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Fiduciary trust

Foreword by John Nugée

Finance is an industry which relies on two qualities above all else: the financial soundness of its institutions, and the confidence of society in the ethical standards of those working in it, what one might call fiduciary trust. It seems to me that the current financial crisis has gone on for so long, and has proved so difficult to solve, because the crisis has severely damaged not just one of these two qualities but both. Too many of our institutions are still financially unsound and, in the eyes of many in the general public, the industry as a whole is morally unsound.

The authorities' challenge is that much of the work deemed necessary to repair and strengthen the *financial* soundness of the industry – all the new regulation, the extra requirements and restrictions – merely emphasises that the *moral* soundness of the industry remains deeply suspect. And this has led to a general mistrust of finance, where to many it seems that we have reached a point where the market belief is that "if it is not actually illegal it is OK", and there is in finance a complete absence of any moral code to go alongside the legal code.

This is very different from the world of yesterday, where there was a strong moral code. It could be summed up in just 11 words:

- "my word is my bond";
- "nothing to excess";
- And finally, "remember the client".

Which is not an obviously less comprehensive or effective code than the modern regulatory regime. Indeed you could replace the entire corpus of tens of thousands of lines of current legal documentation, it often seems, by the single sentence: "Don't take advantage of your position, don't put your own interests ahead of your clients', don't do anything you could not defend if it became public knowledge, and use your common sense."

Or rather, you couldn't. Because the appeal to "common sense", and with it the implied appeal to a common set of moral understandings of what is right and what is wrong, is no longer possible.

One of the features of a global world is that we do not all have the same instinctive understanding of what words mean. A simple example — a sign outside a barber's shop saying "haircut, 17" would be taken by some cultures to imply that it will cost precisely 17, by others to imply "with tip that means 20" and by yet a third group as the starting price and "would they do it for 12?"

And so, in the absence of an underlying and implicit basic common moral code that we can assume everyone will adhere to, we must craft an explicit code through regulations. The challenge here is that in creating an overtly rules-based culture, we have no longer got an overarching moral ethos that the authorities can expect financiers to obey and can rely on to backstop the gaps in the legal code. So they have to respond to all innovations with yet more rules.

This has two damaging consequences. First, the authorities are always in reactive mode: the rules are usually incomplete and always *post hoc*, and so regulatory *lacunae* and arbitrage are built into the system. And secondly, the more extensive the legal code, the more the attitude of relying on it as the sole arbiter of right and wrong grows, and the sentiment that "If it is not actually illegal it is OK" takes deeper root.

Society's distrust of the financial sector is now deeply damaging not just to the financial industry but to society itself. We need a healthy, trusted and financially sound industry and, to achieve this, we need the authorities and the political class to realise the damage that their ongoing assault on the industry – through extensive regulation and overtly populist and hostile attacks – is having and to show a sense of urgency in sharing the task of rebuilding fiduciary trust, as the report of the Parliamentary Commission on Banking Standards has so clearly stated.

I am not saying this because we *want* to exonerate the banking system and allow past misdeeds to be overlooked. Much less is it because the banking system *deserves* society's forgiveness. No, it is because as society, we *need* to, in much the same way that when banks fail, we *need* to rescue them, uncomfortable, undeserved and expensive though that is.

Later, the question must be how the financial community responds to this generous act by society, and I hope the response contains both a degree of humility and a commitment to a more ethical industry. But first, society needs to ensure that the financial system survives.

John Nugée
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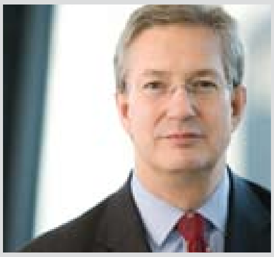

Message from the Chief Executive

Whether one looks at ICMA's market practice and regulatory policy work, or the conferences, round tables, seminars and calls we organise for members, or our education activities through ICMA Executive Education, the period since the last Quarterly Report in April has been particularly busy.

A highlight of our annual calendar is the AGM and Conference held this year at the end of May in Copenhagen. This was extremely well attended by members and guests with eminent keynote speakers and panellists – feedback has been overwhelmingly positive. There are more details in this report, but suffice to say that this event gathered together the majority of our members globally and, besides providing opportunities for them to network widely, provided us with valuable input on our agenda and a validation of the relevance of ICMA to the day-to-day activities of our members.

We have also held a number of other high profile events for members – for example, the Covered Bond Investor Conference in Frankfurt in April, various seminars and round tables on current topics such as FTT, EMIR and MiFID II, and in June an academic conference on *The Future of the Repo Market*. All have been well attended – not surprising given the importance of the topics to participants in the securities markets.

Our committees, councils and forums are also running at top speed and have a heavy workload given the pace and sheer volume of new regulation. The topic on top of everyone's list at the moment is the European Commission's proposal for a Financial Transaction Tax, and we have spent a substantial amount of time putting out papers which explain the impact of this tax and using these in market seminars throughout Europe, as well as with a wide range of public authorities to raise awareness of the damage the FTT will cause to the financial markets. Whilst this is particularly evident in the repo market, our concerns and focus are much broader, looking at the detrimental impact it will have on secondary market liquidity and structure, and the increased costs of borrowing in the primary markets for governments and corporates which will limit growth in the economy. The debate continues to rage and, whilst there are indications that the tax will not be implemented precisely as proposed, there is as yet no clarity and no cause for complacency given the political agenda.

Whilst this has occupied much attention we have not dropped the ball on the many other market practice and regulatory initiatives in the primary, secondary and short-term markets – more detail is set out in this Quarterly Report. We have responded through our committees to relevant consultation papers put out by the authorities (despite the increasingly tight deadlines), and have arranged for representative groups of members to meet certain regulators directly for all sides to get a better understanding or each other's concerns.

In this issue of the Quarterly Report we lead with two themes – John Nugée's Foreword on the need for the restoration of trust in the industry and Paul Richards' Quarterly Assessment entitled *Capital Markets and Economic Growth*. These expand upon the comments made in the April 2013 Quarterly Report where we emphasised that it is critical for policy makers, politicians and the public at large to appreciate the increasingly important role the capital markets play in intermediating funding in the real economy given the constraints on bank lending. These remain ongoing – and interrelated – themes and sit well with ICMA's education agenda – both through the enhanced approach in 2013 to ICMA Executive Education as well as the broader agenda including the various conferences, seminars and round tables referred to above.

