ICMA
International Capital Market Association

ICMA Regulatory Policy Newsletter

Quarterly Assessment – Issue No. 9: April 2008

Editor: Paul Richards

In this issue:

ICMA welcomes feedback and comments on the issues raised in the Regulatory Policy Newsletter. Please e-mail: regulatorypolicynews@icmagroup.org or alternatively the ICMA contact whose e-mail address is given at the end of the relevant article.

Achieving the pan-EEA securities market

Foreword by Lachlan Burn, Partner, Linklaters, and member of the ICMA Legal & Documentation Committee

Jawaharlal Nehru is quoted as saying "Failure comes only when we forget our ideals and objectives and principles". Let us then avoid failure by remembering the objective behind the European Union's Financial Services Action Plan – to create a true, cross-border EEA market for securities by sweeping away the multiplicity of different national laws and replacing them with a single set of rules, administered by a single "home" state.

It should be said at the outset that the Plan was a huge concept. 42 Directives is no mean legislative undertaking. Given the fragmented and often contradictory market practices among the Member States, it was often difficult – and sometimes impossible – to broker sensible compromises in hammering out a common, harmonised framework. It is perhaps a matter for congratulation that the Commission was able to do as much as it has achieved. However, those difficulties and compromises, together, in some cases, with imperfect implementation at national level, have produced flaws in the legislation that will continue to hamper the development of a pan-EEA market, unless they are recognised and removed.

A few examples must suffice to illustrate the point[1]. First, public offers. We now have a Prospectus Directive that makes significant changes in the way public offers of securities work, both in each Member State and across borders. Notably, one prospectus in one language will now satisfy the disclosure requirement in every EEA country. Or will it? In practice, you will often find that you have to satisfy additional requirements in the second country. For example, you may have to publish a notice, in a particular (and infrequently published) journal, saying where the prospectus can be obtained. Or, worse, in order to ensure that the contract with the retail investor is enforceable, you might have to translate the terms of the securities into the local language.

There is perhaps an even greater confusion in this area – namely whether you need a new prospectus for subsequent offers. Some countries interpret the Directive as requiring this; others say that the original prospectus, prepared for the first public offer or admission to trading, can be used for all subsequent public offers. Such divergent views will do little to develop a pan-EEA market.

Lachlan Burn, Partner, Linklaters, and member of the ICMA Legal & Documentation Committee

[1]More details can be found in an article I co-authored for the Capital Markets Law Journal (OUP) volume 2 number 3 at page 263.

Finally, an example from the medium term note market. MTNs account for the bulk of the issuance in the international fixed income market – a sizeable market, amounting to some US$11.5 trillion at the end of 2007. The whole point of the MTN market is to standardise documentation, so that issues can be made quickly as market opportunities present themselves. So, a base prospectus is prepared at the beginning of the year and approved by the relevant listing authority, permitting issues to be made during the year without the need for any further approval, thus saving cost and time. But all this is subject to the requirement to update the prospectus (and get a new approval) whenever there is a significant change. The question is, when is a change "significant"? Can one do an issue where the redemption amount is defined by a new and lengthy algebraic formula without getting a new approval? Do you need to go back for approval when you include an event risk put in a particular drawdown? Can you create an entirely new type of security, whose terms are not described in the base prospectus, without a new approval? The problem is that some listing authorities appear to take different views on these questions; and that makes it very difficult for those trying to organise cross-border retail offers.

So, it would be a mistake to think that the job is done and the market is now free to roam across the EEA, without undue let or hindrance. There is more to be done, if a true pan-EEA retail market is to develop. And where this cannot be done at European level (for example, because of the limited legislative powers of the Commission), law-makers and regulators should be persuaded to make changes at a national level. It would be a pity if the good progress made over the past few years failed to achieve the objective, for lack of a final push – or perhaps because, ignorant of Nehru's advice, we have forgotten our original objective.

Lachlan Burn
Partner, Linklaters

Inventory of practical steps in response to market turbulence

The global market turbulence since 9 August last year has proved as difficult for many market firms to manage as any previous episode that their senior managers can remember. This article provides an inventory of the practical steps being taken, either by the authorities or by the market itself in the form of market-led initiatives, in attempting to restore market confidence. (See also the box on the Financial Stability Forum Report on page 5, and the *Interim Report of the Institute of International Finance Committee on Market Best Practices*).

Market liquidity

The Bear Stearns case has demonstrated how quickly lack of liquidity can become a threat to solvency. More generally, commercial banks have often been reluctant to lend to the wider market or even to each other, except for short periods and at high rates, since the freeze in liquidity began. Central banks have therefore had a critical role to play in attempting to restore market confidence, without giving rise to moral hazard. They have attempted to do this, not just by cutting interest rates where feasible, with the Federal Reserve taking the lead. But they have also provided liquidity to the market, and found ways of providing it without attaching a stigma to its use. In addition, some central banks have extended the maturity at which liquidity is provided; extended the range of counterparties with which they are prepared to deal; and also extended the range of collateral they are willing to accept in exchange (at a price). A joint industry working group is recommending that the acceptance of broader and generally consistent types of collateral across different central bank systems on a readily usable basis would be an important step in restoring the health of the international financial system.

Market transparency

In some cases, policy makers appear to have been taken by surprise by the sudden onset of the liquidity freeze on 9 August, and consider that they do not receive sufficient information in particular from the securities markets. They have therefore encouraged market-led improvements in standards of market transparency, with the implication that, if they judge the improvements to be inadequate, a more prescriptive approach by the authorities themselves may prove necessary. For its part, the market believes that lack of transparency is not one of the main causes of recent market turbulence, and that there is a high level of transparency available to investors in securitisation markets already. But the industry recognises that improvements should be made, where this is practicable.

The joint industry letter of 8 February to the European Commission on transparency in securitisation markets is a good example of the industry's approach. This commits the industry: to develop guidelines of good practice in implementing the securitisation disclosure requirements in the Capital Requirements Directive; to provide consolidated data to the Commission in asset-backed commercial paper (ABCP), asset-backed securities and collateralised debt obligations markets on a regular basis; and to set standards of disclosure for investors – such as the Voluntary Code of Conduct on Disclosure in the ABCP Market in Europe (set out in draft in the January edition of this Newsletter), on which ICMA has been consulting the market and which is now being finalised.

Disclosure of losses

Since the market turbulence began, one of the main uncertainties overhanging the market has been where the losses lie. The authorities have been pressing market firms to disclose their losses. They are understood to consider that the sooner that market firms provide realistic market values for their assets and the uncertainties that surround these values, the sooner buyers will return and the market overhang will clear. Firms have responded by disclosing as much information as they can in their financial results. Separately, there has been an intense effort to prevent market abuse through the effect on share prices of spreading false rumours.

