



BANK OF ENGLAND

Speech

Shining a light in the shadows

Reflections on transparency in the securities lending and repo markets

Remarks given by

Andrew Hauser, Head of Sterling Markets Division, Bank of England and Chair of the Securities Lending and Repo Committee

ISLA Conference, Madrid

21 June 2012

I am very grateful for the opportunity to speak with you today. The Bank of England, in common with other central banks, has a deep interest in ensuring thriving, well-functioning and stable markets for securities lending and other forms of secured financing. That interest arises in part from our operational responsibilities: we are daily users of securities lending and repo markets, often in considerable size. Only yesterday, for example, the Bank of England began a new series of monthly auctions, providing £5bn of central bank reserves at a term of six months against a wide basket of assets, including loans and other credit claims originated by banks. We rely on well-functioning secured markets and infrastructure both to carry out such operations, and to transmit their effects to wider financial markets. But central banks also have a much broader interest in the stability and functioning of your markets, reflecting our responsibilities for ensuring stability of the financial system as a whole.

In pursuing these objectives, the Bank of England has always believed in maintaining a close dialogue with market participants, particularly given our privileged position at the heart of the London markets. With that in mind, we established the Securities Lending and Repo Committee – or SLRC for short – in the early 1990s, to bring together market practitioners, trade associations, infrastructure providers and the UK authorities to discuss issues of mutual interest. The history of the SLRC has followed the ebbs and flows of the markets in which it is engaged. In its early period, much of its work was focused on drawing up the market standards, legal agreements and infrastructure needed to turn what had been mostly domestic markets into genuinely global undertakings. That was important, and highly successful, work. But, once completed, it left the SLRC somewhat casting around for a role – and for a time the Committee had a relatively low profile.

That has all changed in light of the recent intense regulatory interest in the role of secured financing markets in so-called ‘shadow banking’ triggered by the financial crisis, coupled with the advent of the Bank’s new Financial Policy Committee, and the rapid innovation in central banking operations. To reflect this new-found purpose, we have taken a number of recent steps to re-invigorate the SLRC, refreshing its membership by bringing in more leading practitioners from the securities lending and repo markets, and re-focusing its work on the issues of greatest importance in today’s markets. I have been struck by the very positive response to this re-launch, not least from ISLA’s Chief Executive, Kevin McNulty, and its Chairman, Richard Thompson, as well as James Templeman, the Co-Chair of this Conference, each of whom has taught me a great deal in a very short space of time.

Many of the SLRC’s early discussions have been framed by the Financial Stability Board’s review of the role of secured financing markets in shadow banking – and both David Rule and his colleague Carlos Molinas have been good enough to come along regularly to brief us on their work. The Bank’s Deputy Governor for Financial Stability, Paul Tucker, has played an important role in shaping the policy debate around the FSB’s broader work¹. Although the SLRC’s meetings have ranged broadly (and vocally!) across the issues raised

¹ See for instance ‘Shadow banking: thoughts for a possible policy agenda’, Speech given by Paul Tucker at the European Commission High Level conference, Brussels, 27 April 2012.

in the FSB's interim report, the market participants on the Committee determined at an early stage – and with David's active support – that they would focus on examining ways in which the transparency of securities lending and repo markets might be enhanced, and in particular the potential role of a trade repository. With that in mind, they formed a small working group, which in recent months has collated current practices in both securities lending and repo markets, spoken to the major regulatory bodies, and engaged closely with key infrastructure providers of both central clearing and trade repository services in other markets. One key focus has been on learning the lessons from colleagues in the OTC derivatives markets, where the introduction of trade repositories is already quite well advanced, as many of you will know.

I wanted to share the key conclusions of that working group with you here today. They make, I think, for interesting reading – not least because they are the findings of market practitioners, not the official sector.

The first key finding is a simple but powerful one: despite significant improvements in recent years, there remain **clear transparency gaps in certain parts of the securities lending and repo markets**. Some of those gaps are a matter of concern to regulators. But that should itself also be a concern to you – not least because of the risk that policy makers may act, not because they know that something is wrong, but because they suspect that it might be. When David Rule and I co-chaired a series of fact-finding meetings with the markets earlier this year, we heard many times how market conventions had improved significantly as a result of the crisis. But the absence of clearly-available data can make it hard to prove this beyond reasonable doubt. Shining a light on the operation of your markets through stronger transparency could help to increase the chances of a proportionate regulatory response.

