

STOCK LENDING AND REPO COMMITTEE

WEDNESDAY 9 OCTOBER 2002

SUMMARY OF MEETING HELD

AT THE BANK OF ENGLAND

Members present:	David Rule	Bank of England, Chair
	Dagmar Banton	London Stock Exchange
	Krystyna Beck	Deutsche Bank (London Investment Bank Association)
	Cameron Dunn	Merrill Lynch (European Repo Council)
	Hugh Gibson	HSBC (Association for Payment Clearing Services)
	Simon Hills	British Bankers Association
	Steve Russell	HSBC
	John Rippon	Bank of England
	Allison Holland	Debt Management Office
	Philip Reichhardt	Euroclear
	John Burke	LCH
	Tim Westover	Dresdner Kleinwort Wasserstein
	John Serocold	London Investment Banking Association
	Jens Pöhland	Bond Market Association
	Howard Jones	Bank of England, Acting Secretary
Also in attendance:	David Sheppard	Bank of England
	Stephen Kirby	Bank of England
	Jon Carr	Bank of England
	Margot Marshall	Financial Services Authority
	Richard Westoby	BNP Paribas
	Andrew Gavin	CRESTCo

SUMMARY OF MEETING HELD ON 15 AUGUST 2002

The minutes of the previous meeting were agreed. Previous meetings' minutes are available at: <http://www.bankofengland.co.uk/markets/slr.htm>. It was agreed that in future minutes of meetings could be posted on the Bank's website prior to their approval by the group at the next meeting. Members would be consulted individually before posting if it was clear that comments were attributable to them.

FSA UPDATE ON SHORT SELLING WORK

1. The FSA representative gave an update on their work programme on short selling.
 - The FSA had held its round table on short selling. This had allowed a useful exchange of views between a range of interested parties including corporate share issuers, hedge funds and market intermediaries. Broadly, representatives of issuers had felt that greater disclosure of short selling was desirable from an investor relations perspective. Some representatives of intermediaries were more sceptical about the need for, and practicalities of, greater disclosure requirements. Nobody called for short selling to be banned and few favoured regulation eg a tick regime.
 - Comments from the round table discussion would be reflected in an FSA Discussion Paper that it expected to issue in the next few weeks [issued on 21 October].
 - The deadline for responses to the Discussion Paper will be the end of January. A Consultation Paper might follow, depending on the nature of the responses to the Discussion Paper

DISCUSSION

2. Some on the committee doubted the need for greater disclosure to reveal the identity of short sellers to issuers. One view was that issuers could already obtain the information using a notice issued under section 212 of the Companies Act 1985. Another view was that corporate brokers would be expected to be able to find out the identity of those with any large short positions. Mr Serocold offered to raise this issue with LIBA members if people felt there was some breakdown in the flow of information.
3. The Chairman said that the Group could discuss the issue again at its next meeting in the light of the FSA Discussion Paper.

PUBLICATION ON STOCK LENDING

4. The Chairman recalled that at the previous meeting some members had identified a need for a publication describing the stock lending markets. Since then, the Bank had undertaken a trawl of existing literature and a gap did seem to exist. One indication was that financial journalists researching the subject had struggled to find a basic explanation of why the market exists, how it works and who is involved. The 1999 BIS/IOSCO study was one source but there seemed to be nothing authoritative written by market practitioners.

5. A number of members said that inaccurate statements had sometimes been made about stock lending and its relationship with short selling and that a “user friendly” guide would be useful. Ms Banton suggested that a pamphlet published by the LSE under the aegis of the SLRC some years ago might provide a suitable model for a future publication, although it was clearly out-of-date. The Chairman said he would circulate copies to members.

6. The Chairman asked members who they thought the target audience should be. Suggestions included pension fund trustees, financial journalists and corporate share issuers.

7. The Chairman said that Mr Clayton (who was unable to attend the meeting) had said that ISLA would be willing to contribute to the writing of such a publication and he wondered if the various trade associations represented would be willing to cooperate on its production. There was general agreement from members present that it could be appropriate for the work to be published jointly by the London Stock Exchange, the International Stock Lending Association, the London Investment Banking Association and the British Bankers Association, with SLRC endorsement. The Chairman asked Mr Serocold if he would consult with ISLA, BBA and LSE representatives on how the work could be taken forward. Hopefully the next SLRC meeting could discuss a firm proposal.

