

SECURITIES LENDING AND REPO COMMITTEE

Tuesday 11 March 2008

Bank of England

MINUTES

Attendees

Michael Cross	Bank of England, Chairman
John Hale	ABI
Anthony Littleton	APACS
Nick Baker	Bank of England, Secretary
Cassandra Kenny	BBA
Rahim Nanji	Deutsche
James Woodley	Financial Services Authority
Ian Fox	HBOS
Christian Hellmund	ICMA
Laurence Marshall	ISLA
Hugh Gibson	ISLA
Richard Steele	JP Morgan
Nigel Bradley	LCH.Clearnet
John Serocold	London Investment Banking Association
Dagmar Banton	London Stock Exchange
Joyce Martindale	NAPF/RPMI
David Hopton	Santander
Reuben Levermore	SIFMA
Chris Ryan	UK Debt Management Office

Also Present:

Sumita Ghosh	Bank of England
Toby Wallis	Financial Services Authority
Lisa Cleary	Freshfields
Michael Raffan	Freshfields

1 **Introductions**

Mr Cross welcomed a new member to the Committee, Cassandra Kenny (BBA), who was replacing Alex Merriman.

2 **Minutes of the previous meeting on 5 December 2007**

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 **Report on progress of harmonisation of legal opinions for repo and securities lending agreements**

John Serocold (LIBA) updated the Committee on the harmonisation of legal opinions for repo and securities lending agreements. A structure was now in place, and work was underway to establish the 2009 opinion set, which, at this very early stage, could be broader geographically and also deeper by geographical region. The work being done on the harmonisation exercise had been very broadly accepted in the market.

Christian Hellmund (ICMA) added that following the agreement between ICMA, ISLA, SIFMA and the SLRC subscribers on the combination of the opinion seeking/updating exercise on the GMRA as well as the securities lending agreements in autumn 2007, ICMA finalised fee negotiations with counsel in January 2008 and subsequently instructed counsel to prepare combined and update opinions. Freshfields currently reviews the initial draft opinions. In addition, ICMA provided in-house lawyers of members with the initial draft of combined opinions of those jurisdictions for which the GMRA opinion was formerly reviewed by the ICMA/SIFMA Joint Opinion Committee. The in-house lawyers were requested to review the combined opinions and provide their comments by March 14, 2008. The associations expect to be able to publish a total of 63 update opinions (out of the total of 63 opinions, 56 will be combined opinions) by March 31, 2008.

ICMA and SIFMA had bilaterally discussed the issue of SIFMA's contribution to ICMA's past investment costs incurred by ICMA for obtaining ICMA only opinions in the past. Following a letter from SIFMA to ICMA on February 20, 2008, ICMA and SIFMA resolved the issue and agreed to continue with the current approach of distinguishing between ICMA/SIFMA joint opinions and ICMA only jurisdictions.

5 Country report on legal opinions

Mr Hellmund provided the Committee with a country report on legal opinions. ICMA had notified the entire membership on February 8, 2008 and March 4, 2008 about the publication on its website of new legal opinions for Iceland, India, Anguilla and Dubai, respectively. The opinions for Anguilla, Iceland and India are opinions which had been jointly obtained with SIFMA. The opinions for Iceland and Dubai are combined opinions (i.e. covering the GMRA as well as the securities lending agreements).

New opinions for the United Arab Emirates (other than Abu Dhabi and Dubai for which opinions already exist) are expected to be finalised shortly. ICMA recently commissioned a combined opinion for Oman.

Since a clean opinion can be obtained for Qatar, ICMA will, subject to reasonable costs, in conjunction with the SLRC subscribers, commission a combined opinion for this jurisdiction. SIFMA has not yet confirmed that they will join ICMA in seeking the GMRA part of the combined opinion.

ICMA is establishing whether a clean legal opinion can be obtained for Bulgaria. ICMA continues to monitor legal developments in Malaysia, Romania and Russia with a view to ascertaining at what stage a clean opinion can reasonably be expected for each of these jurisdictions.

6 Review of the GMSLA

Hugh Gibson (ISLA) reported that the review of the GMSLA was progressing well and a working group to update the GMSLA was now meeting fortnightly. The tax group had now

produced a new tax addendum, which is in its final draft. The new version of the GMSLA could be completed by end April and made available for the 3 June SLRC for final agreement.