Valuation methods

Disclosure of losses leads on to the question of how to value securities, which are normally valued by marking them to market, when there is no longer a market. Valuation is a matter for individual market firms and their auditors. But an industry working group has been looking at the issue more generally. In normal markets, mark-to-market accounting has proved very useful in promoting transparency and market discipline. But when there is no liquidity in secondary markets, or liquidity is severely restricted, some market participants consider that marking to market has the potential to complicate valuation by creating self-reinforcing effects – eg by forcing firms to sell assets and mark them down further in a vicious circle. Some insurance companies are also concerned that marking their portfolios to market may distort their financial results, if they have no intention of selling their investments until maturity.

The authorities are understood to consider that firms which ordinarily look to prices established in liquid markets need to have in place methods for valuing assets when markets become illiquid; and that there should be greater disclosure of liquidity, correlation and volatility risk. The industry has therefore been discussing whether firms should provide greater disclosure of valuation methods and of the limitations of models, including adjustments and risk sensitivities. One of the issues being considered is whether the industry and the accountancy profession should discuss with providers of pricing information how disclosure could best be achieved without infringing any legal constraints. A separate issue for some firms has been an acute shortage of staff able to carry out manual valuations of a large number of highly complex bespoke structures.

Risk management

It is clear that supervisors will focus on

Inventory of practical steps in response to market turbulence - continued

the capacity of each firm as a whole to manage risk. This involves assessing firms' risk management capacity, but also the extent to which firms integrate risk assessments into their overall decision-making processes and controls, from board level downwards. And it involves assessing the effectiveness of firms' use of stress testing, a key element in risk management.

The authorities are understood to consider that larger and more robust liquidity buffers are necessary. Guidelines for managing liquidity risk are being revised both by the authorities and by the industry. And a joint industry working group is recommending that management needs to consider the risk of over-dependence on any single form of funding, including access to securities markets, in its day-to-day liquidity risk management.

The authorities are also understood to be planning to raise Basel II capital requirements for certain complex structured credit products. At European level, the Commission is expected later this year to adopt a proposal to amend the Capital Requirements Directive. The Commission is understood to believe that clearer rules are needed, *inter alia*, on: concentration risk; banks' trading book exposures; banks' liquidity requirements; and risk management standards for non-bank investors. And an amendment to the Accounting Directives is expected to oblige companies to disclose off balance sheet commitments in the notes to their accounts published from 2009 onwards.

Raising new capital

Some firms have needed to raise new capital – from existing shareholders or new investors such as Sovereign Wealth Funds – in response to the damage to their balance sheets arising from the market turbulence. Their balance sheets have been constrained by: write-downs of assets; the retention of assets that they would normally wish to sell but have not been able to do so; and decisions to take back, onto their own balance sheets, off-balance sheet vehicles they have created.

Credit ratings

The role of credit rating agencies (CRAs) has come under intense scrutiny, not least by the CRAs themselves (see box on page 6). At European level, the Commission expects the CRAs significantly to improve their practices dealing with conflicts of interest, ensuring transparency of the methods they use in deciding on ratings, improving the quality of ratings and ensuring that they have adequate resources. At global level, the International Organisation of Securities Commissions (IOSCO) has been considering amendments to its Code of Conduct on CRAs, focusing on: the quality and integrity of the rating process; independence and avoidance of conflict of interest; and responsibilities to the investing public and issuers.

Standardisation of documentation

Joint industry working groups have been set up, *inter alia:*

- to develop, to the extent possible, standardised global definitions of securitisation products in order to improve consistency between them and ensure that they are fully understood by investors;
- to consider whether the industry should assess the feasibility of introducing standardised offer documents for various types of structured products; and
- to consider whether standardised methods for determining weighted average life of instruments should be developed along the lines of existing methods used in the US for mortgage-backed securities.

Compensation

The industry has been considering whether to establish a code of best practice which would be designed to discourage banks from providing compensation incentives which are asymmetrical.

Early warnings

Finally, the authorities are understood to be considering whether securities regulators and supervisors can improve existing arrangements to share information with each other and with central banks on key firms through a more effective "early warning" system. And a joint industry working group is also recommending that a monitoring group should be set up to provide "early warning" of systemic issues affecting the industry in future.

Contacts: Paul Richards
and David Clark
paul.richards@icmagroup.org
david.clark@icmagroup.org

Financial Stability Forum Report

The Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience, dated 7 April, which has been endorsed by the Group of Seven Finance Ministers and Central Bank Governors, makes a number of recommendations:

Strengthened prudential oversight of capital, liquidity and risk management

- *Capital requirements:* Specific proposals will be issued in 2008 to: raise Basel II capital requirements for certain complex structured credit products; introduce additional capital charges for default and event risk in the trading books of banks and securities firms; and strengthen the capital treatment of liquidity facilities to off-balance sheet conduits. Changes will be implemented over time to avoid exacerbating short-term stress.

- *Liquidity:* Supervisory guidance will be issued by July 2008 for the supervision and management of liquidity risks.

- *Oversight of risk management:* Guidance for supervisory reviews under Basel II will be developed that will: strengthen oversight of banks' identification and management of firm-wide risks; strengthen oversight of banks' stress testing practices for risk management and capital planning purposes; and require banks to soundly manage and report off-balance sheet exposures. Supervisors will use Basel II to ensure banks' risk management, capital buffers and estimates of potential credit losses are appropriately forward looking.

- *Over-the-counter derivatives:* Authorities will encourage market participants to act promptly to ensure that the settlement, legal and operational infrastructure for over-the-counter derivatives is sound.

Enhancing transparency and valuation

- *Robust risk disclosures:* The Financial Stability Forum (FSF) strongly encourages financial institutions to make robust risk disclosures using the leading disclosure practices summarised in the FSF Report, at the time of their mid-year 2008 reports.

- Further guidance to strengthen disclosure requirements under Pillar 3 of Basel II will be issued by 2009.

- *Standards for off-balance sheet vehicles and valuations:* Standard setters will take urgent action to: improve and converge financial reporting standards for off-balance sheet vehicles; and develop guidance on valuations when markets are no longer active, establishing an expert advisory panel in 2008.

- *Transparency in structured products:* Market participants and securities regulators will expand the information provided about securitised products and their underlying assets.

Changes in the role and uses of credit ratings

- *Credit rating agencies* should: implement the revised IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies* to manage conflicts of interest in rating structured products and improve the quality of the rating process; and differentiate ratings on structured credit products from those on bonds and expand the information they provide.

- *Regulators* will review the roles given to ratings in regulations and prudential frameworks.

Strengthening the authorities' responsiveness to risks

- *A college of supervisors* will be put in place by end-2008 for each of the largest global financial institutions.

Robust arrangements for dealing with stress in the financial system

- *Central banks* will enhance their operational frameworks and authorities will strengthen their cooperation for dealing with stress.

Credit ratings

Credit ratings and Credit Rating Agencies (CRAs) have been under intense scrutiny since the global market turbulence began last August. Questions have been asked about rating quality. Some issues have been the subject of a drastic downgrade of several notches overnight. This has led to discussion about the methodology used by the CRAs. In addition, it has been argued that, especially when rating structured products, databases of defaults do not go back far enough and that, even if default probabilities are correct in a static environment, ratings do not capture changes in default probabilities in changing economic conditions and/or liquidity.