In conclusion I must mention ICMA's anniversary dinner celebrating 50 years of the Eurobond markets held at the Savoy on 24 June. ICMA's history is inextricably linked with the growth of the cross-border international debt capital markets and we were delighted that so many of the luminaries of the early days of the Euromarkets were able to join. We are grateful to all the speakers. Many of them provided fascinating – and entertaining – snapshots of life in the early days of the markets, with the final speaker, Sir David Walker, Chairman of Barclays, giving his views on the future of the capital markets and the increasingly critical role they play in modern society.

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Quarterly Assessment
by Paul Richards

Capital Markets and Economic Growth

Capital markets are at the centre of the debate about how to restore sustainable economic growth. This is because growth needs to be financed, and the banking system is not in a position to finance growth through traditional bank lending in the foreseeable future to the same extent as in the past. Many banks have been deleveraging in response to the last international financial crisis and they need to meet higher capital and liquidity requirements as part of the attempt to prevent the next one. Capital market financing represents a complementary alternative to traditional bank financing.

2 The economic recovery from the international financial crisis, particularly in Europe, has been much slower than after a normal economic downturn. Six years since the crisis began, much of Europe is still in recession. In some of the countries on the periphery of the euro area, unemployment – and particularly youth unemployment – is at exceptionally high levels. In Japan, lack of growth has been a problem for over twenty years. By contrast, there is more evidence of economic recovery in the US. And emerging markets, particularly in Asia, have been less affected by the crisis than has the western world. (Table 1.)

Table 1: Economic indicators

END-2Q2013	GDP GROWTH 2013	CONSUMER PRICES 2013	UNEM-PLOYMEN	CURRENT ACCOUNT 2013
United States	+2.0%	+1.6%	7.6%	-2.8%
Euro area	-0.6%	+1.6%	12.2%	+1.6%
United Kingdom	+0.8%	+2.7%	7.8%	-2.8%
Japan	+1.6%	+0.1%	4.1%	+0.9%
China	+7.8%	+3.3%	4.1%	+1.7%

Source: *The Economist*

There is a close relationship between the effectiveness of economic policy and the response in capital markets.

3 In attempting to restore sustainable economic growth, the authorities have adopted a mix of measures: fiscal policy; monetary policy; structural reform; financial stability; and financial market regulation. In some cases, there is more common ground among policy makers than in others. But in all cases, there is a close relationship between the effectiveness of economic policy and the response in capital markets. This Quarterly Assessment, which covers the period until the end of the second quarter of 2013, considers the steps which the authorities are taking – particularly in Europe – to encourage economic recovery, and the contribution to the economic recovery that the capital markets can make as a source of finance.

Fiscal policy

4 Policy makers differ about whether the most effective route to restoring sustainable economic growth is through austerity – ie by cutting government spending or increasing taxation (or both) in an attempt to reduce the budget deficit and government debt as a percentage of GDP – or whether austerity is likely to prove self-defeating, particularly if governments all engage in it together. It is clear that a prolonged period of low growth leads to higher government deficits and debt; and that, the higher the government deficit and debt, the greater the risk that deficit financing will become unsustainable, with the result that the government is cut off from access to capital markets. The BIS estimates that government debt above about 80% of GDP starts to become a drag on growth, while public debt is currently above 100% of GDP in most developed countries. But it is also clear that the capital markets do not make a judgment about the sustainability of the public finances of a country on the basis of a precise level of the deficit or the debt. The judgment depends not just on the size of the deficit or the amount of the debt, but on its maturity structure and interest cost, and on contingent liabilities in the private sector; and also on the effectiveness of government policy in reducing the deficit, and on market conditions generally. (Table 2.)

Table 2: Fiscal positions

% OF GDP	FISCAL BALANCE 2009	FISCAL BALANCE 2013	GROSS PUBLIC DEBT 2009	GROSS PUBLIC DEBT 2013
United States	-11.9	-5.4	89	109
Japan	-8.8	-10.3	189	228
United Kingdom	-10.8	-7.1	72	109
Germany	-3.1	-0.2	77	88
France	-7.6	-4.0	91	114
Italy	-5.4	-3.0	130	144
Spain	-11.2	-6.9	63	98
Greece	-15.6	-4.1	138	184

Source: BIS, IMF and OECD

5 Even so, the funding of government deficits and debt has been a particular problem on the periphery of the euro area, where governments are no longer responsible for issuing their own national currency because they use the euro. When euro-area debtor governments have been cut off from access to the capital markets, they have had no alternative but to seek an official bail-out from creditor governments through the European Stability Mechanism (ESM), which sets policy conditions (eg relating to fiscal consolidation) in exchange. Subject to these policy conditions, the ECB has stated that it is willing – under its Outright Monetary Transactions (OMT) programme – to intervene by buying the government's debt in unlimited amounts in the secondary market. This commitment from the ECB has undoubtedly had an impact over the past year in reducing sovereign yield differentials over bunds throughout the periphery of the euro area, though the OMT programme has not so far had to be used, and its legitimacy is currently being challenged in the German constitutional court.

6 Apart from the case in the German constitutional court, there are three other unresolved issues:

- First, the ECB is currently only willing to intervene if a government in the euro area decides to agree to policy conditions under an official bail-out. For some governments, that is a decision which it is politically difficult to take, and they seek to put it off for as long as possible in the hope of avoiding it altogether.

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Electorates in debtor countries on the periphery of the euro area are not willing to put up with austerity indefinitely.

- Second, the ESM is currently only able to lend direct to the sovereign. But in some cases (eg Ireland, Spain and Cyprus), the creditworthiness of the sovereign has been threatened by the potential insolvency of some of the banks. If the ESM could be used directly to recapitalise banks, that would help to break the link between the banks and the sovereign. Under a euro-area agreement in June, the ESM is expected to be able directly to recapitalise banks, subject to conditions, but only initially up to €60 billion (out of the ESM's total resources of €500 billion), and with a financial contribution also being made by the sovereign in the country concerned as an incentive. And direct ESM recapitalisation of banks is not expected to be possible until the proposed Single Supervisory Mechanism is fully operational.
- Third, it is proving increasingly difficult to obtain financial support from creditor governments for the official bail-out of debtors. In the most recent official bail-out – Cyprus – one of the policy conditions set was that the bail-out should be accompanied by the bail-in of both bond holders and uninsured depositors so that the cost would be shared. It is not clear whether Cyprus is regarded as a special case or a precedent.

