

SECURITIES LENDING AND REPO COMMITTEE

Wednesday 5 September 2007

Bank of England

MINUTES

Attendees

Michael Cross	Bank of England, Chairman
David Hopton	Abbey
John Hale	ABI
Nick Baker	Bank of England, Secretary
Rob Fair	Euroclear
Rahim Nanji	Deutsche
Charlotte Hannavy	Deutsche
Vivienne Bannigan	Financial Services Authority
David Roberts	Fortis
Audra Wamsteker	HSBC
Christian Hellmund	ICMA
Gregor Pozniak	ICMA
David Rule	ISLA
Richard Steele	ISLA/J P Morgan
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
Cameron Dunn	Merrill Lynch/European Repo Council
Joyce Martindale	RPMI
Emmanuelle Roux	SIFMA
Sarah Viner	UBS
Chris Ryan	UK Debt Management Office

Also Present:

John Rippon	Bank of England (Acting Chairman for items 1-14)
Simon Wells	Bank of England

1 **Introduction**

John Rippon (Bank of England) noted that Michael Cross, the Chairman, was delayed at another meeting but would arrive shortly. In the meantime, the meeting would proceed with Mr Rippon temporarily in the chair. Mr Rippon welcomed a new member to the Committee, David Rule (ISLA). Audra Wamsteker (HSBC), Charlotte Hannavy (Deutsche), Sarah Viner (UBS) and Vivienne Bannigan (FSA), attending in place of James Woodley, and Chris Ryan (DMO), attending in place of Nick Fisher, were also welcomed as special guests.

2 **Minutes of the previous meeting on 8 June 2007**

The minutes of the previous meeting were agreed.

3 **Matters Arising**

Mr Rippon noted that, as agreed at the June SLRC, the Equity Repo Code had been repealed and taken off the Bank's website. The equity repo market should be kept under review by members close to this market, and if it seemed that the market could become materially larger the possibility of introducing a new code would be considered.

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

Mr Rippon updated the Committee on the UNCITRAL draft legislative guide on secured lending. A carve out in the guide for securities repo and lending had been recommended by UNCITRAL, although this was subject to the caveat that there should be further work on the position of securities. Mr Rippon said that he had asked the Insolvency Service to inform the Bank of any material developments, so that the SLRC could be kept in the picture.

5 **LCH.Cleernet sterling GC service**

Nigel Bradley (LCH.Cleernet) summarised developments regarding the sterling GC service. Volumes had increased significantly with a peak of £14bn in the period end July-August, up from £7.5bn in June. The average volume was £9-10bn per day, and LCH.Cleernet expect

volumes to pick up further in October. Mr Bradley reported that there were new participants in the pipeline, with two or three expected to join before the end of October.

6 CREST developments: term repo

Rob Fair (Euroclear) reported on CREST developments in term repo. Consultation with settlement banks and APACS (amongst others) will start imminently, and a working group will be formed, covering both the UK and French markets. A consultation paper is scheduled to be released in November, with a 3 month consultation period. Euroclear will invite members of the SLRC to comment, and CREST developments in term repo will be picked up at the December SLRC.

Mr Fair reported on recent CREST performance. Transaction volumes had been extremely high, and Mr Fair said that the performance of CREST had been generally good. There had been some issues, but they had not always been CREST-related.

7 Progress report of the revision of the Gilt Repo Code

Mr Rippon provided the Committee with an interim report on the revision of the Gilt Repo Code. The Working Group on the updating of the Code had met again on 25 July to consider written comments provided by members and next steps. In light of this a fourth draft had been produced, although some further contributions are awaited. Once these had been received, the draft would be updated further and circulated to Group members. The aim was for the Group to meet again in the autumn, and a text would subsequently be produced for comment by the SLRC and MMLG. Any comments and suggestions on issues not covered by the present Code would be welcome bilaterally.

8 Regulatory developments:

a) Markets in Financial Instruments Directive (MiFID): best execution

Vivienne Bannigan (FSA) updated the Committee on developments in MiFID: best execution. A feedback statement (07/15) had been released in August 2007, which presented feedback on issues raised by correspondents to DP06/03 and CP06/19 on best execution for securities

lending. Best execution MiFID requirements could apply to securities lending, depending on how the securities lending transaction is structured and the status of the client. The Commission response to CESR explains this analysis. Ms Bannigan noted that firms were advised to review carefully the Commission response in the context of the particular facts and circumstances of their business. In analysing how best execution applies, it is appropriate to consider the securities transaction as a whole. The requirement need not be applied to each leg of the transaction separately. Respondents to 07/15 proposed that the Securities Borrowing and Lending Code could be amended to meet the requirements for best execution.