PARTIALLING

8. The Chairman said that the Bank had received reports from market participants that they were concerned that guidance on partial delivery in the Gilt Repo Code of Best Practice was not being respected. In particular, they had received partial deliveries in CREST without prior agreement.

9. Mr Rippon said that current guidance was a product of extensive discussions that had taken place in the SLRC and between the Bank and market practitioners. He said that the Bank wished to get a sense of the extent to which the guidance was being adhered to and whether there was any appetite to make revisions. It was clearly stated in the Code that:

“In the absence of prior agreement, either at the point of trade or before when bilateral trading arrangements are decided, a partial delivery may be declined, but participants are encouraged to act in such a way as to facilitate the settlement of trades and, in particular, should shape their trades according to their settlement capability.”

10. There was a general consensus that the Code was widely adhered to and members did not want to revise current guidance.

11. The Chairman said that the minutes should state clearly for the record the Committee’s view that the current wording of the Code remained a statement of good market practice and market participants should be expected to follow it.

PRE-HEDGING CONVERTIBLE BONDS

12. Mr Hills said that he had some reservations about the distinction being drawn by the FSA in their Consultation Paper 149 between non-contractual “icing” and other forms of hedging prior to issuance of convertible bonds, which might be considered as market abuse. He wondered whether this solution would be suitable if, for example, people then began to charge for “icing”.

13. It emerged in discussion that the market had in fact already moved the debate forward and it was generally agreed amongst members that this discussion would be best taken up with the FSA in the context of the consultation.

EUROPEAN REPO COUNCIL SURVEY

14. Mr Dunn introduced the findings of the third European Repo Council (ERC) survey which were available in full at <http://www.isma.co.uk/>.

- The survey represented the responses of 86 market participants with a number, particularly French institutions, responding for the first time.
- The gross amount of repo transactions by value had increased significantly to \$3.3 trillion. This not only reflected the greater number of responses but also a 16% increase in the business of those firms that had taken part in all three surveys.
- It was estimated that trading in London represented approximately 35% of the repo trades reported. With 10% of the total denominated in sterling.
- It appeared that 88% of reported repos had been conducted under the TBMA/ISMA Global Master Repurchase Agreement (including perhaps some use of the European Master Agreement) with 12 % under securities lending agreements. 9% were conducted on an undocumented basis, although the ERC strongly encouraged all participants to use documentation.

SLRC NETTING SUB GROUP

15. The Acting Secretary informed the Committee that the sub-group had met on the 10 September. The legal opinions, which are updated on a rolling basis, were up to date. One issue that had been mentioned at previous SLRC meetings was the risk of the re-characterisation of stock loans in South Africa following recent case law. At the sub-group Mr Jones from ISLA had said that members appeared to be continuing business as normal in South Africa but members were advised to keep abreast of developments.

UK ANNEX TO THE STOCK BORROWING AND LENDING CODE

16. Mr Rippon said that the key issues in the preparation of the UK Annex were the deadlines for dealing with stock events, primarily dividend elections, and the

concern about unnotified returns of stock close to an election date. The former had been largely dealt with by amendments to the London Stock Exchange rules and by developments in CREST functionality. As regards unnotified returns, it was envisaged that a possible solution would be to amend the stock lending agreement to require the borrowers to notify during a specified 'callover period' any intention to return the stock. The 'callover' period, envisaged would be the day before the election/record date. If, however, the borrower failed to give notification, the borrower would be constrained by any buyer instruction issued up to 11am that day (which is the deadline for buyer instructions). ISLA would be seeking legal advice on the feasibility of amending the legal agreement in this way.

SHAREHOLDERS VOTING WORKING GROUP

17. Mr Sheppard said that the Shareholders Voting Working Group had met on the 3 October and that the chairman of this group would be writing to the Chairman of the SLRC to arrange a meeting to discuss voting on lent stock [arranged for 1 November].

NAME CHANGE

18. There was a suggestion from one member that the Stock Lending and Repo Committee might better be described as the Securities Financing Committee. The Chairman invited anyone with views on this subject to contact him ahead of the next meeting.