7 In addition to these unresolved issues, the most important remaining problem is that fiscal consolidation has not so far been working as well as expected in debtor countries on the periphery of the euro area (with the partial exception of Ireland). It is not clear whether this is simply a matter of time. But there are signs that electorates in debtor countries on the periphery of the euro area are not willing to put up with austerity indefinitely, especially in countries where unemployment has risen to very high levels. Overall unemployment in the euro area is over 12% on average, as opposed to under 8% in the US, while youth unemployment is over 50% in Greece and Spain. The European Commission has now recognised this, by giving a number of governments in the euro area more time to meet their 3% budget deficit targets, provided that they demonstrate a commitment to structural reform. There is also an increasing consensus in debtor countries that they would be under less economic pressure themselves if creditor countries with proportionately lower budget deficits and government debt were willing to take steps to expand their own economies. So far, Germany in particular has been reluctant to do so, though there are some signs that the German economy is recovering anyway.

Monetary policy

8 As the effectiveness of fiscal policy in restoring economic growth has so far been limited, a great deal of reliance has had to be placed on monetary policy. All the major central banks in developed countries have followed an accommodative monetary policy which is deliberately designed to provide ample liquidity to the financial system. Official short-term interest rates in developed countries – though not, for example, in China – have been reduced to historically very low levels, and kept there for a prolonged period. In some cases, in an attempt to influence market expectations through forward guidance, central banks have made public commitments not to increase official short-term interest rates again until growth targets (eg target reductions in levels of unemployment) have been met. And in some countries, central bank inflation targets are in practice now being interpreted more flexibly than before.

9 Low official short-term interest rates have been accompanied by quantitative easing or alternatives which also involve the use of the central bank balance sheet: eg central bank purchases of government and mortgage debt in the US; central bank purchases and Funding for Lending in the UK; Longer-Term Refinancing Operations (LTROs) with the banks in the euro area; and a proposed doubling of the monetary base in Japan, which has been accompanied by a significant fall in the effective exchange rate of the yen. As a result, the balance sheets of the central banks in the major developed countries have grown around three times as a proportion of GDP since the crisis began to around 25% of GDP on average now. Quantitative easing helped initially to keep longer-term bond yields at historically low levels, both for governments and corporates with high credit ratings.

But in June, longer-term bond yields rose sharply, as capital markets began to anticipate the tapering (ie a reduction in central bank asset purchases) and eventual withdrawal of quantitative easing in prospect, particularly in the US. (Table 3.)

Table 3: 10-year government bond yields

	END 2Q2013	1 MONTH CHANGE	1 YEAR CHANGE
United States	2.49%	+0.48%	+0.87%
Japan	0.86%	+0.02%	+0.04%
United Kingdom	2.45%	+0.54%	+0.77%
Germany	1.73%	+0.28%	+0.18%
France	2.35%	+0.37%	-0.31%
Italy	4.56%	+0.51%	-1.65%
Spain	4.77%	+0.45%	-2.13%
Greece	11.02%	+1.94%	-15.59%

Source: FT

10 Quantitative easing or its equivalent buys time in which to resolve the underlying problem in the banking system and the real economy, but it cannot itself be expected to resolve the problem. Withdrawal of quantitative easing also involves risks, which need to be managed carefully by the authorities. If quantitative easing is withdrawn too early, it risks jeopardising the recovery. But if it is withdrawn too late, there is a risk of higher inflation later. Inflation reduces the real value of government debt, but it also has damaging side-effects, not least the potential damage to the credibility of the central banks whose remit is to control it. In addition, the relationship between central banks and their governments has inevitably become much closer during the crisis. If too close a relationship persists post-crisis, there is a risk that at least some central banks will in practice lose their operational independence for setting monetary policy, as the Bank of Japan appears to have done already.

11 Within the euro area, there is an additional problem to be addressed. The monetary transmission mechanism is still not working smoothly across the euro area as a whole. Markets are still partly fragmented along national lines:

- Bank cross-border holdings of government and corporate bonds, which rose significantly in the period before the crisis began, have now fallen back to levels below those when the euro was launched, and foreign deposits with banks on the periphery of the euro area have fallen significantly since the crisis began.
- Even though spreads over bunds are now lower than they were during the crisis, and Ireland and Portugal – both subject to official bail-outs – have been able to return to the capital markets, governments on the periphery of the euro area are still borrowing at substantial spreads over bunds.
- And small and medium-sized enterprises in these countries have found bank financing very expensive, where they are able to obtain it at all.

12 As a legacy from the crisis, a number of banks – particularly in parts of the euro area – are still not able to attract external finance from the market at sustainable rates. They have therefore relied on central bank funding (eg through the ECB's LTROs). While some banks, particularly in the core of the euro area, have already repaid a significant proportion of their LTROs, other banks – mainly on the periphery – may not be in a position to repay them for the foreseeable future because they still cannot obtain refinancing in the market. In those cases, the ECB will need to decide whether to continue to support them by providing liquidity indefinitely. And as banks can only borrow from the ECB against eligible collateral, and high quality collateral is in short supply, there is a risk that they will run out of collateral with which to borrow. One option would be for the ECB further to extend collateral eligibility: eg in relation to bank financing of SMEs.

> **Withdrawal of quantitative easing involves risks, which need to be managed carefully by the authorities.**

> Structural reforms take a long time to be effective.

Structural reform

13 It is common ground that fiscal policy and monetary policy both need to be accompanied by structural economic reforms in order to make debtor countries in the euro area more competitive: eg by improving job mobility across borders; by increasing wage flexibility to reduce unit labour costs and encourage employment; and by removing restrictive practices to encourage competition. Debtor countries in the euro area need to improve their competitiveness in terms of creditor countries; and Europe as a whole needs to improve its competitiveness in terms of the rest of the world. It is sometimes estimated that Europe currently represents 7% of world population, 25% of global GDP and 50% of social spending. The most significant new international initiative in this area is the agreement at the G8 Summit in June to start EU/US negotiations on transatlantic trade and investment with the aim of completing them in two years.

