

STOCK LENDING AND REPO COMMITTEE

TUESDAY 11 SEPTEMBER 2001

MINUTES OF MEETING HELD

AT THE BANK OF ENGLAND

Present:	Neal Hatch	Chairman
	Marco Angheben	Bond Market Association
	Dagmar Banton	LSE
	John Burke	LCH
	Andy Clayton	ISLA
	Simon Hills	BBA
	Sarah Hobbs	LIBA
	Graham Jones	Intermediaries
	Margot Marshall	FSA
	Mike Ness	DMO
	Steve Russell	IEMRC
	Guy Simpkin	LCH
	James Tomkinson	ERC
	Tim Westover	MMLG
	Kate Wormald	FSA
	Jon Carr	Bank of England
	Alison Emblow	Bank of England
	Caroline Pitt	Bank of England
	John Rippon	Bank of England
	Kieran Wright	Bank of England, Acting Secretary

The Chairman noted apologies for absence from Krystyna Beck, Tony Hibbitt, Philip Reichardt and John Serocold. In addition he welcomed Marco Angheben and Margot Marshall to the meeting as alternates to Scott Rankin and Merope Sylvester respectively. The Chairman also welcomed Kate Wormald from the FSA.

MINUTES OF 12 JUNE MEETING

1 These were agreed as final and have been posted on the Bank of England's Markets website as agreed at: <http://www.bankofengland.co.uk/markets/src.htm>

EQUITYCLEAR

2. Mr Simpkin provided an update for the committee. Two documents have now been published – a service outline and a white book by CRESTCo which provides technical details.

3. He noted that stock lending had not been raised as an issue. The LCH does not handle stock lending while fails are dealt through the LSE; that division will not change with the introduction of netting.

REPOCLEAR

4. Mr Burke said that an Italian service had still to be introduced due to regulatory barriers. Nevertheless there remained broad support within the market and he thought the service would hopefully be up and running in the next 6-9 months.

5. Repoclear have taken the first steps towards the introduction of a UK gilts service. Work is continuing on the operational development (in particular with the functionality for same day value and DBV), with an initial live date scheduled for next year. Initially, maturities will be up to one year and limited to conventional stocks (hence not index-linked).

6. Third party clearing is to be introduced at the end of October i.e. LCH members of a certain size will be able to settle for a third party; that third party will have to satisfy certain criteria.

7. A General Collateral service is being developed with the first wave – German Government bonds under 10 years - set to go live by the end of November. There is demand for a pan-European basket but that will need to wait until further progress has been made on the initial GC developments.

8. Turnover in August reached £1.8trillion of business, much of which was from German bonds.

ISSUES RELATING TO THE EURO

9. Mr Carr said that it was envisaged that the next issue of *Practical Issues Arising from the Euro* would be published in December. It would focus on the

completion of the euro changeover, including preparations for the introduction of euro notes and coin.

10. He said that the next meeting of the City Euro Group would take place on 1 October. The group would cover among other things residual end of transition period issues for the UK, including those relating to legacy currency derivatives contracts outstanding at end-2001 (cf the new euro Protocol to ISDA's Master Agreements).

11. Finally he noted that the ECB had published in August a comprehensive guide to 'The monetary policy of the ECB' covering monetary policy strategy/implementation etc.

BASEL ACCORD

12. Miss Emblow said that a second consultative paper from the Basel committee had been sent out in January. Comments had been received from the market who had expressed concern about the size of the capital requirements for repo and stock lending. The Basel Credit Risk Mitigation sub-group had responded with a number of proposals:

- Recognition of netting agreements
- Allowing firms to calculate counterparty exposures using VaR models
- Carve out from "w" (residual risk factor) should be made wider to include all repo transactions and also equity stock lending [The Basel Committee subsequently announced on 21 September that the residual risks in all collateralised transactions would be addressed under the supervisory review process, rather than via a "w" factor].

13. The sub-group would like further data from the market in order to model the potential impact on firms. As such, a survey will be sent out to banks – and potentially to a wider circulation – by the end of September. While the questions will be public knowledge, the answers will remain confidential. The Chairman suggested that the survey be circulated to the SLRC committee provided the FSA do not have any objections.

14. Miss Emblow also mentioned that there had been substantial feedback on the holding period for haircuts – firms had proposed a reduction from 10 days to 5 days.