It could also, the working group believes, be of potential use to market practitioners. There is clearly a demand for better information on the size of different market segments, on market trends and risk practices, such as for example the distribution of haircuts on different types of business. It is striking how many US market participants have commented favourably on the recent initiative by the New York Fed to publish a range of high level, aggregate information on the size, composition, concentration and haircuts in various segments of the US triparty repo market. It would be interesting to see a 'wish list' from securities lending practitioners on the key bits of aggregate data that, if made public, would be useful to you in your day-to-day business.

Now there are clearly a number of different ways to plug information gaps. A first step could be for regulators to make the best possible use of existing data sources – including market surveys, information from CCPs and CSDs, triparty agents, custodian banks, private data providers and so forth. But existing sources necessarily form something of a patchwork – each will measure data in different ways, to different levels of quality and granularity, using different IT systems, and will have gaps either in terms of product or counterparty coverage.

With those problems in mind, the SLRC working group saw merit in the authorities exploring the potential costs and benefits of a more comprehensive solution that might be offered by a global trade repository for securities lending and repo. A well-designed repository might, the group found, help to provide a window into currently opaque segments of the market, give timely insight into the build up of potential systemic risks, and thereby provide for a more targeted and proportionate response by regulators.

At the same time, the group identified four key messages for regulators considering establishing such a trade repository.

The first is that **regulators need to give a clear steer on the data and information they need before rushing to implement a trade repository**. What scope of information is required? How granular? At what level of aggregation? How frequently? From what sources? Those with existing experience of trade repositories also note the importance of future proofing data needs, comparing the task of changing data requirements mid-course to stopping a supertanker. A particular contrast is drawn between the needs of market conduct regulators, who may wish to see trade-by-trade information, and those interested in market-wide stability, where daily data on positions and collateral at a counterparty level may be more than sufficient. And a whole range of other data may be of no interest to regulators whatsoever.

The second key message is a strong preference for a **single, global solution**, bringing together different countries, regulatory bodies, counterparties and asset classes. This is clearly no small challenge, but the reasons for this conclusion are clear. Global markets need a global response. Gaps in data provision, for example the omission of major market players or key markets, create concerns about level playing fields, and risk giving firms to engage in so-called 'disclosure arbitrage'. And multiple overlapping data demands from different jurisdictions and regulators are costly and complicated to monitor. Even if this ideal is unattainable in its purest form, it is an important challenge to those seeking to improve transparency.

The third key message is the importance of **paying close attention to the operational and legal details involved with establishing a trade repository**. Who would run it? Where would it be located and how would the data be held? How would it be governed and funded? A particularly strong concern is ensuring consistency with contractual and legal obligations regarding data confidentiality: that only highly aggregated data are ever published, and that any repository is provided via a tried and tested solution with proven infrastructure and by a member-owned, not-for-profit operator. Much of the devil in implementation is in the (very) fine detail, including issues such as ensuring consistent legal entity identifiers, effective connectivity to member firms and so forth. These are all issues currently being discussed intensively by colleagues in the OTC derivatives markets, from whom there is much to learn.

The fourth key message is that **no transparency method can be a panacea** for regulators. There is a big difference between gathering large amounts of data and using it effectively to reduce financial stability risks.

It is risky for any regulator to be sitting on data that it cannot effectively analyse or act upon. This is not an argument against collection of granular data – far from it; rather, it emphasises the importance both of gathering the right data from the outset, and of ensuring regulators have the right aggregation and analytical tools for interpreting that data in an effective and timely way.

Where is this work likely to go next? The SLRC group stressed the importance of maintaining the momentum for change. As David Rule has explained, the FSB is now moving quickly towards its policy recommendation stage. The SLRC group has presented its findings to the FSB's transparency team – and has noted with interest the recent public comments from European policy makers including Vitor Constancio, Vice President of the ECB who recently gave a very thoughtful speech proposing a central database for euro repo markets.² Authorities in the United States have also made supportive noises. The SLRC stands ready to help inform regulatory initiatives as and when the scope of those initiatives becomes clearer.

I hope that in the short time available this gives some sense of the scope and nature of the SLRC's work in providing a neutral forum where all participants in these debates can exchange their views in an open and constructive manner. You can find out more about the Committee's work from the Bank's website, and I would encourage anyone with thoughts about future issues we might focus on to approach me or other SLRC representatives amongst you.

Thank you and I look forward to answering any questions you may have.

² 'Shadow banking – the ECB perspective' by Vitor Constancio, Vice-President of the ECB, European Commission Conference, Brussels, 27 April 2012.