allen and Overy
Steve Russell	HSBC
Christian Hellmund	ICMA
Christian Krohn	ICMA
Laurence Marshall	ISLA/UBS
Nigel Bradley	LCH.Clearnet
John Serocold	London Investment Banking Association
Ian Fox	London Money Markets Association/ HBOS
Dagmar Banton	London Stock Exchange
Joyce Martindale	National Association of Pension Funds/Railpen
Volinka Reina	SIFMA
Nick Fisher	UK Debt Management Office

Also Present:

Anthony Beaves	Bank of England
Ben Norman	Bank of England
John Rippon	Bank of England

1 **Introduction**

Mr Cross introduced himself as the new Chairman of the SLRC, replacing David Rule who has left the Bank to join ISLA. Mr Cross also welcomed the new secretary, Nick Baker, a new representative from CREST, Paul Miles, replacing Warren Alsop, Natasha Powell and Matthew Cherrill of the FSA supporting James Woodley. Joanna Perkins, FMLC secretary, and Ed Murray, Allen & Overy, were welcomed as special guests for agenda item 4.

2 **Minutes of the previous meeting on 6 December 2006.**

The minutes of the previous meeting were agreed.

3 **Matters Arising**

No items were picked up for attention.

4 **UNCITRAL draft legislative guide on secured lending**

Ed Murray (Allen & Overy) and Joanna Perkins (FMLC) presented to the group. Mr Murray and Ms Perkins explained to the committee that the UNCITRAL guide on secured lending posed a threat to repo and secured lending markets, with their key feature of title transfer. This was because the guide suggested that in so far as they involve directly held securities such transactions should be treated on the same basis as secured lending (eg fixed charges), which would mean that repo and securities lending could be re-characterised as secured loans, thus undermining all the advantages of title transfer and with market participants being disadvantaged in the event of counterparty insolvency.

The Committee acknowledged the concern that some states may be sympathetic to the guide and may press for its adoption in Europe, despite the fact that current Community policy, as expressed in the Financial Collateral Arrangements Directive, was to provide appropriate legal underpinning for title transfer. The Secretariat was asked to prepare a letter from the SLRC Chairman on behalf of the SLRC to HMG and the EU Commission to press for the case for opposing the adoption of the guide in Europe and to flag wider concerns about the

implications of the guide for other repo and securities lending markets. The Committee agreed to endorse the letter by written procedure.

5 CREST Single Settlement Engine (SSE)

Paul Miles (CRESTCo) updated the group on developments since the last SLRC meeting. Mr Miles said that the main focus of CREST/Euroclear had been on the stability of the system. Although there had been some interruptions to the service, notably an outage in mid-January leading to a late close of sterling payments, fixes were now being scheduled for release to eradicate any potential production issues. Mr Miles said that CREST/Euroclear was now moving into a period of scheduling domestic releases for 2007 that will not impact the day to day service, and this work will run parallel to any Group scheduling of releases.

Mr Serocold reported that the LIBA Settlement Committee were watching developments closely. Mr Serocold said that his impression was that day-to-day business was generally being managed efficiently, but firms felt that it would be helpful for information from CREST/Euroclear relating to degradations in service quality or interruptions to be given in plain English designed to ensure that it is clear to the market what the problem is and when it is expected that it will be fixed. Mr Serocold said that firms felt that the UK market had suffered disproportionately in the migration to the SSE, as the UK market was supported by functionality not deployed elsewhere. Mr Serocold said that firms had sought and been given reassurance that the UK market's concerns were given due weight.

6 LCH.Clearnet Gilts DBV service

Nigel Bradley (LCH.Clearnet) updated the group on developments since the last meeting. Mr Bradley said that the service was now branded 'Sterling GC' as the service supports more than clearing of standard DBV trades, e.g. clearing of term DBV is also supported. Mr Bradley said the Sterling GC service was part of a family of products, with work underway within LCH.Clearnet to develop a broadly equivalent Euro GC product. Mr Bradley said the go-live for Sterling GC is 14 March 2007, provided members progress through testing without any issues. Mr Bradley said that on go-live there will be 17 members, with an additional 7 or 8 members joining further down the line. (Post meeting note: Sterling GC was successfully launched on 14 March.)

7 **Markets in Financial Instruments Directive (MiFID)**

James Woodley (FSA) updated the Committee on MiFID developments. Mr Woodley said that since the last meeting HM Treasury and the FSA had transposed MiFID into UK legislation.

Mr Woodley said CESR had published two consultation papers. The first paper covers best execution, for which CESR is proposing to issue a number of recommendations setting out for its members a common approach to the best execution regime. CESR has asked the European Commission for clarification on some issues, with comments on the consultation invited by 16 March 2007.