Questions have also been asked about the methodology used for rating corporate bonds in comparison with structured bonds. The recovery rate may be quite different between them even though they have the same rating. The lack of comparability may be a concern.

There has also been discussion about whether investors should rely less on ratings. Many are concerned that an environment has been created in which investors do not perform their own due diligence, and instead rely solely on the rating. This is linked to the question of a possible conflict of interest. The CRAs are paid by issuers, who would like a high rating, and not by investors, who would like an accurate rating.

Investors in AAA bonds want an asset which will maintain its value during difficult economic conditions. This has not been the case lately. Should the rating also address the likelihood of future rating changes? Is it sufficient for the rating of a security to be based on the assumption that economic conditions remain the same?

A key issue is whether CRAs should be more heavily regulated or whether the *status quo* should continue. Some regulators would like the CRAs to draw up their own code of conduct. At present, the major CRAs participate voluntarily in the IOSCO *Code of Conduct Fundamentals for Credit Rating Agencies*, as a result of which they report to the Committee of European Securities Regulators (CESR) on an annual basis on how they have complied with the standards set out in the IOSCO Code. In addition, last year the European Commission issued a request for CESR to review the role of the CRAs and whether recent developments should result in regulation.

As a follow-up to the annual report on CRAs' compliance with the IOSCO Code, CESR has asked four CRAs to answer 38 questions mainly relating to structured products. They include in particular:

- *Transparency of rating methodology:* how easily can investors access information on key limitations and assumptions in complex structured finance methodologies?
- *Human resources allocated to rating and monitoring:* are CRAs adequately resourced for the volume and complexity of structured finance rating they are producing?
- *Periodic monitoring of the ratings:* is there regular public disclosure of structured finance rating performance?
- *Methodology changes:* what procedures are followed when CRAs change their methodology and to what extent are these disclosed to investors?
- *Potential conflict of interest:* does the nature of CRA interaction with issuers lead to un-managed or poorly managed conflicts of interest leading to reduced rating integrity?

On 13 February, CESR published a Consultation Paper, *The Role of Credit Rating Agencies in Structured Finance.* The purpose of this paper is to seek market participants' views on the main issues raised by the Commission. The Consultation Paper, related press release and the earlier December CESR Report on CRAs can be found here. CESR has now published the responses to the Consultation Paper, and CESR is expected to report to the Commission before the end of May.

On 26 March, IOSCO published a Consultation Report, *The Role of Credit Rating Agencies in Structured Finance Markets*, prepared by its Technical Committee. The Report has two objectives: to provide analysis of the role of CRAs in structured finance markets and to make several recommendations for modifying the existing IOSCO CRA Code of Conduct. The deadline for comments is 25 April.

The CRAs themselves have taken very seriously the criticisms that have been made, and are currently working on measures to be taken to regain investors' confidence. Standard & Poor's has, for example, created a new website on steps to be taken to strengthen the ratings process and better serve the market.

Contact: Kristin Selnes:
kristin.selnes@icmagroup.org

Implementation of the Statutory Audit Directive

In June, the Statutory Audit Directive will be implemented in the EU. The Directive creates a framework for regulating and supervising audit firms and their statutory audit services. It will, however, also have an impact on issuers accessing European securities markets, namely issuers from non-European countries and special purpose vehicle (SPV) issuers.

Non-European issuers

A specific regime will apply to non-European audit firms auditing non-European issuers admitted to trading on European regulated markets (unless they are issuers of above-€50,000 debt only). Such an audit firm will need to register in the relevant Member State and will be subject to regulation and supervision in that Member State. Failure to register invalidates, in that Member State, audit reports of annual or consolidated accounts issued by such an audit firm. This would, among other things, make it very difficult for non-European issuers to comply with their reporting obligations under the Prospectus and Transparency Directives.

This regime may, however, be disapplied if the regulatory regime in the relevant third country is equivalent and if there is reciprocity. The Commission has tentatively assessed 37 third countries. In January, it proposed to grant them a transitional period until the end of 2010. During this period, the new regime will not apply if the audit firm is from one of the recognised third countries and supplies the European authorities with certain information. The proposal is still subject to discussion and the final decision is expected ahead of the June implementation of the Directive.

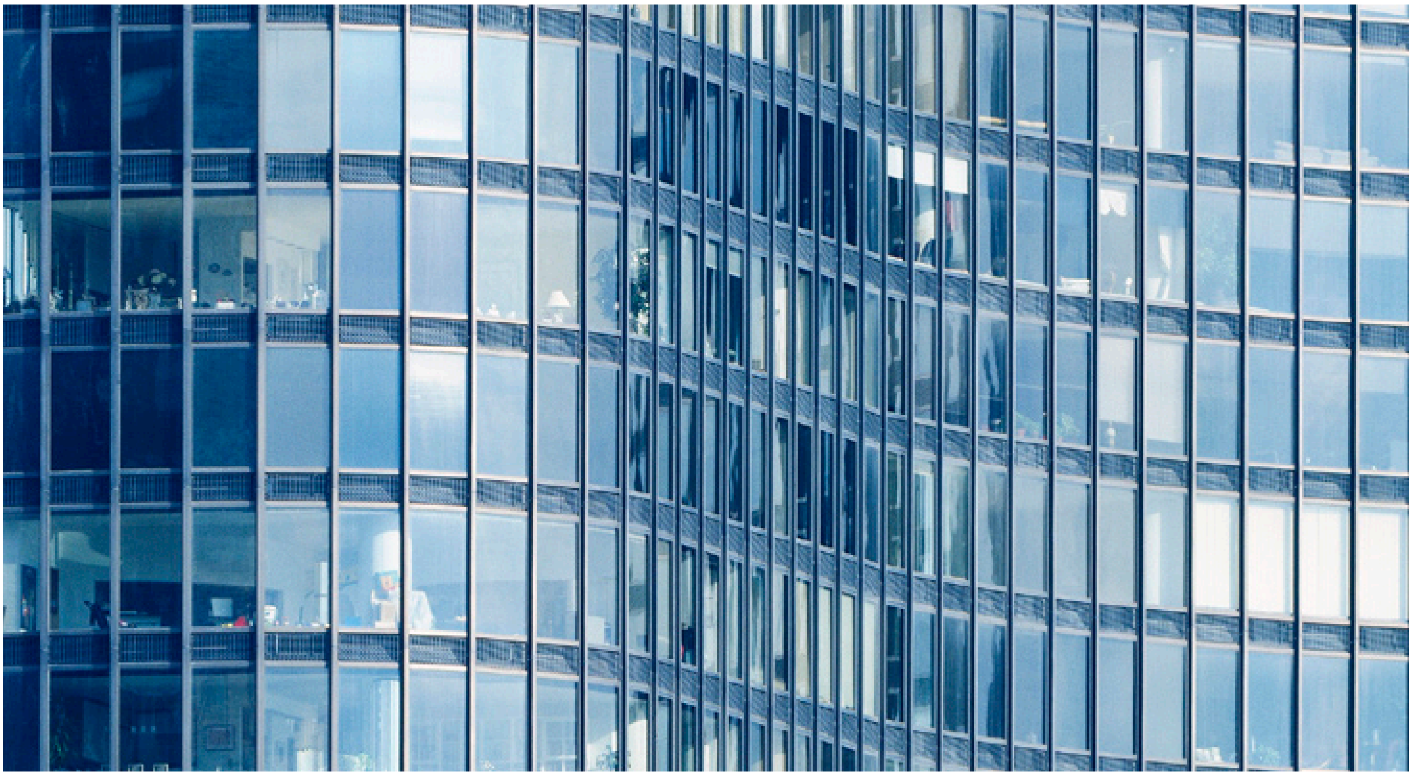
Non-European issuers and their advisers will need to investigate the final transitional rules, the applicable national rules implementing the Directive and the status of the audit firm auditing the issuer, and to analyse the impact they will have on both contemplated and outstanding issues of the issuer.