Richard Steele (JP Morgan) noted that ISLA had seen evidence that some firms were adopting differing approaches as a result of talking to their compliance departments, and it is important that all firms affected by MiFID are fully aware of its implications. Ms Bannigan signalled the willingness of the FSA to continue discussions with the securities lending industry about whether they wished to modify the current industry code or otherwise develop guidance dealing with best execution requirements set out by MiFID.

In November 2006 the FSA published DP06/05: FSA confirmation of industry guidance. PS07/16, just published by the FSA, provides feedback to DP06/05, and intends to facilitate greater use of industry guidance as the FSA moves towards a principle-based approach to regulation.

Markets in Financial Instruments Directive (MiFID): non-equity transparency

Ms Bannigan updated the Committee on developments in MiFID: non-equity transparency. The Commission's work in this area is currently mainly focussed on bonds. CESR had submitted advice in July, which had suggested that there was no obvious market failure in the EU bond markets but retail investors might in some cases benefit from more trading information and, in the first instance, the industry should have an opportunity to deliver ways of doing this. The Commission is hosting a full day of presentations and discussion on 11 September 2007, including both European and US presenters (including the Securities and Exchange Commission and National Association of Securities Dealers). A short paper should be released ahead of this meeting. The Commission's position on non-equity transparency has not yet been made clear.

Gregor Pozniak (ICMA) noted that ICMA had developed a proposal for some additional forms of post-trade bond market transparency for the benefit of the retail community. This proposal would be presented at the 11 September Commission meeting.

Markets in Financial Instruments Directive (MiFID): transaction reporting

Ms Bannigan updated the Committee on developments in MiFID: transaction reporting. Securities lending and repo continues to fall outside the scope of the MiFID transaction reporting regime. The Transaction Reporting User Pack (TRUP) was published in July 2007 and is available for download from the FSA's website. The TRUP has been developed in conjunction with various firms and trade bodies, and it aims to give detailed instructions and guidelines to help firms prepare for transaction reporting to the FSA following the implementation of MiFID.

The implementation date of MiFID transaction reporting has been moved to 5 November 2007. Following discussions with reporting firms and trade bodies, the FSA moved the UK implementation date to a Monday, significantly reducing the implementation risk associated with the transition to the new reporting regime for both firms and Authorised Reporting Mechanisms (ARMs). For further information on transaction reporting Ms Bannigan asked that members call the Transaction Monitoring Helpline on 020 7066 6040 or send an email to tmu@fsa.gov.uk.

b) FSA work on CFDs

Ms Bannigan updated the Committee on developments on FSA work on CFDs. A consultative paper was expected to be delivered in October, with securities borrowing and lending outside the scope of the paper.

Securities borrowing concerns have been flagged by other bodies. The Takeover Panel have committed to giving further consideration to securities borrowing and lending and whether these types of transactions should be treated as dealings and therefore disclosed during offer periods. The EU is also considering the issue of voting borrowed shares.

c) Agent/lender disclosure and Basel II

Ms Bannigan updated the Committee on developments on agent/lender disclosure and Basel II. During visits to IRB banks it was discovered that in agency lending transactions, some securities borrowers were not always receiving timely information from agent lenders about their underlying counterparties, which raised difficulties in determining the appropriate exposure amount and risk weight to calculate their credit risk requirements.

Discussions had been held with ISLA to try to find an industry-wide solution. In the US a solution had taken about three years. ISLA have proposed an interim solution whereby agent lenders provide full disclosure of underlying loan data at least monthly and borrowers use that data to calculate capital requirements based on conservative assumptions. Under ISLA's proposal, the interim approach would be available for two years, giving the industry a window to implement full disclosure. This proposal has been considered by the FSA and an initial response has been sent to ISLA seeking more information. The FSA recognises that the implementation date is close and time for preparation tight.

David Hopton (Abbey) noted that there are two issues. First, are agents/lenders in a position to disclose? Second, what is the securities borrower doing with the information? Laurence Marshall (ISLA) said that answers to the first question were mixed. ISLA had engaged CapCo to undertake a survey of European agent lenders and borrowers to get a clear picture. But many agent lenders were either disclosing information at the point of trade or able to use the US ALD hub.