7 Progress report of the revision of the Gilt Repo Code

Mr Cross provided the Committee with a report on the revision of the Gilt Repo Code. The Working Group had completed their work on the revised Code and a draft had been circulated to all members of the SLRC and MMLG for comment. The Working Group had concluded that the original Code was essentially right in its scope and layout, and therefore it has not sought to re-cast the Code radically but merely to update it, to take account of developments in the gilt repo market, in the roles of electronic broking and central counterparties, and in regulation. The group also took the opportunity to remove material which is now out of date or only of historical interest. The Glossary has been pruned and revised and the annexes on Conventions in the Gilt Repo Market and on example gilt repo calculations have been updated. The annex on CREST settlement times has been removed, as the information is easily available from Euroclear sources. The aim would be to keep the Code under regular review and to update it as and when necessary.

The aim was to get the agreement of SLRC and MMLG to the revised Code so that it could be posted on the website by early April. Mr Cross asked members for further comment at the meeting or shortly thereafter to the SLRC secretary. If members had ideas for covering other matters in the Code, then this need not necessarily delay approval of the current version - the Code is meant to be a 'living document' and could be amended later in the year. Mr Cross thanked Working Group members for their work.

8 Updating the Securities Borrowing and Lending Code, including on best execution and regulatory developments

Mr Gibson reported that ISLA had proposed new paragraphs on best execution and agency lending for the Code, on which they have received comments from the FSA. Mr Gibson reminded members that it was up to practitioners to decide whether they are subject to best execution. Mr Gibson noted that it had not yet been decided whether a question and answer section with input from the European Commission would be included in the Code. James Woodley (FSA) recommended that members of the Committee chase the EC directly for a

response on the Q&A section. The proposed new paragraphs did not contain much new information, they simply tightened up the documentation and made more precise what best execution achieved. Mr Gibson recommended that the paragraphs be added to the Code as soon as possible, since they had been accepted in the marketplace and ISLA members were keen for them to be included.

Regarding shareholder voting, Mr Gibson noted that an update would wait until the European Commission had completed its assessment. The text on voting in the Code may need to be tightened, and Mr Gibson had agreed to run through the paragraphs on voting with John Rippon (Bank of England).

Mr Gibson recommended that, like the Gilt Repo Code, the Securities Borrowing and Lending Code become a living document. SLRC members were invited to comment on the Code by 25 March.

9 FSA recognition of SLRC Codes

Mr Gibson informed the Committee that the FSA had a new policy whereby market codes can be given more recognition. Mr Gibson recommended that the SLRC seek recognition from the FSA on the Securities Borrowing and Lending Code. ISLA were happy to drive the work required for FSA confirmation.

Mr Woodley gave the Committee a brief overview of FSA confirmation before asking Toby Wallis (FSA) to provide an overview of the confirmation process. In September 2007 the FSA published a policy statement (PS07/16:

http://www.fsa.gov.uk/pages/Library/Policy/Policy/2007/07_16.shtml) recognising greater emphasis on high level and outcome focussed rules. Firms had expressed a desire for some sort of approval from the FSA on market codes, and so a process was established. The process is not hugely onerous, but can take a number of weeks, and so it was recommended that the FSA were engaged as early as possible. Overall timing, however, depends on how much input is sought from the FSA, and at what stage the document is at when presented to the FSA. Mr Wallis noted that it was important that it was made clear what part of the handbook guide the submission would be biting on, as the FSA did not want an extension of FSA rules. The FSA did not recommend a particular format, but those drafting market codes should retain focus on

who their target audience is, and what value the code would add. The FSA website (www.fsa.gov.uk/Pages/About/What/industry_guidance/index.shtml) gives links to other guidance that has received FSA confirmation.

Mr Cross noted that it would be beneficial for the Gilt Repo Code to be confirmed by the FSA, and would ask Mr Rippon to pick this up.

10 **Regulatory developments:**

a) MiFID implementation overview

James Woodley (FSA) gave the Committee an overview of MiFID implementation and its impacts since implementation. The new MiFID transparency calculations were uploaded by Member States on 3 March 2008 on the CESR transparency database (<http://mifiddatabase.cesr.eu>) and will be effective from 1 April 2008 – 31 March 2009 - these figures underpin the MiFID transparency regime. The European Commission's report on non-equity transparency had yet to be published, and was currently going through the review process. On equity transparency, Mr Woodley noted that in September 2007 the FSA had said that it would conduct a review of how the MiFID regime was bedding down, including: pre-trade and post-trade transparency, systematic internalisers, block trades and the overall impact of MiFID. The first stage would be to open discussion with a range of firms and trade associations. The European Commission is to commence its own review toward the end of 2008. Mr Serocold asked whether MiFID transparency would perpetually be under review, given the proposed FSA review closely followed by the EC review. Mr Woodley noted that as much information as possible would be extracted from the FSA review and included in the EC review.