The second paper covers transaction reporting. Article 25 of MiFID establishes a transaction reporting regime where investment firms must submit reports of executed transactions to their authorities regarding financial instruments admitted to trading on regulated markets.

Comments on these proposals were invited by 2 March 2007, although it is left to CESR to make final recommendations and it is likely that securities lending and repo will fall out. David Nowell at the FSA should be contacted for further information.

Mr Woodley said a CESR consultation paper covering non-equity transparency would be published in April following a request from the European Commission for advice on Article 65 of MiFID. CESR will report back to the Commission by June 2007. In a response to a question from Mr Serocold, Mr Woodley said that it would need to be checked whether securities lending and repo will be within the scope of the non-equity consultation paper. Laurence Marshall (ISLA/UBS) noted that the current timescale was particularly tight. Mr Woodley said that if representatives had any questions regarding best execution, Jeremy Clivaz at the FSA should be contacted.

8 **Transparency Directive**

Natasha Powell (FSA) updated the Committee on Transparency Directive developments. Ms Powell reported that the legislation implementing the Transparency Directive came into force on 20 January 2007 in the UK. The UK was one of only four countries to meet the

implementation deadline, and the only country to fully implement both Level 1 and Level 2 of the Directive. Ms Powell said implementation had been smooth, although more clarification had been sought initially by market participants on major shareholdings notifications. Ms Powell said that for securities lending and repos, a decision had been taken to offset loans against borrowings, although feedback had indicated that for loans within one day this was not practical and it was being discussed what could be done.

Ms Powell said that the treatment of securities lending as constructed by the FSA does not currently apply to repos, but now if market participants wished to include repos in the exemption then they should inform the FSA.

Ms Powell reported that the FSA were awaiting feedback from the Commission on storage of regulated information, and the FSA were hoping that there would be movement on this topic within the year.

9 **Contracts for differences (CFDs) and securities lending and repo**

Ms Powell reported to the group on this new item for the SLRC. Ms Powell said that the FSA has the power to extend the Major Shareholding Notification regime to cover economic interests such as CFD captured under derivatives, which could include securities lending and repo. There are mixed feelings in the market about extending legislation in this area: institutional investors and issuers are keen to see this change, as they feel it would add clarity and enhance transparency in a particularly murky area of the trading activity, but investment banks and hedge funds were against any expansion of the disclosure regime.

Ms Powell reported that the FSA was in the process of looking at the treatment of CFDs, with a discussion paper, or perhaps consultation paper, to be published in July 2007. The draft discussion paper focuses on empirical evidence for three market failures: CFDs affecting efficient price discovery; CFDs causing or permitting manipulation of voting rights; and CFDs causing a general lack of confidence in the market. Ms Powell said that this is the first time there has been work in this area, and cost benefit analysis is currently being performed by the FSA on this exercise.

Mr Marshall (ISLA/UBS) said that this was an area in which members are very interested and, although Ms Powell said that the FSA were not proposing to include securities lending as yet, it is likely to feature in the discussion at some point.

10 New Collective Investment Schemes sourcebook

Matthew Cherrill (FSA) updated the committee on the New Collective Investment Schemes sourcebook. Mr Cherrill reported that responses had indicated widespread acceptance of extending the list of permitted counterparties with which securities lending may be undertaken, permitting the use of Euroclear Bank's Securities Lending and Borrowing Programme and extending the list of acceptable types of collateral to include commercial paper and liquidity funds subject to certain limitations as outlined in October 2006. Mr Cherrill said that resulting rule changes had been made on 1 March 2007.

Mr Cherrill reported that there had been some resistance on the new rule proposed for treatment of income generated from securities lending and the reinvestment of cash collateral, and the detail of that proposal had been challenged. Feedback relating to these proposals would be published during Q2.

Mr Cherrill concluded by reporting that there would be consultation related to Permitted Links rules published during March 2007 and that this would include a proposal to refer to the New Collective Investment Schemes sourcebook in relation to securities lending.

11 Updating the Gilt Repo Code

The Chairman reported that a Working Group for updating the Gilt Repo Code would be formed and he would write shortly to the prospective group members. John Rippon (Bank of England) would circulate an agenda for the sub-group for a meeting. The Chairman said that the code should reflect the views of the SLRC and the MMLG and seek to address any concerns of the market. Mr Rippon said that the Code would not be regulatory (this was for the FSA), but it should seek to reflect the market consensus on good practice. The committee acknowledged that there were several options including updating the whole code or having a code that fills gaps acknowledged in the ERC repo guidance.

