ISLA

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Dear Sirs

CESR/ESCB Consultation on Draft Recommendations for Securities Settlement Systems

We thank you for the opportunity to comment on the above paper.

As in the past, we will confine our comments to Recommendation 5: Securities Lending. Our members are, almost without exception, parts of global financial institutions who will, either themselves or through relevant Trade Associations, be commenting on the broader aspects of your paper.

We note that the proposed wording of Recommendation 5 has not changed since it was last published and we continue to welcome the encouragement given to the practice of securities lending. We would like to think that the recommendation can be interpreted in the broadest sense. Originally, and by this we mean at least two decades ago, securities lending and borrowing was carried out merely to facilitate settlement of trades by market makers who were obliged to quote continuous two-way prices and who would not necessarily wish to buy in shares for temporary short positions caused by day-to-day trading. Since the rapid expansion of the markets from the late 1980s, securities lending and borrowing has been a key component allowing a wide number of trading strategies to be carried out in the certainty that stock will be available if necessary, not only to guarantee settlement but also to control risk. It is essential that support should be given to securities lending for all purposes.

Key Issues B, 2
We are aware that previous consultations have attracted some opposition to automated and centrally provided lending facilities. For our part, we continue to support such facilities, where the markets justify their provision and where there are satisfactory risk controls. We believe that bi-lateral and centrally provided facilities can, and do, co-exist to the benefit of all participants.

Key Issues B, 4
We fully support this recommendation and would welcome a wide adoption of more public material on the subject of securities lending. We believe that all parties to securities lending, for example, regulators, beneficial owners, asset managers, trustees, agents (custodians, third party agents and CSDs) and borrowers should have ready access to Best Practices and we would recommend the adoption/publication of such documents as the UK's Securities Lending and Repo Committee's Code of Guidance, a copy of which may be found here: http://www.bankofengland.co.uk/markets/gilts/stockborrowing.pdf.
We have also produced a series of Market Guidance papers, which may be found here: http://www.isla.co.uk/dynamic.aspx?id=52

Further papers will be published in due course.

Short selling

Many jurisdictions have introduced special, temporary regulations over the past three months. Whilst the general direction has been the same, our members have encountered a few regulators (for example Italy and Spain) who have imposed the regulations in such a way as to unnecessarily hamper the day to day lending for settlement purposes, and indeed have made trading in the normal course of business more difficult.

For example, it is normal practice for an asset manager to sell shares and advise his custodian accordingly. If the shares are on loan, the custodian will, on receipt of the settlement instruction, recall the shares (or more probably reallocate the loan to other lenders in a pool) on loan and deliver them on due settlement date. Some regulators have treated such sales as being naked short selling unless the shares are recalled, and in some cases redelivered, before the sale order is executed. Such are the practical difficulties in implementing such procedures that some lenders have withdrawn their stock from lending programmes, thus impinging on the general liquidity in the markets concerned.

We are very keen that all regulators should adopt convergent regulations that enable the lending market to function normally within any temporary or permanent restrictions.

We are of course aware of the work being conducted on short selling by, for example, IOSCO and CESR and, within the UK, FSA are due to publish a consultation within the next week or two. We are already liaising with these parties and very much hope that the resultant recommendations and implementation thereof locally will result in a harmonised environment in which securities lending can continue to play its important role in facilitating settlement and contributing to the liquidity of the markets.

We acknowledge that this response will be made public.

Yours faithfully

David Rule
Chief Executive
International Securities Lending Association

The International Securities Lending Association (ISLA) represents the common interests of lenders and borrowers of securities internationally. ISLA has more than 90 members comprising insurance companies, pension funds, asset managers, banks and securities dealers representing more than 4,000 clients. While based in London, the Association has members from more than 20 countries.