

## SECURITIES LENDING AND REPO COMMITTEE

WEDNESDAY 22 SEPTEMBER 2004

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Members present:	David Rule	Bank of England, Chairman
	Nicola Stead	Bank of England, Secretary
	Mark Hutchings	International Securities Lending Association/ AIG
	Hugh Gibson	International Securities Lending Association
	Andy Clayton	International Securities Lending Association/ Northern Trust
	Stefano Bellani	European Repo Council/JP Morgan
	Ian Fox	London Money Markets Association/ HBOS
	Nick Fisher	UK Debt Management Office
	Adrian Tgetgel	International Securities Market Association
	Dagmar Banton	London Stock Exchange
	John Serocold	London Investment Banking Association/ Chair, SLRC Netting Sub-group
	Anthony Littleton	Association for Payment Clearing Services
	Jason Waight	CRESTCo
	Tony Hibbitt	Cater Allen International
	Mark Weeks	London Investment Banking Association/Goldman Sachs
	Markus Sgouridis	The Bond Markets Association
	Also present:	
	John Rippon	Bank of England
	David Sheppard	Bank of England
	Jon Carr	Bank of England

1. The minutes of the meeting held on 8 June were agreed. Previous meetings' minutes are available at: <http://www.bankofengland.co.uk/markets/slrc.htm>.
2. After suggestions by members, the Chairman had asked the National Association of Pension Funds whether they wished to propose a member for the SLRC. The

NAPF Investment Committee were considering the matter. It was agreed that Mr Rule would also ask the Association of British Insurers if they wished to propose a member. Members also raised no objections to the proposed membership of the ACI, represented by David Roberts (Royal Bank of Scotland).

#### UPDATE OF THE STOCK BORROWING AND LENDING CODE OF GUIDANCE

3. Mr Rippon reported on the draft Code. Several drafts had been circulated to members of the Code's sub group in August. The group is due to meet on 15 October to discuss a draft to circulate to the wider SLRC.
4. The main changes in the updated Code were
  - Coverage of gilts
  - Reference to the *Introduction to Securities Lending* publication
  - Update on regulatory arrangement
  - Reference to the responsibilities of beneficial owners
  - Changes to reflect the introduction of electronic trading platforms
5. The aim was to complete the updated Code by the end of the year. Some changes would also read across to the two repo Codes, which were due to be amended.

#### ECB PROPOSAL FOR A UNIFIED LEGAL AGREEMENT

6. Mr Hutchings reported on a meeting held at the ECB in July with FBE, ESBG, EACB, ISDA, ISMA and ISLA, the sponsors of the main standard market agreements used in the European financial markets. The aim of the meeting had been to explore the possibility of harmonising the terms of agreements as far as possible. Attendees had agreed that it might be useful to have a single legal agreement, though it was noted that this would have to cover the US, not just Europe, to become acceptable. All parties agreed that it should be drawn up under English law. A follow up meeting was to be arranged.
7. SLRC members agreed it was important that any merged agreements could also be used in US markets. Most thought that, while the principle of a unified legal agreement was attractive, it would be difficult to achieve in practice and the gains might not be sufficient to justify these efforts. Convincing evidence of the benefits would be needed. Some also thought that an agreement applicable across OTC derivatives, repo and securities lending markets might be unwieldy and the

updating process might become more difficult. Committee members encouraged ISLA and ISMA representatives to participate in the initiative and report back to the Committee on developments.

8. Mr. Tgetgel pointed out that when inviting the various associations, the ECB had stated that it wished to act as a facilitator to allow market associations to enter into a dialogue on how the different standard agreements could be further harmonised.
9. Mr Tgetgel reiterated ISMA's position that international, cross-border repo transactions should be documented by the GMRA because the GMRA currently provides the desired uniformity since it is subject to English law, the jurisdictions of the courts of England and is worded in English, irrespective of where the counterparties are based.

#### HMT/FSA/BANK OF ENGLAND PAPERS ON EU FINANCIAL SERVICES ACTION PLAN (FSAP)

10. Mr Carr said that the deadline for comments on the European Commission's four expert group reports on post-FSAP (EU Financial Services Action Plan) had now passed and the next steps were likely to be the publication of a synthesis paper and then, early in 2005, a Commission work programme for financial services over the period to 2009. The joint HMT/FSA/Bank of England response to the four reports was likely to be published soon.
11. He flagged the work that would be required by firms in adjusting to EU measures which had been adopted by Member States, but not yet implemented in national legislation. The Market Abuse Directive and the Directive on Markets in financial instruments ('MIFID') which were due to be implemented by October 2004 (in practice a little later) and May 2006, respectively, were cases in point. A number of key measures were still under discussion in Brussels, including the Capital Requirements Directive (CRD) (where work on the trading book continued), and on clearing and settlement (where a regulatory impact analysis on what might be done, was likely in 2005). It was important that firms identified the consequences of new EU legislation for them at an early stage. The joint HMT/FSA/Bank paper on 'FSAP: Delivering the FSAP in the UK' of May 2004, which described measures not yet implemented, might be helpful in this regard.

## REFORM OF THE BANK OF ENGLAND'S OPERATIONS IN THE STERLING MONEY MARKETS

12. Mr Rule reported on progress on the Bank's reform of its money market operations. The Bank had issued a press release on 22 July announcing that the new system would be based on reserve averaging, with voluntary reserves remunerated at the Bank's repo rate. Maintenance periods would run from one MPC decision date to the next, with weekly refinancing operations of one week maturity. A consultation document setting out the detail of the reforms would be issued shortly, probably in late October.
13. In response to a question, Mr Rule said that the Bank was not planning to change the range of collateral taken in its operations as part of these reforms. But, separately, the Bank was intending to introduce concentration limits (by issuer) on the collateral taken in its open market operations and against intra-day liquidity in the RTGS payment system.

