BANK OF ENGLAND

Minutes

SECURITIES LENDING COMMITTEE

6 July 2017

Location: Threadneedle Street, Bank of England

Attendees:

Members

Aberdeen Asset Management	Matthew Chessum
Aviva Investors	Mick Chadwick
BoNY Mellon	Staffan Ahlner
Clifford Chance	Habib Motani
DMO (Observer)	John Goldsmith
FCA (Observer)	Wladimir Kraus
ICMA / ERCC	Godfried De Vidts
ISLA	Andrew Dyson
Lloyds	Jamie Smith
Morgan Stanley	Matt Collins
Norges Bank Investment Management	Matt Brunett
Prudential	Nina Moylett (Chair)
Prudential	Simon Dunderdale
State Street	Alex Lawton

External Presenters

Equilend	Jonathan Hodder
Equilend	Iain Mackay
GSAV	Lawrence McLaughlin
GSAV	David Hopton
Pirum	Ben Challice
Pirum	Rajen Sheth

Bank of England	Sarah John Aakash Mankodi (Secretary) Jonathan Pyzer

Apologies:

Paul Wilson (**JP Morgan**), Mark Short (GS), Andy Krangel (**Citi**), and Mark Stancombe (**Insight Investment Management**)

Item
1 **Introductions**

1. The minutes of the May 2017 Securities Lending Committee (SLC) were agreed by members, and will be published on the Bank's website.

2. The Chair provided a brief introduction of the purpose of the meeting. It was noted at the May meeting that developments in market infrastructure are a topic of interest, and the committee welcomed the idea of inviting specialist external participants to present their views on these issues. The Bank had reached out to three securities lending market participants in this regard – Gross Short Arbitrage Value (GSAV Ltd.), Equilend and Pirum. They would each be presenting their views to the Committee with opportunities for Q&A, which would be followed by a discussion. Each presenter would also be reminded by the Chair that there will be a non-attributable record of the meeting published on the Bank's website as per the Terms of Reference for the Committee.

3. Finally, the Chair welcomed new Committee member, Matt Brunett from Norges Bank Investment Management to the Committee.

2 **Presentation 1 – GSAV**

4. GSAV presented their views on the issue of price transparency in the securities lending market. They were of the view that the current infrastructures for trading, margining and settlement through financial intermediaries made pricing opaque. This may also be leading to difficulties in assessing the performance, risk and use of collateral in the market. It was also acknowledged that there were a number of regulatory and market best practice initiatives underway which were encouraging greater transparency across markets - for example, via MifiD 2 and the UK Money Markets Code.

5. It was noted that regulation was demanding greater transparency through electronic trading and clearing conventions, but these were not yet gaining traction amongst market participants. Therefore, alternative solutions to improve the current infrastructures in the market should in GSAV's view be considered. Current market conventions were thought to be complex and may prove an impediment to incorporating cost-effective trade reporting. GSAV's technology solution to deliver more transparent pricing was designed to address some of these challenges in the market.

6. The floor was opened for Q&A. Questions covered issues such as consistent measures for re-hypothecation, the frameworks for counterparty netting and whether it was possible to determine a “fair price” for securities lending transactions which are ultimately bilaterally negotiated.

   Members also noted that the central clearing infrastructure for securities lending had been around for a number of years but market participants continued to be reluctant to adopt this avenue. It was noted that participants continued to debate on: i) the appropriate cost of clearing, ii) benefits from a credit, collateral and term perspective, iii) its impact on underlying market liquidity and market fragmentation and iv) the implications of CCP failure. It was acknowledged that the committee could further consider the benefits of CCP clearing from a market transparency and price discovery perspective. **[ACT: CCP clearing to be considered for agenda at next meeting]**

3 Presentation 2 – Equilend

7. Equilend presented their views on regulatory initiatives such as the Securities Financing Transactions Regulation (SFTR) and MifiD 2, and their impact on securities financing markets. They noted that more industry dialogue was required to ensure the effective implementation of these initiatives. In particular, there may be inconsistencies between their respective trade reporting requirements that needed to be better understood and addressed.

8. They were seeing demand from different types of market participants for services which offer more pre and post trade transparency. It was thought that participants were prepared to pay for such trading services in order to benefit from access to a wider swathe of the market, automate existing manual processes and generate more price transparency. It was also noted that the market continued to consider clearing, although acknowledged that there were challenges around its adoption.

9. Committee members questioned whether the increasing numbers of platforms being introduced can co-exist in a new market structure. Members noted that the liquidity implications of such a development were not clear. Co-existence of platforms needed to be considered alongside the commercial benefits. It was thought that the current trends were likely to lead to a period of fragmentation, as there are several platforms attempting to create their own niche. It was highlighted that these challenges were

not unique, as these transitions have already occurred at varying degrees of success in other markets.

10. It was noted that the trade reporting under SFTR could lead to the risk of confidential data being passed around the market. It was suggested that using electronic trading platforms instead of bilateral over-the-counter transaction reporting could help address such risks. Beneficial owners were beginning to understand the implications of SFTR on their business models, and considering whether to incorporate direct trading platforms in their securities lending activities.

11. When asked about the top three changes in securities lending markets over the next few years, Equilend noted: i) They expected that 2-3 platform providers would likely emerge as market leaders, ii) business models on the borrower and lending sides were likely going to transform, and iii) the industry would have to agree on how the costs of such changes will be borne by those active in the market. It was noted that securities lending trading costs may need to be passed down to hedge funds and other end users for it to remain a commercially viable business.

3 Presentation 3 - Pirum

12. Pirum explained that their trading platform helped automate connectivity between market participants and infrastructure providers. Due to their broad-based engagement with the market, they presented views on a wide range of topics including: counterparty risk management, corporate actions, disparate data/interconnectivity, SFTR, collateral visibility and exposure management.

13. Counterparty risk management was discussed. It was noted that the current model involved manually intensive processes for borrowers to maintain accounts for all principals, manual settlement instruction management and little transparency within the undisclosed agent lending model. Failed trades in particular were highlighted as a problem against the CSDR backdrop. Ineffective booking disciplines combined with inadequate penalties for failed trades were contributing to failed trades in gilt markets. A few solutions such as greater automation for trade booking, centrally cleared products and different types of collateralisation options e.g. pledge were noted.

14. Increasing failure to correctly deal with corporate actions were discussed as a significant issue. Lack of automation and settlement discipline were highlighted as

contributory factors. It was also noted that for voluntary events, the market risk could have significant RWA implications and capital charges that might not have been anticipated. There was also a growing problem with participants facing more unsecured credit risk. So there was a growing business case for investing in the infrastructure for automating features like dividend compare, notification, election management and compensation. Members agreed that more could be done within the market to mitigate this issue.

15. Other areas of discussion included: Blockchain - and how the market consideration of this new technology needed to be an evolution rather than ‘big bang’, data aggregation using financial technology, enterprise collateral management and digitisation of the collateral schedule process. On the latter, it was highlighted that Brexit and Structural Reform (ring-fencing) would have significant implications for collateral mobility and inter-company flows and was an issue that needed consideration over the next year.

4 Committee Discussion

16. Members identified transparency and CCP clearing as areas that needed further consideration and discussion. The Committee also welcomed this type of meeting format which involved specialist market participants, and encouraged the Bank to consider arranging more sessions in the future.