14 One of the problems here is that, even if they can be agreed, structural reforms take a long time to be effective; and, within the euro area, quick adjustment through the exchange rate is not an option without leaving it (though Cyprus has had to impose capital controls in order to stay in). If a country on the periphery were to leave the euro area, it would reintroduce a national currency, which would fall in value significantly against the euro, and give the national economy a quicker opportunity to adjust. But this would not be an easy option:

- First, the result would not necessarily be to re-establish growth; there would still be a risk that exchange rate depreciation would lead to higher inflation, unless strict policy measures were taken to pre-empt this.
- Second, exit would be complex and liable to dispute: eg over which financial assets and liabilities would be redenominated in the new national currency and which would remain denominated in euro; and over whether liabilities in euro would need to be rescheduled.
- And third, by demonstrating that the commitment to the euro was not irrevocable, exit by one country would create a precedent for others. As a result, capital markets would price back into the bond market the redenomination risk which the ECB has been so keen to avoid.

Financial stability

15 While taking steps to encourage economic recovery from the last crisis, the authorities are committed to promoting sufficient financial stability to ensure that a crisis on this scale cannot happen again:

- First, under Basel III, bank capital and liquidity requirements will be increased to reduce the risk that banks fail in future. The increases are formally due to take place over a number of years. But the capital markets – and some regulators – have been pressing banks to demonstrate that they can achieve the capital and liquidity requirements well ahead of the deadline. There is a debate about whether increasing the requirements for capital and liquidity in this way, and imposing bank leverage ratios, will help the banks support future growth or prevent it. That may depend on whether banks are in a position to raise extra capital to meet the new requirements or whether it is more economic for them to deleverage and reduce the size of their balance sheets instead. But clearly, banks which have insufficient capital are too weak to lend.
- Second, the European Commission is considering the recommendations in the Liikanen report about ring-fencing banks' retail banking operations from their investment banking operations, so that it is less difficult if necessary to resolve them in an orderly way. Liikanen has proposed a ring-fence around banks' trading operations. Several governments in the EU – eg Germany, France and the UK – are introducing their own versions of ring-fencing.
- Third, to improve the quality of banking supervision across the euro area in future, there is to be a *Single Supervisory Mechanism (SSM)* under the ECB – separate from the ECB's monetary policy function. The SSM is intended to be the first step towards European Banking Union. It is expected that the ECB will itself supervise directly the larger cross-border banks with more than 80% of the banking assets of the 6,000 banks in the euro area. But the ECB will also rely on national supervisors, in particular for the supervision of the smaller banks. National bank supervisors in the euro area will therefore be

closely involved in the SSM, and other national bank supervisors in the EU have the option to participate if they wish. The ECB expects the SSM Regulation to be approved by the European Parliament in September 2013, and to take over supervisory responsibility one year after this (ie in September 2014). Before the SSM becomes fully operational, the asset quality of banks in the euro area will be assessed and the banks will be stress-tested to determine whether they need more capital.

16 These preventive steps are intended to reduce the risk that banks fail in future. But in the event that failures still occur, the authorities are determined to ensure that the costs of failure are not borne by the taxpayer, even in the case of banks hitherto regarded as "too important to fail": ie they have hitherto been treated in the capital markets as carrying implicit government guarantees. These systemically significant banks are all required to prepare "living wills" showing how they can be broken up on insolvency in an orderly way, if necessary, without jeopardising the stability of the financial system as a whole.

17 Preventing the need for taxpayers to support the banking system in the euro area in future will also require agreement on bank resolution and on the funding of retail deposit guarantees. In addition to the SSM, these are the remaining two steps towards European Banking Union. They are intended to ensure that confidence in bank deposits is not dependent on the national jurisdiction in which the deposits are located, with the result that monetary policy can be transmitted across the euro area as a whole without fragmentation along national lines, unlike the position at present. Both of these two remaining steps to European Banking Union have proved difficult to agree.

18 In the case of *bank resolution* (ie the second step towards European Banking Union), there are three key issues:

- *Single Resolution Mechanism:* At present, bank resolution is the EU is funded on a national basis. The European Commission is due to put forward proposals for a Single Resolution Mechanism involving an independent authority, which will decide on recapitalising and winding down banks on a common euro-area basis, funded by burden-sharing among the banks. The German Government has argued that this could technically require a Treaty change.

The authorities are determined to ensure that the costs of failure are not borne by the taxpayer.

- *Bail-in:* There also needs to be agreement under bank resolution on the hierarchy of creditors to be bailed in, so that the cost of failure in future is borne by investors and creditors rather than by taxpayers. EU Finance Ministers have now agreed, subject to European Parliament approval, a common approach from 2018, with a limited degree of national discretion. The bail-in hierarchy would start with equity investors, then junior debt holders, then senior debt holders and finally uninsured depositors. Uninsured deposits from large companies would be bailed in before deposits from small companies and individuals. Currently, some countries in the EU give preference to uninsured depositors over bond holders, but not other countries. The new proposal might reduce the risk of bank runs by uninsured depositors. But it would have implications for the cost of issuing senior bank debt to bond holders. The position needs to be clear so that the pricing of debt is not clouded by uncertainty.
- *Backstop:* Despite bank bail-in, a common official backstop would still be needed as a last resort. But its role would be intended to be temporary, with any costs subsequently being recovered from a sale of the bank concerned to the private sector or a levy on the banking system.

19 The final step to European Banking Union is *retail deposit guarantees*. At present, retail deposit guarantees are insured at national level up to a common EU level (of €100,000). There is agreement that retail depositors should continue to be insured up to a common level, though the cost of insurance would potentially be prohibitive if it had to be borne by the banks themselves without recourse to the taxpayer. There is no agreement yet on replacing national retail deposit guarantees with common euro-area guarantees. This would effectively involve banks in surplus countries insuring retail depositors with banks in deficit countries.

> There is a risk that the measures intended to prevent the next crisis will delay the recovery from the last one.

20 It is not yet clear how effective these measures will be in removing the need for taxpayer support in a future crisis. As the financial system is closely interconnected, there is a risk that some financial institutions and parts of the financial infrastructure will always in practice be too important to fail. But good risk management and effective regulation should reduce the risk arising in the first place. Closer cooperation will also be required between regulators at global level to ensure consistency of approach and to avoid regulatory arbitrage.

Financial market regulation

21 Fiscal policy and monetary policy are both designed to help the international economy recover from the crisis. The financial regulations being introduced by the G20 – and at European and national level – are intended to prevent the next one. But there are costs in making the system safer:

- By imposing higher capital and liquidity requirements on the banks to make them safer, banks which cannot raise new capital externally have no option but to reduce their lending.
- By proposing that taxpayers must never again have to bail out banks, the use of bail-in regimes raises the cost of debt payable to new bond holders and risks unsettling uninsured depositors.
- And by making markets more transparent and safe, the unintended consequence has been to make them less liquid. Indeed, the proposed Financial Transaction Tax on secondary market transactions in 11 EU Member States in the euro area (and with extra-territorial effect) is in essence a tax on market liquidity, which would have a significant cost, not just for the financial system, but for future economic growth.