SPV issuers

The Directive designates certain issuers as "public interest entities" and imposes on them an obligation to have an audit committee fulfilling certain functions. Public interest entities include all European-incorporated companies admitted to European regulated markets. Member States may exempt certain entities, most importantly SPVs issuing asset-backed securities, from this obligation.

On transactions involving SPVs, it will be necessary to analyse which Member State's implementing rules apply (this should in principle be the Member State where the SPV is incorporated); whether they exempt SPVs or not; and, if they do, what disclosure requirements they impose on them.

Contacts: Ruari Ewing and Ondrej Petr
ruari.ewing@icmagroup.org
ondrej.petr@icmagroup.org



State guarantees

The European Commission has published a revised draft of a notice on the application of the EC state aid regime to guarantees. The notice will be very important for all issuers who benefit from state support.

Building on our detailed response to the first draft of the notice, we have made a brief submission which commends the Commission for the improvements made and suggests further areas where more clarity would be helpful. It also highlights certain wider policy implications of the debate which should be subject to further discussion.

Contacts: Ondrej Petr
and Annina Niskanen
ondrej.petr@icmagroup.org
annina.niskanen@icmagroup.org

"Substitute" retail investment products

In the January edition of the Newsletter, we reported on the European Commission's Call for Evidence on the need for a coherent approach to product transparency and distribution requirements for "substitute" retail investment products.

Together with other associations which support the Joint Associations' Committee on Retail Structured Products, we have submitted an extensive response which summarises the regulatory frameworks of the key retail investment products, explains the differences between the products as well as differences in the approach to their regulation and argues against harmonisation which would disregard these differences.

Contacts: Ondrej Petr
and Annina Niskanen
ondrej.petr@icmagroup.org
annina.niskanen@icmagroup.org

Preparation for the review of the Prospectus Directive

In anticipation of the formal review of the Prospectus Directive, we have sent the Commission a letter which summarises, in generic terms, our key proposals.

Contacts: Ondrej Petr and Kristin Selnes
ondrej.petr@icmagroup.org
kristin.selnes@icmagroup.org

Disclosure of contracts for difference in the UK

Together with the Securities Industry and Financial Markets Association (SIFMA), with whom we convene a joint major shareholding disclosures working group, we responded to the UK FSA's consultation on introducing a "super-equivalent" disclosure regime for contracts for difference (CfD) in the UK.

We do not believe that sufficient evidence of market failure has been presented to justify increased disclosure of CfD positions and are concerned that any benefits of such increased disclosure would not outweigh the considerable costs of its implementation. Building on the expertise of the working group members, we made a number of specific suggestions which we believe should be considered in further discussions of this difficult topic.

Contacts: Ondrej Petr and Ruari Ewing
ondrej.petr@icmagroup.org
ruari.ewing@icmagroup.org

Review of the UK listing regime

The UK FSA is consulting on a possible review of the UK listing regime. This currently consists of several separate segments with different standards. Concerns have been expressed by some market participants that this may lead to misunderstandings. The FSA has invited comments on several options intended to address these concerns and a number of other questions concerning the listing regime.

We believe that no changes to the substance of the listing regime are needed or indeed desirable. Specifically, we are concerned about the adverse impact that some of the proposed options might have on issuers and investors as well as the competitiveness of the UK market generally. We would not, however, object to relabelling of the listing segments to highlight the differences between the applicable standards. We have submitted a response to this effect together with the British Bankers' Association (BBA).

Contacts: Ondrej Petr and Annina Niskanen
ondrej.petr@icmagroup.org
annina.niskanen@icmagroup.org

UK listing regime at a glance

In the UK, the FSA, acting as the UK Listing Authority (UKLA), grants listing status. There are several distinct listing segments:

- Primary listing of equity securities required for UK and optional for overseas companies which, in both cases, satisfy stricter UK standards additional ("super-equivalent") to those set out in the EU directives.
- Secondary listing of equity securities available to overseas companies, where generally only the requirements of the EU directives apply.
- Listing of global depositary receipts (GDRs), debt securities and securitised derivatives, where generally only the requirements of the EU directives apply.

Updating ICMA's secondary market Rules and Recommendations

The Rules and Recommendations of the ICMA have been in existence for many years and have formed the basis of the orderly development of the international debt securities market, trading between members of the ICMA and between members and other professional market participants, and clearing and settlement of trades. The Rules and Recommendations have made a major contribution to the success of the international debt securities market and its recognition by legislators and regulators as Europe's and the world's most integrated cross-border securities market. Key to this success has been the active contribution of the ICMA members in the evolution of the Rules and Recommendations through committees such as the Market Practices Committee, the Committee of Reporting Dealers and the International and European Repo Committees.

Over the years, the Rules and Recommendations have been amended on many occasions to take account of market developments but have not been subject to a major "root and branch" review since June 2000. ICMA's Board has agreed that the time is right to carry out a "root and branch" review of the Rules and Recommendations on secondary market practice, for two main reasons:

- The enormous changes in the market in the last five years, such as the growth of the credit default swaps (CDS) market, high yield bonds and complex structured products alongside plain vanilla fixed incomes securities, and their interaction with over-the-counter and on-exchange derivatives, require the Rules and Recommendations to be assessed for their on-going relevance as the core determinant of inter-professional conduct in the secondary market for international debt securities.

- The regulatory landscape has substantially changed in Europe over the same period with the introduction of numerous and complex EU directives intended to bring greater harmonisation of legislation governing primary market issuance and secondary market trading and to create a single integrated European capital market. On the primary market side, the IPMA Handbook has been amended to deal with changes brought about by new EU legislation. With the implementation of MiFID in November 2007, we need to consider whether the same process needs to be undertaken with the Rules and Recommendations in the secondary market, while recognising that the Rules and Recommendations focus on transactions between counterparties rather than between counterparties and clients.