15. The next formal stage will be for Basel to issue a third consultative paper.

PRE HEDGING OF CONVERTIBLES

16. Ms Wormald of the FSA spoke on the change in the treatment of pre hedging of convertibles (a paper was circulated ahead of the meeting). Under the Code of Market Conduct, the treatment will change with the key question being whether the action is “behavioural” or “dealing”. As such what was acceptable in the past may now not be and vice versa. The FSA will in due course issue some market guidance on this. This guidance explains why there has been a change in the treatment and broadly speaking it suggests that icing stock before it is issued will be acceptable since it is not “dealing” but if participants enter into OTC or other “deals”, then that will be regarded as unacceptable.

17. She also spoke about what constitutes “public knowledge” noting that the FSA is keen to find out reactions from those in the dealing community: e.g. whether the market at large hears about when a convertible is due to be issued, if participants are aware of icing behaviour and whether there is support of the current practises.

18. Mr Russell said that the majority of information that he obtained came from the press where there was substantial speculation regarding companies potentially aiming to raise cash (though usually it did not specify whether it would be convertible). Ms Wormald added that most deals tended to have a third party issuing the stock. The Chairman encouraged others to make bilateral contact with the FSA if they had further views [John Serocold of LIBA has since been in contact with the Bank and FSA].

UK ANNEX: STOCK BORROWING AND LENDING CODE OF GUIDANCE

19. Mr Rippon said that a situation report had been given back at the June meeting regarding notification deadlines for handling equity stock events, in particular as they relate to dividends with scrip/cash alternatives. At that time, the possibility of a partial solution was being explored, through amending the LSE rules to reflect

proposed CREST central counterparty functionality. The LSE was now close to putting out a consultation document on this to its members.

20. Parallel to this work, ISLA have made some proposals in an attempt to meet all the concerns of lenders and borrowers. However there was a risk that pursuing this wider solution might slow down work on the partial solution. In order to make further progress, there will be a meeting next week, chaired by the Bank, with representatives from the LSE, LIBA, CRESTCo and ISLA. The aim would be to make progress on an interim solution, whilst not prejudicing progress on a wider solution. Mr Rippon will keep the SLRC informed on developments.

LEGAL AGREEMENTS IN STERLING MONEY MARKETS

21. Mr Rippon said that the Money Market Liaison Group had suggested that it would be helpful to consider the legal agreements used in the sterling money markets, with a view to exploring the scope for harmonisation. To take this forward, the Bank conducted a survey of London Money Market Association members to see what agreements were used and to canvass views on possible changes.

22. A number of suggested changes were identified but the majority of these have been or are being dealt with already e.g. in the work on updating the GMRA or to produce a unified stock lending agreement. Moreover, there were various other fora in which further changes could be considered. It seemed sufficient generally to rely on this other work; but it was also important to ensure that MMLG and SLRC were kept informed of such work and that they were given the opportunity to discuss concerns that were now being considered in other fora. Mr Rippon also asked to be kept up to date with any legal developments as a matter of routine at john.rippon@bankofengland.co.uk

SLRC NETTING SUB-GROUP

23. Mr Jones detailed the progress made at the August netting sub-group meeting.

24. The majority of GMSLA opinions will have been finalised and sent out to subscribing firms by the end of September.

25. The sub-group decided that the UK and US opinions should cover the enforceability of the agreement as a whole and not just close-out netting: work is now continuing in order to achieve this.

26. It was also agreed to discontinue work on Malaysian opinions due to a lack of customer demand. Italy remained delayed due to legislative changes and Luxembourg is behind schedule due to problems communicating with local counsel.

EUROPEAN REPO COUNCIL SURVEY

27. Mr Tomkinson circulated a handout detailing the results of the European repo market survey. Details can be found at: <http://www.isma.co.uk/statistics/repo.html>

28. He noted the survey was an important step forward in terms of information on the repo market. The ERC would now build on this, targeting some of the larger players who had not been involved in this first survey. The next one will be in December, and thereafter every six months.

29. Mr Carr thought it might be interesting to compare the survey with the repo section of the ECB's July 2001 report on 'The euro money market'.

ANY OTHER BUSINESS

30. Mr Hills raised the issue of fails in the bond market, noting squeezing ahead of futures' maturities. Mr Tomkinson said that the ERC had highlighted the issue of fails and the associated problems.

31. The Chairman asked about whether the Committee felt it necessary to continue meeting on a monthly basis or whether to move to longer and more detailed meetings on a quarterly basis. After discussion it was provisionally decided that the next meeting would indeed be quarterly, on 11 December.