BANK OF ENGLAND

Minutes

Securities Lending Committee

13 November 2017

Location: 20 Moorgate, EC2R EDH

Attendees:		
	Prudential	Nina Moylett (Chair)
	Prudential	Simon Dunderdale
	Insight	Mark Stancombe
	Aberdeen Standard Investments	Matthew Chessum
	LCH	Paul Elkins (By Invitation)
	Citi	Andy Krangel
	Citadel	Timothy Tomalin-Reeves
	Lloyds	Jamie Smith (Dialled In)
	Clifford Chance	Matt Collins
	Morgan Stanley	Habib Motani
	Norges Bank Investment Management	Matthew Brunette
	DMO	John Goldsmith
	FCA	Wladimir Kraus
	Goldman Sachs	Mark Short
	BoE	Sarah John
	BoE	Jonathan Pyzer
	BoE	Aakash Mankodi (Secretary)
	BoE	Chukwuma Nwankwo

Apologies:		
	BoNY Mellon	Staffan Ahlner
	Aviva Investors	Mick Chadwick
	ISLA	Andrew Dyson
	ICMA/ERCC	Godfried De Vidts
	State Street	Alex Lawton

Minute no.

1. Introductions, Minutes

Nina Moylett (Chair) welcomed new member Timothy Tomalin-Reeves (Citadel) to the Committee.

There were no further comments on the July 2017 Committee minutes, and they will be published on the Bank's website.

2. CCP clearing

The Chair noted that the issue of central counterparty (CCP) clearing was highlighted as an area that warranted further discussion at the SLC's July meeting. It was also noted that CCP clearing was discussed at the September Money Markets Committee (MMC) meeting[1].

Paul Elkins (LCH) was invited to speak about recent developments in this space. He noted that incorporating clearing arrangements in delivery versus payment (DvP) and stock lending markets each posed unique challenges. It was re-iterated that continued challenges for non-cash collateral clearing included: risk mutualisation, clearing costs and legal hurdles for non-bank counterparties. The potential phase-in of pledge structures in European securities lending markets also added a different credit risk implication when considering CCP clearing. Members noted that there had been no major developments regarding non-cash collateral clearing in recent months, and it would need to be further discussed and developed to be suitable for the market. It was thought that buy-side participants needed to further engage with this issue.

One member from a major investment management firm, who had made public its recent move to engage in sponsored clearing in repo, provided their perspective. They had been exploring peer-to-peer (P2P) solutions for a number of years and are live with a number of counterparties. However, it was noted that central clearing through a sponsor model relieved to an extent some well-established challenges with P2P like assessing the credit risks of non-bank counterparties (such as DB pension schemes), which can be a hurdle when trading on a peer-to-peer basis. The sponsor model also addressed the mutualisation of risk issue.

Some members noted that fixed income securities lending was more balance sheet intensive than other asset classes, which increased the value of the netting benefit from central clearing. However, the capital benefits were still thought to be relatively limited. There was some discussion around the potential for cross-margining benefits to be realised through clearing, although the complexity of some of these structures continued to weigh on broader understanding and adoption. There was broad agreement that the standardisation of central clearing contracts could be beneficial particularly given the regulatory drive for mandated clearing. The ability of UCITS to enter into clearing was currently confusing, and clarity was needed for further development by these entities. Sponsored clearing for securities lending also remained unable to deal with corporate events.

It was noted that timing was likely to be key to the success of initiatives being developed to improve market functioning. Currently, the move towards pledge structures in security financing was being prioritised above developing sponsored clearing. It was agreed that developments in this space would remain a slow moving issue.

3. Pledge Structures

The Committee had discussed pledge structures at its May meeting[2]. It was noted then that ISLA were looking at market standard documentation around pledge structures, and had appointed Clifford Chance to develop this documentation.

The Chair invited Habib Motani (Clifford Chance) to provide a progress update.

It was noted that pledge structures had a risk-weighted asset (RWA) capital benefit from the borrower's perspective, and for larger lenders there was also a disclosure benefit in reducing capture by large exposure reporting. The pledge structure under consideration covered pledging the whole collateral requirement, not just the excess margin. These structures were thought to work effectively as a triparty arrangement. JP Morgan, BoNY, Euroclear and Clearstream were engaged in initial discussions on this front.

Some felt that while title transfer benefited from greater transparency, pledge structures could ease regulatory reporting across multiple jurisdictions. Developing a means for handling defaults, that worked as seamlessly across jurisdictions as title transfer, was however

[1] For more information see http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/mmc0917.PDF
[2] For more information see http://www.bankofengland.co.uk/markets/Documents/sterlingoperations/slc0517.pdf

identified as a key hurdle. Pledge structures altered the risk profile of securities lending, to the extent that they affected the speed with which either party could take possession of (and liquidate) collateral in the event of default. Members agreed that it would be useful to consider a timeline in the event of default under pledge and title transfer scenarios, and the implications of each for stay risks.

Members also noted that pledge structures could lead to development of a two-tier market, with market participants that accepted pledge enjoying beneficial flows and pricing. Knock-on impacts could include larger institutions ceasing to accept collateral due to limit breaches and potentially a greater shift to synthetic securities lending – for example via Total Return Swaps (TRS), for those not able to access traditional markets. Members agreed that the pledge arrangement would not be suitable for all market participants. It might prove out of reach for smaller participants who might choose to reduce their activity the market.

There was general agreement that lenders would need to fully understand the risks before wider adoption. Pledge was thought to mitigate some risks, for example given re-hypothecation of collateral was not allowed; thereby allowing lenders to identify the location of their securities more easily. It remained unclear the extent to which current indemnities under title transfer provided by agent lenders would be available in the pledge structure.

Some buy-side representatives also noted that pledge structures added complexity whilst the (marginal) cost savings were largely perceived to accrue to the sell-side. This was thought particularly pertinent given securities lending was not currently seen as a major revenue stream for large asset managers.

It was noted that banks generally preferred non-cash collateral, with capital implications being the main obstacle in most cases. Members agreed that ultimately firms would consider all direct and indirect financial impacts (FX, regulatory reporting) of trade structure and gravitate towards the most efficient.

4. Banking Resolution and Recovery Directive (BRRD)

The floor was opened for discussion of the potential changes proposed by the European Commission to the moratorium powers under BRRD.

Under the changes being proposed, a lender's ability to enforce default could be stayed. Members noted the interaction with the potential development of pledge structure. Members noted that this risk could be mitigated with higher haircuts. But risk ratings would be increased given increased time exposure. It was also felt the proposal ignored daily margining and could accentuate and accelerate firm failure.

AOB: 2018 Agenda

5. Members were invited to raise any topics they thought relevant for the agenda in future meetings. It was noted that impending tax changes in Germany in relation to securities lending highlighted the complexity and operational challenges inherent in processing changes in a shortened timeframe. It was noted that absent a mechanism to effectively process a market participant's obligations, there was potential for some participants to temporarily suspend their securities lending activity in this jurisdiction.

Future meeting dates for May and November 2018, with a further meeting in July if required, were announced. The Bank would issue diary appointments in the coming weeks.