22 The authorities consider that the cost of making the system safer is a cost which the industry should pay to reduce the risk of another crisis. But there is also a risk that the measures intended to prevent the next crisis will delay the recovery from the last one. The risk is all the greater because of:

- uncertainty in capital markets, in the case of some of the large number of new regulations, about exactly what the authorities propose;
- inconsistency between different regulations, both between different jurisdictions and within them;
- unintended consequences for capital markets from new regulations; and
- an arguably over-optimistic assessment by the authorities of the extent to which new regulations can reduce unnecessary risk in the financial system, when sometimes the effect is simply to transfer risk from the regulated to the unregulated – or less regulated – sector.

Financing the economic recovery

23 The common thread running through all the measures which the authorities are taking – to encourage economic recovery from the last crisis and to prevent the next one – is the need to restore confidence and re-establish trust in the financial system on a lasting basis. In addition to the measures taken by the authorities, market firms themselves can help to re-establish trust on a lasting basis, both directly and through their trade associations.

24 Inevitably, it will take time for confidence to return. But as confidence returns, there will not only be an incentive for the corporate sector to draw down its substantial holdings of cash for investment, but there will also be an opportunity for the capital markets to play an increasingly important role in supplying demand from the corporate sector to help finance the economic recovery:

- That is particularly the case in Europe where, on the one hand, the supply of bank finance is significantly constrained while, on the other hand, bank finance currently represents a much higher proportion of lending to the corporate sector than in the US, and the capital markets a correspondingly lower proportion. In Europe, the potential growth in bond market finance to the corporate sector is therefore proportionately all the greater. This includes bond market issuance by banks themselves with sufficiently high credit ratings.
- The international bond market has proved a stable and reliable source of long-term finance from

investors for corporate sector issuers over a long period of time. Clearly, bond yields for corporates with high credit ratings are at historically low levels, and investors will be concerned about interest rate risk – as well as credit risk – if they expect interest rates to rise. But changes in market expectations from time to time become reflected in the shape of the yield curve. And fixed rate issuance can be supplemented by floating rate issuance and by the use of swaps to hedge interest rate risk.

- The main supply of bond finance for the corporate sector is currently provided by institutional investors. But there is considerable scope – eg in Europe – for increased retail investment in the bond market, directly as well as indirectly (through mutual funds), so long as the remaining obstacles (such as the heavy cost to issuers of pan-European offerings to retail investors under the EU Prospectus Directive) are removed.
- Bond issuance has traditionally been the preserve of large corporate and bank issuers with high credit ratings. While SMEs do not generally have direct access to the bond market, indirectly many of them are financed through the banking system, and through multilateral development banks (like the EIB and EBRD) and national public sector agencies (like KfW), which themselves have direct access to, and are large users of, the bond market.
- There is a thriving covered bond market in Europe and the potential to rebuild the securitisation market, taking account of lessons from the crisis. In addition, there may be scope for the private placement market in Europe to develop, as European issuers currently account for more than a third of funds raised in the US private placement market. However, it is important to recognise that significant differences exist between the regulatory framework for the private placement market in the US and current regulatory constraints in Europe, and standard documentation in Europe still needs to be developed.
- Finally, corporates ultimately depend for their viability on equity as a source of funding. While the equity of most large corporates is publicly quoted, institutional investors in public equity are increasingly also investing in private equity and loans, real estate financing and infrastructure financing. Unlike publicly quoted equity, which is tradable, these sources of funding for longer-term projects are by their nature illiquid, but often appropriate for investors who can afford to take a long-term view. Private equity and mutual funds are also sources of capital for SMEs in the form of both equity and debt.

25 In all these ways, the international capital markets provide a potential source of funding for the economic recovery which is complementary to traditional bank lending. While the restoration of confidence will encourage greater use of the capital markets, the capital markets can also contribute to the restoration of confidence themselves.

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In brief

- Capital markets are at the centre of the debate about how to restore sustainable economic growth.
- Policy makers differ about whether the most effective route to restoring growth is through austerity or whether austerity is likely to prove self-defeating, particularly if governments all engage in it together.
- As the effectiveness of fiscal policy in restoring growth has so far been limited, a great deal of reliance has had to be placed on monetary policy. Quantitative easing or its equivalent buys time in which to resolve the underlying problem, but cannot itself be expected to resolve it.
- It is common ground that fiscal policy and monetary policy both need to be accompanied by structural reforms, though they take a long time to be effective.
- Preventive steps are being taken to reduce the risk that banks fail in future. But in the event that failures still occur, the authorities are determined to ensure that the costs of failure are not borne by the taxpayer.
- While fiscal policy and monetary policy are designed to help the recovery from the last crisis, new financial regulations are intended to prevent the next one. But there are costs in making the system safer.
- The common thread running through all the measures which the authorities are taking is the need to restore confidence and re-establish trust in the financial system on a lasting basis.
- As confidence returns, there is scope for the capital markets to play an increasing role in supplying demand from the corporate sector to finance the economic recovery.

Practical initiatives by ICMA

The purpose of the following list is to summarise practical initiatives on which ICMA is currently, or has recently been, engaged with, and on behalf of, members.[1]

Primary markets

1 *Prospectus Directive and PRIPs:* In implementing the new Prospectus Directive regime and proposals on PRIPs, ICMA is working with members to obtain clarity from regulators about how they should be interpreted or applied, and has responded to an ESMA consultation on supplements.

2 *ICMA Primary Market Handbook:* A fundamental review of ICMA's Primary Market Handbook is continuing, with its structure being reorganised to follow the timeline of transactions.

3 *Retail structured products:* The Joint Associations Committee, supported by ICMA, has responded to consultations by IOSCO and (on AIFMD implications) by the UK FCA.

4 *Asset encumbrance:* ICMA has responded, on behalf of the Financial Institution Issuer Forum, to the EBA consultation on Implementing Technical Standards on *Asset Encumbrance Reporting.*

5 *Collective Action Clauses:* With help from Clifford Chance, ICMA is in the process of updating the Collective Action Clause (CAC) in the ICMA Primary Market Handbook, and drafting a new *pari passu* clause, in response to the Argentinian case.