To the greatest extent possible, any changes to the Rules and Recommendations should be consistent with other rules, guidelines and best practices in the market. Internally, the Rules and Recommendations in the secondary market should be consistent with the IPMA Handbook (Primary Market) as well as the Repo Guidelines. Externally, the review will consider how best to secure consistency with relevant rules, guidelines and best practices issued by other trade associations and similar institutions.

A Secondary Market Working Group has been set up under the chairmanship of Michael Ridley of JPMorgan to make recommendations. The Regulatory Policy Department of ICMA is providing secretarial and other necessary support. Individuals from member firms with a wide range of front, middle and back office expertise are encouraged to participate in the Working Group. For more information, please e-mail Kristin Selnes at ICMA.

Contacts: Kristin Selnes, Richard Britton, André Seiler and Paul Richards
kristin.selnes@icmagroup.org
richard.britton@icmagroup.org
andre.seiler@icmagroup.org
paul.richards@icmagroup.org

The European Repo Council and Committee

On 13 March, the European Repo Council (ERC) held its Annual General Meeting in Paris in the context of the Euroclear Collateral Solutions Conference. The ECB presented the Target-2 Securities project and Correspondent Central Banking Model (CCBM2) in the context of the repo market. The European Commission presented its policy response to the financial turmoil. An update was presented of the available Global Master Repurchase Agreement (GMRA) opinions. 61 jurisdictions are now covered – most recently: Anguilla, Croatia, Dubai, Iceland, India and Israel.

The Council members also elected the 19 members that will compose the ERC Committee, a sort of steering committee. The group of 19 practitioners meet regularly to discuss market developments. One of the reasons for the establishment of the ERC has been that the leading practitioners did not feel that their practical day-to-day issues were fully understood and dealt with adequately through existing organisational structures.

The latest European repo survey was presented at the AGM. The 14th survey results show resilience of the European repo market. The survey is based on responses from a sample of financial institutions throughout Europe. They were asked for the value of their repo contracts that were still outstanding at close business on 12 December 2007. The figure for total market size, calculated from a consistent sample of banks that have participated in each survey shows a relatively small decline of 11.7% in the collective size of their repo books since the June 2007 survey, indicating a more cautious approach to risk and a reduced requirement for repo financing.

The next survey is scheduled to take place at close of business on Wednesday, 11 June 2008 and will be presented at the next ERC Council meeting to be held on 9 September 2008.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Bond market transparency for retail investors

The European Commission has published its long awaited Report on Bond Market Transparency. The Report finds no evidence of significant market failure in the wholesale European bond markets though some evidence of sub-optimalities in the market for retail investors. The Commission makes extensive references to ICMA's Standard of Good Practice on Bond Market Transparency for Retail Investors as well as ICMA's Retail Investor Bond Information Service.

ICMA's Retail Investor Bond Information Service has been operational since last December and can be found at www.bondmarketprices.com. The service, which is free of charge, is produced by ICMA's market services company Xtrakter Ltd, using data from its TRAX2 trade reporting service as well as closing price data provided by ICMA Reporting Dealers. The service is based on the Standard of Good Practice on Bond Market Transparency for Retail Investors drawn up by ICMA.

The Standard was produced in response to calls for greater post-trade transparency and consequently the service focuses on post-trade reporting of trades in retail size (€15,000-€1 million or equivalent in other currencies). Bonds covered by the standard are those rated A- or better and with an issue size of €1 billion or equivalent. As a consequence of recent market turbulence, the number of bonds for which trades are reported has oscillated sharply on a daily basis. In addition to daily high, low and median trade levels, the service also reports average closing bids and offers of Reporting Dealers and average turnover recorded for trades in the reporting size range, in the second preceding month.

ICMA is encouraging other trade associations and banks to comply with the Standard. Two active regions for retail investors are the Nordic area and Italy: price and other information on Nordic bonds can be obtained through the OMX website; in Italy local regulation requires banks to provide post-trade information on bond transactions. A good example of the information provided can be seen on the website of Banca Nazionale del Lavoro.

It is intended to carry out a review of the www.bondmarketprices.com service after its first year of operation as well as of the implementation of ICMA's Standard of Good Practice. Information about other European bond market transparency services suitable for retail investors as well as comments on the existing www.bondmarketprices.com service may be sent to david.clark@icmagroup.org.

Contact: David Clark
david.clark@icmagroup.org

UK telephone recording regime

The UK FSA issued in March new rules on recording of telephone conversations and electronic communications.

The FSA has identified the prevention, detection and deterrence of market abuse as one of its key priorities. Accordingly, the FSA considers that voice recordings and records of electronic communications may be of assistance in its investigations of market abuse cases and enforcement. In a Consultation Paper, the FSA proposed that it would record lines used for voice conversations that involve the receipt of client orders and the negotiating, agreeing and arranging of transactions across the equity, bond, financial commodity and derivatives markets, and that electronic communications relevant to these activities should be retained.

Following concerns expressed by the industry, *inter alia* related to the soundness of the cost-benefit analysis and practicalities of the proposal, the FSA explained in a Policy Statement that it would take more time to determine the correct approach in this area. The FSA recently published result of a new cost-benefit analysis.

The new rules will be applicable from March 2009. Firms will be required to record all telephone conversations and electronic communications relating to client orders and the conclusion of transactions in the equity, bond and derivative markets. The period of retention will be six months, significantly down from the original proposal of three years. Mobile phone conversations have been exempted from the taping rules but this will be reviewed in 18 months. In addition, discretionary investment managers will not be required to record telephone conversations and electronic communications with firms that are subject to the taping rules.

Under Article 51 of the MiFID implementing Directive, the European Commission is to report before 31 December 2009 in the light of CESR advice on the appropriateness of the discretion Member States have over introducing telephone recording requirements. Telephone recording is an item of high importance in the CESR workplan for 2008, and is likely to be addressed in the fourth quarter.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

ICMA's Asset Management and Investors Council

The newly-formed Asset Management and Investors Council (AMIC) met for the first time on 7 March at ICMA's offices in Zurich. The purpose of the Council is to represent the views of the buy-side members of ICMA and discuss asset management issues of common interest. This may *in fine* include proposing market-led initiatives and market practice guidelines, where these are appropriate, and responding to consultation papers from regulators. The focus will be on asset management in Europe, while recognising that asset management is a global business. Six objectives have been identified by the Chairman, Robert Parker, Vice-Chairman of Credit Suisse Asset Management:

- The AMIC should support and promote the success of the asset management and investment business.
- The AMIC should act as a think tank, identifying the key trends in the industry. This would include the publication of position papers.
- The AMIC should highlight problem areas in position papers, and propose market-led initiatives to address them.
- The AMIC, representing the buy side, should engage with the sell side through ICMA, which has both buy-side and sell-side committees, while recognising that Chinese walls should be put in place to avoid conflicts of interest.
- The AMIC should have a proactive relationship with regulators at international, European and national levels.
- The AMIC should establish contact with organisations focusing on the education of the industry like the Chartered Financial Analyst (CFA) institute, and should assist such bodies where feasible.

ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation. Buy-side and sell-side members within ICMA are both entitled to have their views represented separately (eg to the European Commission and CESR), where they wish to do so. ICMA is also keen to encourage dialogue between the buy-side and sell-side, where both sides consider this appropriate.

Contacts: Nathalie Aubry
and Paul Richards
nathalie.aubry@icmagroup.org
paul.richards@icmagroup.org

Sovereign Wealth Funds

Following recent acquisitions of stakes in diverse financial institutions on both sides of the Atlantic, Sovereign Wealth Funds (SWFs) have attracted both media attention and political scrutiny. The European Commission defines them as state-controlled investment vehicles funded by foreign-exchange assets. To avoid confusion, the IMF has categorised sovereign wealth funds according to their dominant objectives:

- *stabilisation funds* are set up by countries rich in natural resources to insulate the budget and economy from volatile commodity prices (usually oil). The funds build up assets during the years of ample fiscal revenues to prepare for leaner years;
- *savings funds* are intended to share wealth across generations. For countries rich in natural resources, savings funds transfer non-renewable assets into a diversified portfolio of international financial assets to provide for future generations, or other long-term objectives;
- *reserve investment corporations* are funds established as a separate entity either to reduce the negative cost-of-carry of holding reserves or to pursue investment policies with higher returns. Often, the assets concerned are still counted as reserves;
- *development funds* allocate resources for funding priority socioeconomic projects, such as infrastructure;
- *pension reserve funds* have identified pensions and/or contingent-type liabilities on the government's balance sheet.

When the G7 first discussed SWFs in October 2007, they commissioned the IMF, the World Bank and the OECD to look at these issues. The European Commission has published in this context a Communication that may eventually lead to a voluntary global code of conduct for SWFs. The Commission is proposing a set of principles for transparency, predictability and accountability that would apply to the SWFs themselves as well as to donor and recipient nations. In practical terms it is intended to include an annual statement of a fund's investments, details on the size of its resources and information on any voting rights it exercises.

The Commission's proposal is an attempt to set out ground rules for SWFs. José Manuel Barroso, the European Commission President, has explained: "The current financial turmoil shows that Sovereign Wealth Funds can help stabilise financial markets. We want to maintain an open investment environment, in Europe and worldwide. But we cannot allow non-European funds to be run in an opaque manner or used as a tool of geo-political strategy".

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Standardising the process of servicing international securities

The International Central Securities Depositories (ICSDs), Clearstream Banking, Luxembourg, and Euroclear SA/NV, have set up the International Securities Market Advisory Group (ISMAG) to help improve standards for the issuance and asset servicing of international securities deposited with the ICSDs.

The ISMAG is comprised of senior representatives of issuers, lead managers, paying agents, ICSDs and investors and trade associations such as Association of Global Custodians, ICMA and the International Capital Markets Services Association.

Background and objectives

Many market participants feel that there are still too many manual processes in the issuance and servicing processes of the international securities. At the same time, volumes are increasing and the securities are becoming more complex.

Harmonising issuance practices, information dissemination and processing of corporate actions and income distributions would increase processing efficiency and enable straight-through-processing (STP). It would also produce cost savings for the parties involved and improve investor satisfaction. At the same time, it should not constrain financial innovation and flexibility of market practices.

The practical steps and working groups

It is planned that the ISMAG project should be carried out in stages with the objective of completing it in 2010.

Two working groups have been formed to work on aspects of the project in more detail, one focusing on new issues processes and the other on corporate actions. Both are composed of senior operational experts from the market. The working groups will identify inefficiencies in current operational processes and agree upon short- and long-term solutions to increase efficiency and eventually introduce STP between the market participants.

The new issues working group is focusing on the flow of information and documentation during the issuance process. The corporate actions working group is focusing on income events as well as corporate actions during the lifetime of the security. ICMA is involved in both of the working groups as well as on the overall ISMAG Steering Committee.

For further information on ISMAG, please see the Euroclear and Clearstream websites or alternatively contact the Regulatory Policy Department at ICMA.

Contacts: Ruari Ewing
and Annina Niskanen
ruari.ewing@icmagroup.org
annina.niskanen@icmagroup.org

Clearing and settlement: ECB consultations

Following the Target-2 Securities (T2S) draft User Requirements Document, on which consultation ended on 2 April 2008, the ECB published a related consultation on the economic analysis impact. In this consultation, the ECB asked central securities depositories and users to assess the economic impact of T2S on their business. Responses are expected to be returned to the ECB by 15 April 2008 and will be aggregated together to form the basis for the calculation of the economic impact of T2S.

Related to the T2S project is CCBM2: the review of the Correspondent Central Banking Model forms part of the Eurosystem collateral management handling procedures. The ECB launched its consultation on the draft CCBM2 user requirements, with a deadline for responses by 5 May 2008. In the light of the comments received, the Eurosystem is expected to submit a proposal for the CCBM2 user requirements to the Governing Council.

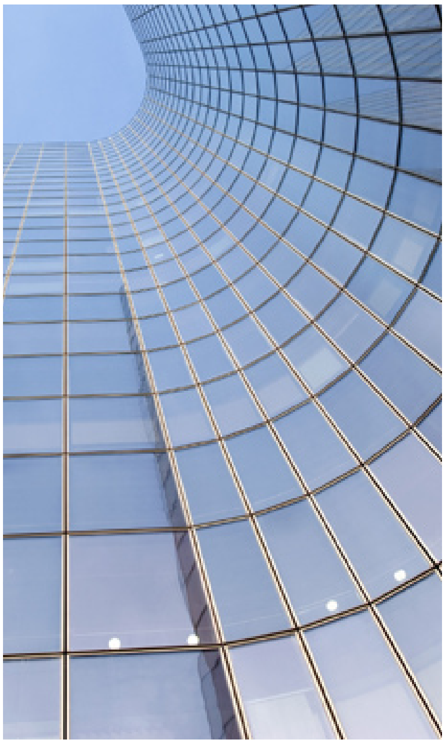
Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Clearing and settlement: Code of Conduct

At the January Monitoring Group (MOG) meeting in Brussels, the European Commission called for more evidence from the market infrastructure providers on the steps they are taking to realise the implementation of the third phase of the Code – namely service unbundling and accounting separation. The MOG also considered the implementation of the other two phases of the Code of Conduct – price transparency and access and interoperability.