12 **Status of harmonisation of the legal opinion gathering exercise**

Mr Serocold updated the group on the status of the legal opinion gathering exercise. Mr Serocold reported that in December a skeleton opinion had been prepared for the Netting sub-group to show how in practice the burden could be taken off investment banks' lawyers. The skeleton opinion had been sent to ICMA and SIFMA on 6 March 2007.

Christian Hellmund (ICMA) reported that ICMA's work on harmonisation was proceeding and progress is being made.

Volinka Reina (SIFMA) noted that the Members of the Joint Opinion Committee (JOC) should have an opportunity to review the draft harmonised opinion (combining the repo and securities lending segments), once the current update exercise is completed. It is important that JOC members be comfortable with any new opinion since the member banks would be the users of any such opinion.

Mr Hopton noted that some major types of counterparty were not covered by the current reviews, and it had been left to individual firms to obtain opinions. Mr Hopton said he would provide a list of those types of counterparty currently omitted.

13 **SLRC Netting sub-group: update on legal opinions**

Mr Serocold updated the group on the SLRC Netting sub-group's progress on the update on legal opinions. Mr Serocold noted that on country coverage, feedback had been obtained in relation to Norway from the netting sub-group, and that he had liaised with ISDA in relation to the current position in Russia.

14 **GMRA: updated legal opinions**

Mr Hellmund reported that ICMA is about to finalise the annual GMRA legal opinions update exercise for 2007. Consistent with the timetable in previous years, ICMA intends to publish the updated opinions on its website at the end of March/beginning of April 2007.

Commencing this year, ICMA will, in addition to the clean versions of the updated opinions, publish blacklined versions of the updated opinions that track the amendments to the opinions (initial or updated) published in the immediately preceding year.

Revised drafts of new opinions for Slovakia, Slovenia and Croatia are currently being reviewed by ICMA. The opinions for these jurisdictions are expected to be published on ICMA's website as part of the 2007 GMRA legal opinions update exercise at the end of March / beginning of April 2007. With respect to Israel an initial draft opinion has been provided by local counsel which is currently being reviewed by ICMA.

ICMA is still in the process of establishing with local counsel whether clean opinions can be obtained for Dubai, Oman and Qatar. Subject to respective confirmations from local counsel and acceptable costs, ICMA will commission legal opinions on the GMRA for these jurisdictions.

At its last meeting the ERC committee concluded that there is sufficient market interest to obtain legal opinions for India and the remaining UAE jurisdictions (other than Abu Dhabi for which an opinion already exists and Dubai for which ICMA is currently establishing whether a clean legal opinion can be obtained). ICMA will establish whether clean legal opinion can indeed be obtained for the respective jurisdictions. Subject to respective confirmations from local counsel and acceptable costs, ICMA will commission legal opinions on the GMRA for these jurisdictions.

The ERC committee members are currently establishing whether there is sufficient market interest in a legal opinion for Anguilla.

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

With respect to Russia in particular ICMA understands from local counsel that concerns remain regarding the risk of recharacterisation of repos as secured loans.

In addition, there is a significant risk that arrangements for netting under a master agreement will not be upheld upon insolvency of a Russian counterparty as an attempt to circumvent the general prohibition of insolvency set-off under Russian bankruptcy laws. Russian bankruptcy laws are likely to apply and will override the governing law of the GMRA in bankruptcy proceedings. At this stage it is therefore not possible to obtain a clean legal opinion for Russia.

15 SLRC work programme for 2007/08

The Chairman presented the proposed SLRC work programme for 2007/08 and sought views from the committee. Mr Rippon noted that the equity repo code, which had briefly been discussed last year, was not on the list, and it was agreed that there should be a discussion on whether it should be withdrawn. Mr Serocold noted that FSA and CESR work programmes needed to be monitored to help members to spot in good time initiatives which might be damaging to the repo and securities lending markets. The Chairman requested that other comments be taken bilaterally.

Mr Rippon said the work programme would be put on the SLRC website, and the content of the programme should be finalised by end March.

16 Any other business

Mr Serocold asked members to note that the next tri-party 'milestone' meeting at the ECB on TARGET2 Securities was taking place on 12 March 2007. Mr Serocold recommended that the SLRC should seek to ensure that lending and repo markets were not unduly adversely affected by the proposed changes to the settlement arrangements underpinning the Euro markets in general, including wholesale markets.

Dagmar Banton (LSE) said that the LSE had published their Consultation Notice for the Rule Book review for changes required for MiFID. Of interest to SLRC would be the removal of the requirement to transaction report. Additionally HMRC had now published draft amendments to the stamp duty legislation for intermediary and securities lending relief. Ms Banton noted that HMRC required comments by 16 March 2007.