Short-term markets

6 *Financial Transaction Tax (FTT):* ICMA published a report on 8 April on the impact of the FTT on the repo market, and a supplementary report on 7 May on the systemic importance of collateral. Both these reports were prepared by Richard Comotto under the auspices of the ICMA European Repo Council (ERC). Using these reports, and led by Godfried De Vidts as Chair of the ERC, we have sought to explain to the relevant authorities in Europe, not just why the FTT as currently proposed would have a damaging impact on the repo market, but also on markets generally, with costs for the real economy and implications for economic growth, the transmission of monetary policy and the safety of financial markets. We have also held roundtables in London and Paris on the impact of the FTT.

1. ICMA responses to consultations by regulators are available on the ICMA website.

7 *Financial benchmarks:* ICMA has responded to consultations by ESMA and IOSCO on financial benchmarks, focusing on the importance of ensuring continuity of contracts, particularly in the case of FRNs. We are also discussing the evolution of secured benchmarks with the European Banking Federation.

8 *Trade repositories:* ICMA ERC has submitted comments to CPSS/IOSCO on their joint consultative report on *Authorities' Access to Trade Repository Data.*

9 *Interoperability:* A Memorandum of Understanding is being prepared to facilitate the development of triparty settlement interoperability.

10 *GMRA:* ICMA has published the 2011 Global Master Repurchase Agreement Protocol (Revised).

11 *Guide to repo best practice:* ICMA is planning to publish shortly a *Guide to Best Practice in the European Repo Market.* This will consolidate and refresh ICMA's existing repo trading practice guidelines and various other published statements.

12 *Repo conference:* A recent ICMA ERC conference on *The Future of the Repo Market* brought together 200 experts from universities, regulatory agencies and the market to reassess the role of repo in the financial crisis, consider whether proposals for macroprudential regulation of the repo market will achieve their aims, and weigh the impact of new regulation, economic and financial constraints and emerging technologies on the structure and efficiency of the repo market in Europe and beyond. Presentations from the conference are available on the ICMA website.

Secondary markets

13 *Secondary market structure:* ICMA has been discussing with members the changing structure of the secondary market – and the implications for secondary market liquidity and the future of the dealer model – both as a result of the international financial crisis and in response to new regulations, in particular MIFID II/MiFIR and the CSD Regulation.

14 *ICMA Secondary Market Rules & Recommendations:* ICMA's Secondary Market Rules & Recommendations will need to be updated when there is a clear outcome from the EU negotiations currently taking place on MIFID II/MiFIR, which will affect the dealer model, and the CSD Regulation, which will affect the regulation of settlement discipline.

Asset management

15 *AMIC:* The ICMA Asset Management Investors Council (AMIC), which was held at the Banque de France on 23 April, discussed a range of issues relating to the future of the asset management industry.

16 *Covered bonds:* The Covered Bond Investor Conference, held in Frankfurt in May, included a presentation by Ulrich Bindseil, Director General of Market Operations at the ECB, on covered bonds.

17 *Long-term finance:* With the support of the AMIC Executive Committee, ICMA has responded to the European Commission Green Paper on *Long-Term Finance.*

18 *Charter of Quality:* The ICMA Private Wealth Management Charter of Quality, which has been signed by over 50 banks in Luxembourg, with the support of the Luxembourg regulator (the CSSF), is due to be discussed in Luxembourg at the IOSCO Annual Conference in September.

Meetings with central banks and regulators

19 *ECB:* Benoit Coeuré, Executive Board member of the ECB for Markets, and Erkki Liikanen, Governor of the Bank of Finland, were guest speakers at the Conference after ICMA's AGM in Copenhagen on 23 May.

20 *EBA:* Adam Farkas, Executive Director of the European Banking Authority, made a presentation and answered questions from members of the Public Sector Issuer Forum during its meeting at the EBRD in London on 24 June.

Other initiatives

21 *Economic importance of the corporate bond markets:* On 8 April, ICMA published a short booklet which is designed to explain to legislators and regulators why the corporate bond markets are important for economic growth.

22 *Regulatory grid:* A further updated version of ICMA's grid of new financial regulations affecting the cross-border securities markets has been posted on a password-protected section of the ICMA website for ICMA members.

Regulatory Response to the Crisis

by David Hiscock

G20 financial regulatory reforms

A communiqué was issued following the Washington meeting of G20 Finance Ministers and Central Bank Governors, held on 18-19 April 2013. This includes points under the headings of *Global Economy and G20 Framework for Strong, Sustainable and Balanced Growth; International Financial Architecture; Long-term Financing for Investment; Financial Regulation; and Financial Inclusion*. In summary, the section on *Financial Regulation* (paragraphs #12-#15) states that:

- half of G20 jurisdictions have now issued final regulations to implement Basel III, and the remainder commits to do so as soon as possible in 2013;
- we will undertake the necessary legislative steps to implement resolution powers and tools consistent with the FSB's *Key Attributes of Effective Resolution Regimes*, including the legal basis for cross-border cooperation and coordination;
- we note the progress in implementation of OTC derivatives reforms and we are committed to complete the remaining legislative and regulatory frameworks for these reforms;
- we also call for a feasibility study on how information from trade repositories can be aggregated and shared among authorities, so as to enable comprehensive monitoring of risks to financial stability;
- we look forward to further policy recommendations for the oversight and regulation of the shadow banking sector by the Leaders' Summit;
- we support the Regulatory Oversight Committee of the LEI initiative in their efforts to launch the Global LEI Foundation as soon as possible;
- we reiterate our call on the IASB and FASB to finalize by the end of 2013 their work on key outstanding projects for achieving a single set of high-quality standards;
- we welcome the work of the BIS and IOSCO to improve the oversight and governance frameworks for financial benchmarks, and call on the FSB to coordinate and guide work on the necessary reforms to short-term interest rate benchmarks;
- we support the launch of the FSB's peer review on national authorities' steps to reduce reliance on CRAs' ratings;

> It is important that we push ahead with work to ensure a consistent implementation of reforms to derivatives and shadow banking.

- more needs to be done to address the issues of international tax avoidance and evasion; and
- we reiterate our support for FATF work, notably the identification and monitoring of high-risk jurisdictions with strategic AML/CFT deficiencies.