The extension of the Code to non-equity markets was also discussed. The Commission noted that there was little support for an extension to fixed income, and mixed views as regards exchange-traded derivatives and over-the-counter derivatives. Moreover, any extension of the cash equity code should not jeopardise its success. The next MOG will take place in April.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org



IOSCO meeting with financial market stakeholders

On 20 March in Paris ICMA joined a number of other associations representing the buy side, sell side, self-regulatory organisations, exchanges and accountants in a day long, wide ranging and fruitful discussion with IOSCO's Technical Committee. IOSCO sought input into its report on the market turbulence issues requested by the Financial Stability Forum and on its ongoing work programme. All agreed on the objective - to restore investor confidence in the market. Present were the Chairs of the two special Task Forces set up to deal with the market turbulence issues and the Chairs of the five Standing Committees which undertake IOSCO's regular work programme: accounting, markets, investment firms, enforcement and collective investment schemes.

The Credit Rating Agency Task Force (chaired by the Securities and Exchange Commission) disclosed that it was shortly to publish (and has now published) a Consultation Paper which discusses changes to the IOSCO Code of Conduct (see above), issues around the use of ratings in the regulatory process (eg Basel II), a possible differentiation between corporate bond and structured product ratings and proposals to deal with conflicts of interest in the rating process for structured products.

The Sub-Prime Task Force (chaired by the Autorité des Marchés Financiers) is considering a range of issues concerning transparency, valuation and accounting.

Stakeholders' views were sought on the transparency of structures and transparency of the originators including their exposures. René Karsenti described the ICMA draft ABCP Code of Conduct to improve information for investors and referred to the work ICMA is doing with other associations in Europe in responding to the European Commission's concerns on securitised products. Richard Britton observed that the current regulatory distinction between private placements and public issues has served the corporate bond markets in Europe and the US very well and this needs to be kept in mind in the debate.

In the discussion on valuation and accounting issues stakeholders highlighted the complex nature of the problems. We noted that a debate has begun as to whether current Fair Value Accounting (FVA) methodology is appropriate in extreme circumstances. It was noted by one association that one result of the rigid application of FVA is that currently capital rich institutions are able to buy good quality assets very cheaply while capital constrained institutions are forced to sell those assets at distressed prices. This led to an interesting discussion on whether there is indeed a current mismatch between the likely cash flows from structured products and the market price, and if so why that has happened.

Discussion on IOSCO's draft work programme focused on several topics which were the subjects of an extensive work programme by sell-side firms during 2007.

- *Standardising disclosure of significant shareholdings.* Industry representatives offered assistance in providing comparative analysis, noting that not only does the present situation create large frictional costs for the industry in cross-border business, it also creates serious problems for regulators in identifying and pursuing market abuse.
- *Fixed income markets.* Richard Britton reported on industry driven initiatives since IOSCO completed its internal report on bond market transparency in 2006 and in particular the European Standard of Good Practice on Bond Market Transparency for Retail Investors and www.bondmarketprices.com.
- *Standardisation of investor definitions.* For firms doing cross-border business this is a high priority topic, though one stakeholder representative commented that domestically focused firms particularly in Europe are reluctant to see more regulatory change in the near term.
- *Mutual recognition.* There was a useful discussion on recent developments that have taken place on a multilateral and bilateral basis.

In conclusion the Secretary General of IOSCO thanked stakeholders for their comments which will be fully considered in completing its report to the Financial Stability Forum and in finalising its 2008/9 work programme.

Contact: Richard Britton
richard.britton@icmagroup.org

EU/US harmonisation

As anticipated in the January edition of this Newsletter, the EU-US Coalition on Financial Regulation (involving various industry associations, including ICMA) announced the publication of its Second Report, *Mutual Recognition, Exemptive Relief and "Targeted" Rules' Standardisation: the Basis for Regulatory Modernisation.* The Coalition will now meet various EU and US regulators and legislators with an interest in this area to brief them on the report. Separately, the US Securities and Exchange Commission made a general announcement on 24 March concerning its long-awaited proposals for amendments to its rules, including US investor access to foreign-broker dealers. Further releases are expected to provide further detail on the proposals. In the background to these developments, the US Treasury recently announced its release of a blueprint for a modernized financial regulatory structure – internal US reform will be a factor in the ongoing transatlantic equation.

Contact: Ruari Ewing
ruari.ewing@icmagroup.org

Islamic finance

ICMA continues to cooperate with the International Islamic Financial Market (IIFM) to assist market practice in this area. Two projects envisaged in the July 2007 edition of this Newsletter are currently underway. First, concerning the development of an Islamic repo-type agreement, a small group of banks led by UBS's Ismail Dadabhoy (with some preliminary *Sharia* input via IIFM) has been involved in complex discussions over various possible structures since the autumn of 2007. These discussions are ongoing and it is intended that a proposal may be published in due course for wider market contribution. Second, concerning primary market practices relating to *sukuk* issuance, an initial draft discussion paper was prepared in January 2007 and, once revised, will serve as the basis for initial small group discussion prior to publication for wider market contribution.

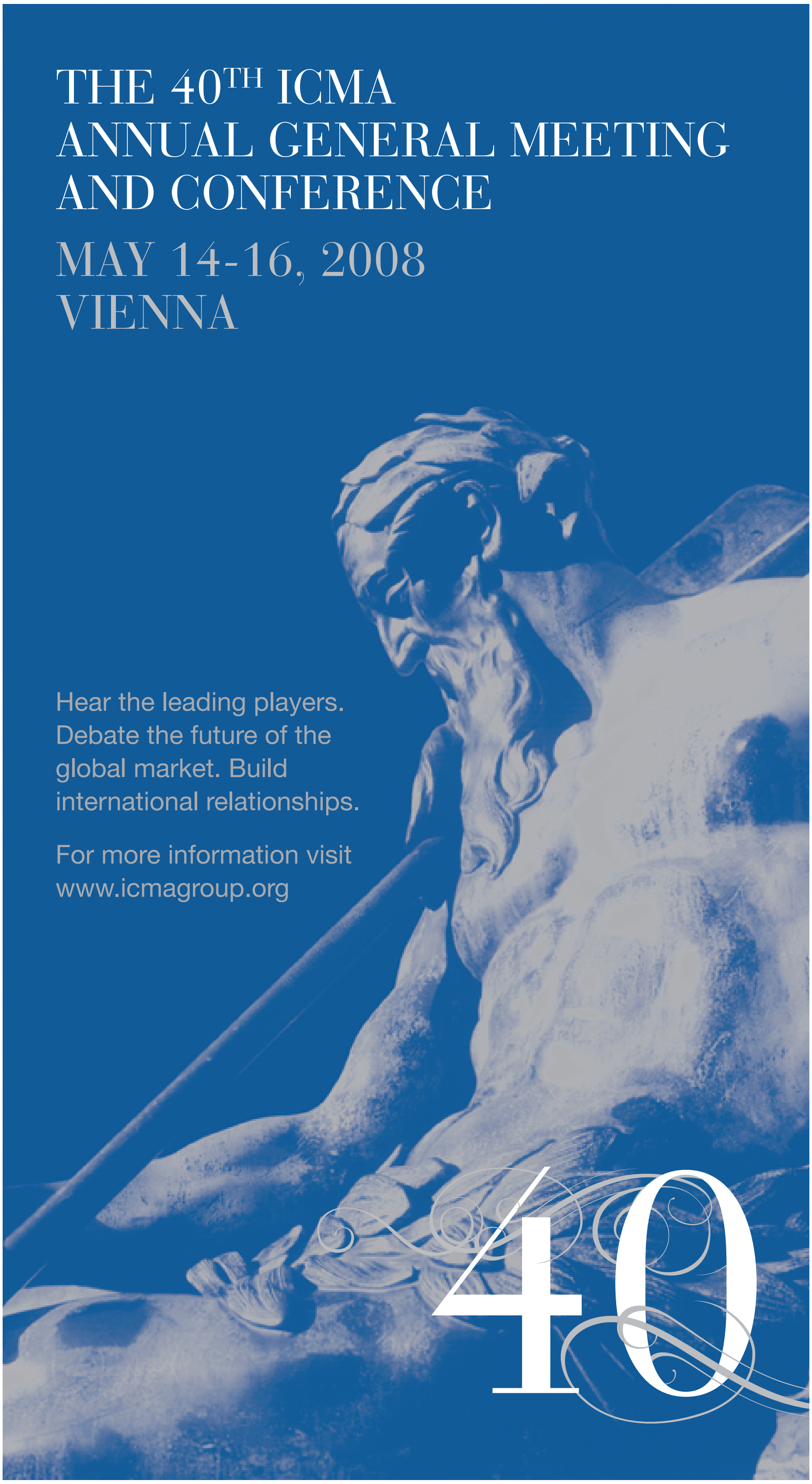
Separately, ICMA has been involved, since summer 2007, in detailed discussions with the Bahrain Institute of Banking & Finance to develop conventional and Islamic primary market practices courses for delivery in Bahrain – hopefully in the 3rd or 4th quarters of this year. IIFM and ICMA are also helping market practitioners to clarify market workings and dynamics in discussions with *Sharia* scholars.