Mr Marshall noted that a number of service providers were looking at the commercial opportunity of providing data.

Mr Rule noted that it had not been possible to establish a single, detailed interim approach for all firms, as it depended on the nature of their business, who were their regulators and what approach they were taking to calculating capital requirements under Basel II. Rather, ISLA had proposed a framework within which individual firms would have to agree their approach bilaterally with their regulators. Ms Bannigan asked that market participants come forward to discuss their concerns with the FSA bilaterally.

9 **EU work on shareholder voting and implications for securities lending**

Mr Rule updated the Committee on EU work on shareholder voting and implications for securities lending. The Commission had issued a consultative paper in May on a proposed recommendation on shareholder voting, including a section on securities lending. ISLA had responded to the paper. Although ISLA did not believe that a recommendation was necessary, ISLA members did not object to the Commission's proposed wording with the exception of the proposal on 'borrowing to vote' where ISLA had suggested the following wording, 'securities should not be borrowed knowingly for the principal purpose of acquiring voting rights'.

10 **Review of the GMSLA: consultative paper from ISLA**

Mr Steele reported on the consultative paper from ISLA on the review of the GMSLA. In July ISLA produced a consultative paper seeking views on proposals for the principles for GMSLA, and legal, tax, operational aspects of the GMSLA. The initial deadline for comments had been 31 August, but ISLA was allowing a period for further responses. Working groups will reconvene later in the year to discuss responses, and will look to redraft by early 2008. Current thinking is that the GMSLA will be brought closer in line with the GMRA 2000.

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

John Serocold (LIBA) noted that this exercise was primarily about reducing the number of opinions that were being obtained. Mr Serocold said that it was very much in the hands of firms to decide how they wanted this to proceed.

Christian Hellmund (ICMA) noted that the fundamental issue that must be resolved is the funding of the securities lending part of the combined opinions which should come from the associations that sponsor the securities lending opinions. SIFMA concurs with this view. Mr Hellmund also noted that it is important for ICMA that it will be exclusively ICMA that will grant access to the GMRA part of opinions to their members should harmonisation go ahead. He further pointed out that ICMA understands from SIFMA that they intend to make available the GMRA part of the combined opinions exclusively to their members.

Mr Rippon reported that a meeting to be chaired by Mr Cross would be held at the Bank with members of SIFMA, LIBA, ICMA, ISLA and others to help review progress.

12 **Country report on legal opinions**

Mr Hellmund reported that revised drafts of new opinions for Croatia and Israel are still being reviewed by ICMA. The opinions for these jurisdictions are expected to be finalised shortly. ICMA has commissioned new legal opinions for Anguilla, India, Qatar and the jurisdictions of the United Arab Emirates (other than Abu Dhabi for which an opinion already exists). ICMA and SIFMA jointly obtain the opinions for Anguilla and India. ICMA is currently establishing with local counsel whether clean legal opinions can be obtained for Bulgaria and Oman. ICMA still monitors 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.

13 **TARGET2 Securities UK National User Group meeting 3/8/07 report**

Mr Serocold reported on the 3 August meeting of the TARGET2 Securities UK National User Group. Around 20 market participants were present, with the Bank, HMT, FSA and City of London attending as observers. The first item of business was to respond to detailed technical descriptions, which was to be run on tight deadlines which had since been extended. In early 2008 a consultation document would be published that would consolidate user requirements, and the legal and economic case for TARGET2 Securities. There were two distinct phases: the governance in the project phase up to 2012 and post 2012 when the facility was in place.

14 **Any other business**

Michael Cross reported that the Bank had just announced that, against the background of the current market conditions, if interest rates for secured overnight borrowing continued to exceed Bank Rate by more than the usual amount, the Bank would in its open market operations on Thursday 13 September, offer to supply at Bank Rate additional reserves up to 25% of the aggregate reserves target. If it did so, any extra reserves taken up would be accommodated by widening the range round banks' reserve targets within which their

reserves are remunerated at Bank Rate. This would be of particular interest to SLRC members involved in the short-term sterling money markets.

Mr Rippon noted that there was some updating/housekeeping to be carried out with regard to the Securities Borrowing and Lending Code. He proposed to discuss possible changes with ISLA and raise them at the next meeting of the SLRC.

Mr Rippon noted that there had been modification to Schedule 13 to the Finance Act 2007, regarding corporation tax on the sale and repurchase of securities. Mr Rippon suggested that tax developments affecting repo or securities lending might be discussed at the next SLRC if there were demand.