b) FSA work on CFDs

Mr Wallis reported that the consultation paper (CP0720) on disclosure had closed for comment on 12 February 2008, and the FSA had been reflecting on responses. Mr Wallis noted that the CP had benefited from a wide range of inputs. The CP had proposed 3 options on disclosure of contracts for difference: (1) leave disclosure at its current level; (2) strengthen the current disclosure regime by (a) requiring a disclosure of any CFDs written in reference to

3% or more of total voting rights unless it was clear that the CFD holder could not exercise or seek to exercise voting rights and had made a clear statement to that effect and there were no arrangements or understandings in relation to the potential sale of the underlying shares by the CFD holder and (b) introducing a 'notification to issuer' power broadly similar to section 793 of the 2006 Companies Act; (3) introduce a general disclosure regime which would achieve the same objectives by requiring CFD holders to reveal all economic interest of stakes of 5% or more in a company's shares. In the CP the FSA had performed analysis of the extent to which market failure was occurring in practice, and had concluded that Option 1 was not appropriate. Draft rules had been prepared for both Options 2 and 3. Responses to the CP indicated that there were still a wide range of views. A number of issues had been raised including around the workability and enforceability of Option 2, the way in which CFD writers might be impacted under (2) or (3), and on the proposed thresholds and approach to aggregation particularly under (3). Mr Wallis also noted that the proposal under option 2 to provide a 'section 793' power had caused some concerns, particularly for CFD writers.

The FSA was now considering how to take the policy forward, and Mr Wallis said that any comments from members of the SLRC were welcome. The next step for the FSA would be to issue the feedback statement which was expected to be published in Q3.

c) Agent/lender disclosure and Basel II

Mr Woodley updated the Committee on agent/lender disclosure and Basel II. An interim approach for disclosure had been agreed with ISLA. Mr Gibson reported that this approach had been underway for a couple of months, and an external consultancy had been asked to provide a long term solution, which was expected in just under 2 years time. A standing committee was meeting fortnightly, and there were currently three key points. First, whether the US model could be followed. The DTCC could not process the information due to OFAC requirements, and so it was hoped that the processing software could be licensed to a provider in Europe. Secondly, to facilitate disclosure DBVs will have to be exploded, as would tri-party repo. Thirdly, European members were very keen to include agency, not principal, repo, which had been excluded from the US solution. Whilst it had been decided to proceed with agency repo, this would not be allowed to delay the main project and further evaluation would be undertaken to decide whether or not this aspect would comprise a later phase of the project. Mr Gibson noted that the disclosure regime was on target to meet the deadlines of the FSA.

11 **LCH.Cleernet €GC service**

Nigel Bradley (LCH.Cleernet) gave a presentation to the Committee on the proposed new €GC service, which is based around the tri-party settlement models of Euroclear and Clearstream. The Member testing process for the new product will be taking place during April with the product going live in the early part of May.

The new RepoClear service is initially based on the clearing and netting of trades in standard baskets of euro area, euro denominated government debt, traded either anonymously via electronic trade platforms or bilaterally. It is a natural extension of the sterling GC (DBV) service, and will provide enhanced STP. Term trades will be characterised as a series of linked one-day settlements such that all open trades expressed in a basket can net against each other, each day, and irrespective of term. There is also the opportunity to extend the range of baskets in the future, to e.g. single-issuer or non-government securities.

Mr Bradley summarised developments regarding the sterling GC service. Since September the product had seen record volumes of £31bn, with average volumes running at around £20bn per day. There had been no settlement failures to date.

12 **SLRC terms of reference**

Mr Cross referred the Committee to the draft terms of reference, and asked members for comment by 25 March, to be directed toward the SLRC Secretary.

13 **SLRC 2008/09 work programme**

Mr Cross referred the Committee to the draft 2008/09 work programme, which had been circulated to members at the December SLRC. Some comments had already been received, with ISLA suggesting the inclusion of ‘monitoring corporate governance proposals’. Mr Hellmund offered the additional comment that item 4 be changed to ‘combination of exercises in gathering legal opinions...’ rather than ‘harmonisation in gathering legal opinions...’.

14 Any other business

Mr Marshall noted that ISLA had recently received calls from members regarding outstanding stock borrowings of Northern Rock, which were problematic for both borrowers and lenders. Dagmar Banton (LSE) noted that the LSE had also received calls regarding outstanding cash trades and stock loans. Both ISLA and the LSE had spoken to Euroclear regarding this, including the identification of open positions. Mr Cross said that the Committee would be interested to hear how this develops.

Euroclear subsequently clarified that, with the nationalisation of Northern Rock, the open loans could not be shown as open positions for settlement given the cancellation of the former shares. But participants could still have seen their transactions and historic balances, even though they were cancelled, if they needed this information.

ISLA subsequently posted guidance on its website on the treatment of former Northern Rock equity loans.