Contact: Ruari Ewing
ruari.ewing@icmagroup.org

Hedge funds and private equity

As anticipated in the January edition of this Newsletter, the report of Sir Andrew Large's Hedge Fund Working Group has been published and a new Hedge Fund Standards Board set up to act as custodian of the standards.

Contact: Ruari Ewing
ruari.ewing@icmagroup.org



ICMA AGM and Conference, 14-16 May, Vienna

The packed two day conference programme for ICMA's Vienna event incorporates debates on the issues facing the global capital markets today, including the immediate risks to stability of the markets and the market response to global turbulence.

The conference will open with a keynote address by Jean-Claude Trichet, President of the European Central Bank and continue with contributions from leading industry figures, central bankers and regulators.

On the list of more than 50 eminent speakers are: Mag. Wilhelm Molterer, Finance Minister of Austria; Yves Mersch, President of the Central Bank of Luxembourg; Eugene Rotberg, Former Vice President and Treasurer, the World Bank; Ian Plenderleith, Former Executive Director, Bank of England; Louis de Montpellier, Deputy General Manager of Banking, Bank for International Settlements; Robert Parker, Vice-Chairman, Credit Suisse Asset Management; Sir Andrew Large, Chairman, Hedge Fund Working Group and Former Deputy Governor, Bank of England; Hans-Joerg Rudloff, Chairman of Barclays Capital; Patrick Butler, Head of Treasury and Global Markets, Raiffeisen Zentralbank Österreich AG; Jean-François Boulier, Chief Investment Officer, Aviva France; David Lawton, Head of Markets Infrastructure and Policy, Financial Services Authority; and Ijlal Alvi, Chief Executive Officer, International Islamic Financial Market.

The sessions will cover: the capital markets: a retrospective of the past 40 years; market transparency; improving international securities processing efficiency; the competitive market after MiFID implementation; the changing role of investors; the advantages of secured finance; developments in the Islamic finance industry; and the realignment of short-term debt markets.

The conference is open to all ICMA members and also to other market participants involved in asset management, compliance and regulatory affairs, debt issuance and trading. Delegates from central banks, regulatory authorities and law firms are also welcome.

Please see the ICMA website at www.icmagroup.org for the full programme and registration details.

Closer co-operation with securities market associations in Japan and Russia

As part of its continuing commitment to the development of internationally recognised common practice and market standards ICMA has recently signed agreements to formalise its relationships with trade associations in both Japan and Russia which will enhance collaboration between their members and ICMA's international membership.

The Japan Securities Dealers Association (JSDA) functions both as a self-regulatory organisation and as a trade association in the Japanese securities market. Today JSDA comprises more than 500 members consisting of securities firms and other financial institutions operating securities business in Japan. Initially ICMA and JSDA will establish an exchange of information on the securities and capital markets that each association represents, on the following topics: law and regulation, including self regulation; planning, development and operation of efficient trading practices and mechanisms; clearing and settlement procedures; and accreditation and training for market professionals.

Over recent years, ICMA and the National Securities Market Association (NSMA), a self-regulatory organisation of major Russian securities market participants numbering about 250 firms, have undertaken a series of joint projects in support of the development of the Russian repo market, including the first publication of the Global Master Repurchase Agreement (GMRA) in Russian and its distribution to the Russian financial market, the development and use of NSMA's Global Master Repurchase Agreement (based on ICMA's GMRA which was adapted to suit Russian regulations and market practice) and the introduction of the ICMA-NSMA Professional Repo Market Course. The recently signed Memorandum of Cooperation will allow the two associations to expand their joint activities related to development of the Russian financial market in line with international best market practice.

ICMA Skills

ICMA Skills is a new suite of training programmes for members and non-members focused on developing those skills in the capital markets, which will enhance our members' business practices and contribute to their profitability. These skills encompass sales and marketing, client relationship management, presentation and negotiation, and, perhaps most importantly, management and leadership.

Drawing on best market practice and a faculty of internationally recognised business skills trainers, ICMA Skills will provide skills training directly dedicated to the needs of the international capital markets. Classes will be limited in size, highly interactive, with a focus on individual exercises and role plays to develop key skills.

Courses will run in the second half of 2008, for more details see box.

ICMA Skills' courses can also be delivered on an in-house basis and targeted to suit a particular member firms' needs, offering a very cost effective option to a public course. Contact Chris O'Malley, Head of Faculty, ICMA Skills, to discuss bespoke in-house ICMA Skills courses covering one to 5 days.

ICMA Skills courses

Successful Sales
3 to 5 September 2008
London

Mastering Mandates
2 to 4 December 2008
London

Management and Mentoring
9 to 11 December 2008
London

ICMA Education courses

Primary Market Certificate (PMC)
9 to 13 June 2008
London, UK

ICMA Professional Repo
Market Course
13 to 14 November 2008
Brussels (hosted by Dexia)

Published by:
Corporate Communications
International Capital
Market Association Limited
7 Limeharbour
GB-London E14 9NQ
Phone: +44 20 7538 5656
Fax: +44 20 7538 9073
info@icmagroup.org