Alongside this meeting, the FSB published a 19 April 2013 press release regarding its report to the G20 on the progress of financial regulatory reforms. Published with this there was an FSB Chairman's letter to the G20; and an FSB progress report on reforming resolution regimes and resolution planning for G-SIFIs. Furthermore, related to the above mentioned topics, in the run-up to this meeting:

- on 8 April, the FSB launched a peer review on the FSB *Principles for Reducing Reliance on CRA Ratings* and invited feedback from stakeholders;
- on 11 April, the CPSS and IOSCO published for public comment a consultative report entitled *Authorities' Access to Trade Repository Data*;
- on 11 April, the FSB published a thematic peer review report on resolution regimes. This report evaluates FSB jurisdictions' existing resolution regimes and planned changes to those regimes using the FSB *Key Attributes for Effective Resolution Regimes for Financial Institutions* as a benchmark, and makes recommendations to support its timely and consistent implementation;
- on 12 April, the BCBS published its report to the G20 on monitoring implementation of Basel III regulatory reform;
- on 15 April, the FSB published its fifth progress report on *Implementation of OTC Derivatives Market Reforms*. This latest edition in a twice-yearly series of reports takes stock of progress made by standard-setting bodies, national and regional authorities and market participants towards meeting the G20 commitments to OTC derivatives market reforms;
- on 16 April, IOSCO published a consultation paper on *Principles for Financial Benchmarks*, which seeks public comments on a set of high-level principles for benchmarks used in global financial markets; and
- on 18 April, the FSB announced the successful implementation of the initial phase of a common data template for G-SIBs. The first phase of the Data Gaps Initiative (Phase 1) started in March 2013 with the harmonized collection and pooling of improved consolidated data on bilateral counterparty credit exposures of major systemic banks, as well as their consolidated aggregated exposures.

The UK Chancellor's closing remarks, following the 10-11 May 2013 meeting of G7 Finance Ministers and Central Bank Governors, include the following statements pertinent to the topic of ongoing financial regulatory reform:

"We then discussed the importance of measures being taken, or under consideration, in some of our economies, to ensure that credit can flow appropriately to support the economy.

We agreed on the importance of ensuring banks' balance sheets are adequately capitalised to enable them to play their role in supporting the economy, and we discussed steps being taken to establish a banking union in Europe.

In line with what we agreed the G7 should focus on, in today's discussions we moved onto the policy priorities where we believed a discussion at the G7 was most important.

Nowhere is that more so than on banking, with the G7 accounting for three-quarters of the world's globally systemic banks. So we reaffirmed our commitment to the faithful implementation of the G20 agenda for financial regulation. It is important to complete, swiftly, our work, to ensure that no banks are too big to fail. We must put regimes in place in each of our jurisdictions to deal with failing banks and to protect taxpayers, and to do so in a globally consistent manner.

It is also important that we push ahead with work to ensure a consistent implementation of reforms to derivatives and shadow banking."

At its meeting in Basel on 24 June 2013, the FSB discussed vulnerabilities affecting the global financial system and progress in authorities' work to strengthen global financial regulation. The associated press release includes points concerning current status and on-going FSB work under the following topic headings:

- vulnerabilities in the financial system;
- resolution of financial institutions;
- Global Systemically Important Insurers (G-SIIs);

- OTC derivatives reforms;
- LIBOR and other financial benchmarks;
- shadow banking;
- accounting and auditing;
- compensation practices; and
- regional consultative groups.

On 26 June 2013, the BCBS published its *Revised Basel III Leverage Ratio Framework and Disclosure Requirements* for consultation, with a comment deadline of 20 September. The leverage ratio is designed to serve as an important backstop to the risk-based capital measures, by constraining the build-up of leverage in the banking system and providing an extra layer of protection against model risk and measurement error. Since the Basel III reforms were announced, the BCBS has been working to formulate a leverage ratio requirement that is not only robust, but also internationally consistent given the underlying differences in national accounting standards.

It was agreed in the Basel III package that banks should start disclosing their leverage ratio, calculated on a common basis, from the beginning of 2015. This consultative document sets out a specific formulation for calculating the leverage ratio by banks subject to the Basel III framework, as well as a set of public disclosure requirements. Final adjustments to the definition and calibration of the leverage ratio will be made by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration. In parallel with the consultation on the proposals, the BCBS will also undertake a Quantitative Impact Study to ensure that the calibration of the leverage ratio, and its relationship with the risk-based framework, remains appropriate.

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European financial regulatory reforms

Under date of 5 April 2013, ESMA published its 2013 Regulatory Work Programme (RWP) which is based on its 2013 Work Programme, published in October 2012, and provides a detailed breakdown of the of the individual workstreams as outlined in the 2013 Work Programme. The RWP should normally be published in conjunction with the annual Work Programme on which it is based, but the 2013 RWP was delayed due to uncertainty over several components of the EU's legislative programme. The RWP enumerates
198 tasks, the majority of which are mandatory and intended to contribute to the objective of establishing the Single Rulebook (91 relate to MiFIR/D, 32 to MAR, 33 to CSDR and 42 to others, including EMIR, TD/PD, Omnibus I/II, AIFMD, UCITS IV/V and CRAR).

On 12 April 2013, the Joint Committee of the ESAs (Joint Committee) published its first *Report on Risks and Vulnerabilities in the EU's Financial System*. This publication, which is the first of what will be a regular series, identifies the key cross-sectoral risks facing the EU's financial markets and system; and sets out recommendations on how these can be addressed through coordinated policy and supervisory action by policy makers, the ESAs and Member States (the cut-off date for this report was 13 March and therefore subsequent events in Cyprus are not discussed). The report has identified the following risks the EU financial system is facing:

- weak macroeconomic outlook and consequently a deterioration for financial institutions' asset quality and profitability;
- low interest rate environment;
- risk of further fragmentation on the single market ;

"Only a concerted response by policy makers and EU Member States can restore the confidence and trust that has been eroded during the financial crisis.

- increased reliance on collateral;
- lack of confidence in financial institutions' balance sheet valuations and risk disclosure; and
- loss of confidence in financial benchmarks.

The Joint Committee believes that only a concerted response by policy makers and EU Member States can restore the confidence and trust that has been eroded during the financial crisis; and urges EU political leaders to press ahead with the establishment of Banking Union, including the Single Supervisory Mechanism (SSM), and bank resolution schemes. The ESAs remain committed to fostering supervisory convergence, amongst others, through a strong role in supervisory colleges and through the development of both the EU-wide Single Rulebook and Supervisory Handbooks.