## EU TRANSPARENCY DIRECTIVE

14. Mr Rule said that he had asked for an FSA update on this Directive given the Committee's previous interest in the proposed notification thresholds and how these applied to lent/ borrowed equities. Mr Wharton had been unable to attend the meeting but had provided the following written update.
15. The CESR Transparency Expert Group had received its first set of provisional Level 2 Mandates from the EU Commission on 29 June 2004. On the same day CESR released a Call for Evidence, inviting interested parties to submit their views as to what should be included in CESR's advice to the Commission. The Call for Evidence had closed on 29 July.
16. The CESR Transparency Expert Group was chaired by the Chairman of the Estonian Financial Supervision Authority, Mr Andres Trink. There were three drafting groups (major shareholding notifications, information dissemination and storage, and equivalence). The UK was participating in all three groups and chairing the group on major shareholding notifications.
17. A CESR consultation on the first round of draft advice was due to be published later this year (it is likely to be November). The consultation period would be three months. The Commission had mandated CESR to provide it with final advice by the end of June 2005. It was currently anticipated that final Level 2

requirements would be published by the Commission by the end of December 2005.

#### VOTING ON LENT STOCK: INTERNATIONAL CORPORATE GOVERNANCE NETWORK

18. Mr Hutchings reported on the results of an IGCN survey on the implications of securities lending for corporate governance. The results (published in June) indicated that most respondents had been broadly neutral on this question.
19. The most important issue seemed to be one of education and communication – ensuring that owners of securities were aware if they had been lent and were able to recall them, if they wished, to exercise a vote. ISLA had been discussing IGCN's proposed best practice guidelines with RMA and the IGCN. The plan was to publish them in July 2005.
20. There was some discussion of voting of shares held to hedge contracts for difference - where economic ownership had passed to the counterparty. Mr Serocold reported on a current consultation by the Takeover Panel, due to end in early October, noting that it applied stricter rules on voting of borrowed stock in a takeover situation.

#### ISMA'S UPDATE REPORT ON GMRA RELATED MATTERS

##### Legal opinions

21. Mr. Tgetgel reported that draft legal opinions for Greece and Poland were now close to finalisation and ISMA intended to publish these opinions in due course.
22. In relation to Hungary and Norway, the respective draft opinions were currently under review by the ISMA/TBMA Joint Opinion Committee.
23. In relation to the People's Republic of China, Cyprus, Estonia, Latvia, Lithuania and Malta, it should be possible to obtain satisfactory opinions and therefore ISMA had recently instructed local counsel from these jurisdictions to produce a draft opinion for ISMA's review.
24. ISMA will clarify with its European Repo Committee whether there is in fact sufficient market demand to justify the high costs of obtaining South Korean and Taiwanese opinions. In relation to Croatia, the Czech Republic, Slovakia and

Slovenia, ISMA was monitoring legal developments with a view to ascertaining at what stage a clean opinion might reasonably be obtained.

25. In relation to Brazil, Mexico and the Philippines, ISMA was currently clarifying whether clean legal opinions could be obtained in each of these countries.
26. In relation to Scotland, ISMA would request its European Repo Committee for feedback on whether there was a market interest in a Scottish legal opinion.
27. In relation to Russia, the legal situation remained unclear. ISMA and TBMA were currently examining the possibility to support the legislative process with the objective that the GMRA would be adopted as the cross-border repo standard document for Russia.

#### NETTING SUB GROUP

28. Mr Serocold reported. The opinions were proceeding without difficulty, except for some discussion with Clifford Chance on fees for the English opinion.
29. Mr Serocold said he still intended to examine the scope to rationalise the opinion gathering process. A mapping exercise would be useful ahead of allocating resources to any projects such as the ECB proposal for a unified legal opinion (see above).

#### ANY OTHER BUSINESS

30. Mr Serocold gave an update on the issues which the market has encountered at Monte Titoli, the Italian settlement system, discussed at SLRC meetings in March and June 2004. He noted that although custodians in Italy only put transactions forward for settlement if they believe the necessary resources were available, this still yields only a 90-93 % settlement success rate in the overnight cycle. Monte Titoli had implemented the existing rule under which a counterparty receiving a dividend as a result of failure to settle an on-exchange trade must pay 159%<sup>1</sup> of the net dividend to the rightful party. Mr Serocold said that this rule had apparently caused some difficulties in the market. The final aim should be to get to a European standard for dividend claims.
31. Borsa Italiana had consulted with the London market, amongst others, about this and other changes in market practice following the recent implementation of a

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<sup>1</sup>The rule is calculated in the basis of the theoretical maximum rate of tax recovery for an Italian resident.

new system at Monte Titoli. They had released the feedback from this consultation which included practical steps to reduce the impact of fails. But any comprehensive solution to the dividend claim difficulties would have to cover over-the-counter transactions as well as on-exchange business.

32. Mr Bellani said that the ERC had been represented at one of the meetings in Milan. They had pushed for harmonisation on the settlement side. Mr Serocold said that his understanding was that the complete set of requirements for legislative and technical changes was unlikely to be completed in time for the start of the dividend season in May. He asked members to make their Italian desks aware of these discussions and give feedback to Borsa Italiana directly.

#### DATE OF NEXT MEETING

33. The next meeting will be on 6 December 2004 at 11am, at the Bank of England. It will be followed by a buffet lunch.

BANK OF ENGLAND

19 OCTOBER 2004