In the previous issue of Quarterly Report, the 27 March 2013 COREPER approval of new capital rules for banks was reported. On 16 April, the European Parliament voted strongly in favour of the agreement reached with the Irish Presidency. President Barroso and Commissioner Barnier commented on the Parliament's approval. The Council's formal adoption of these new rules was subsequently announced on 20 June. The Regulation and the Directive were then published in the *Official Journal (OJ)* on 27 June, triggering their entry into force and allowing for new rules to apply from 1 January 2014.

On 18 April 2013, COREPER approved a compromise agreed with the European Parliament on the establishment of a SSM for the oversight of credit institutions. Subsequently, on 22 May, the draft laws setting up the SSM were approved in a European Parliament plenary vote. The ECB will supervise the euro area's largest banks directly and have a say in supervising other banks. However, the Parliament will give its final seal of approval only later, to allow time for parallel talks with the ECB on detailed accountability arrangements.

The regulations establishing the ESAs and the ESRB include provisions for the European Commission to review their structure and performance within the European System of Financial Supervision (ESFS) and the ESFS as a whole. Accordingly a consultation was launched on 26 April 2013, with a comment deadline of 19 July (a supporting set of frequently asked questions was published alongside the consultation questionnaire and background document). The European Commission also organised a high-level Conference on *Financial Supervision in the EU* on 24 May 2013 in Brussels which offered a platform for representatives of the ESRB and the ESAs, together with other key stakeholders, to discuss the achievements of the individual authorities and to reflect on the effectiveness of the ESFS as a whole, taking into account the possible impact of the Single Supervisory Mechanism. In parallel the European Parliament commissioned two studies reviewing the ESFS, the first dealing with the work of the ESAs (eg ESMA questionnaire – deadline 21 June) and the second to address the work of the ESRB.

The European Commission's consultation on structural reform of the banking sector was published on 16 May 2013, with a request for comments by 3 July (later extended to 11 July). This focuses on the structural separation recommendation of the Liikanen High-Level Expert Group (HLEG). It focuses on the key attributes of the structural reform: ie the scope of activities, the strength of separation, and the possible institutional scope. In order to hear a range of stakeholders' views, the European Commission also organized a meeting on bank structural reform which took place on 17 May, in Brussels. Considering ICMA's 13 November 2012 response to the European Commission's earlier consultation on recommendations of the HLEG on reforming the structure of the EU banking sector ICMA anticipates contributing a short response.

On 21 June 2013, the Eurogroup published a press release reporting agreement on the main features of the European Stability Mechanism's (ESM) direct bank recapitalisation instrument. The Eurogroup has agreed that there will be strict eligibility criteria as well as a clear pecking order for the instrument:

- an appropriate level of bail-in will be applied before the bank is recapitalised by the ESM in line with EU State Aid rules, and applying of the forthcoming Bank Recovery and Resolution Directive (BRRD) as of the start of the supervision by the SSM;
- a burden-sharing scheme will determine the contributions of the requesting Member State and the ESM in order to cater for the existence of legacy assets and to ensure that incentives remain aligned between the ESM and the requesting Member State;
- €60 billion will be the limit on the volume of possible direct bank recapitalisations; and
- potential retroactive application of the instrument will have to be decided on a case-by-case basis and by mutual agreement. Possible cases will have to be discussed and assessed on their own merits once the instrument enters into force.

The instrument is to be finalised when the BRRD has been agreed with the European Parliament. Once this has happened and national Parliamentary scrutiny procedures have been finalised and the Single Supervisory Mechanism is established and effective, the ESM Board of Governors will be able to add this instrument to their toolkit.

The Eurogroup also published a short note regarding its work programme for the second half of 2013.

On 27 June 2013, the Council set out its position on a draft Directive establishing a framework for the recovery and resolution of credit institutions and investment firms; and called on the Presidency to start negotiations with the European Parliament with the aim of adopting the Directive at first reading before the end of the year – the Parliament's position was previously agreed, as reported in ECON's 21 May press release: "*Taxpayers and savers last in line to save banks*". The Directive would establish a range of instruments to tackle potential bank crises at three stages: preparatory and preventative, early intervention, and resolution. The main resolution measures would include: the sale of (part of a) business; establishment of a bridge institution; asset separation; and bail-in measures. The aim is to adopt the directive by the end of 2013.

The bail-in tool would enable resolution authorities to write down or convert into equity the claims of the shareholders and creditors of institutions which are failing or likely to fail. Under the Council's agreed general approach, eligible deposits from natural persons and micro, small and medium-sized enterprises, as well as liabilities to the EIB, would have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which would always step in for covered deposits (ie deposits below €100,000), would have a higher ranking than eligible deposits.

Certain types of liabilities would be permanently excluded from bail-in: (1) covered deposits; (2) secured liabilities including covered bonds; (3) liabilities to employees of failing institutions, such as fixed salary and pension benefits; (4) commercial claims relating to goods and services critical for the daily functioning of the institution; (5) liabilities arising from a participation in payment systems which have a remaining maturity of less than seven days; and (6) inter-bank liabilities with an original maturity of less than seven days. National resolution authorities would also have the power to exclude, or partially exclude, liabilities on a discretionary basis for the following reasons: (1) if they cannot be bailed in within a reasonable time; (2) to ensure continuity of critical functions; (3) to avoid contagion; (4) to avoid value destruction that would raise losses borne by other creditors. Resolution authorities would be able to compensate for the discretionary exclusion of some liabilities by passing these losses on to other creditors, as long as no creditor is worse off than under normal insolvency proceedings, or (subject to conditions) through a contribution by the resolution fund.

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Financial Transaction Tax

In the previous issue of the Quarterly Report we outlined the proposed details of the FTT to be implemented under enhanced cooperation, as set out by the Commission on 14 February 2013. All 27 Member States have been participating in discussions on this proposal. However, it must be remembered that only the 11 Member States participating in enhanced cooperation (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) will have a vote; and they must agree unanimously before it can be implemented. It remains open for any other Member States to join in if they wish.

The February proposal foresaw the FTT Directive for the 11 Member States entering into effect on 1 January 2014, but faced with slow progress towards agreement the Commission has now stated the following on its website: "If agreement is found before the end of 2013, and there is a speedy transposition into national law by the participating Member States, this common framework for an FTT could still enter into force towards the middle of 2014."

In the decision-making process the European Parliament is to be consulted, so ECON has worked on a report on the Commission's proposal. Following adoption in an ECON vote on 18 June, with an ECON report was then tabled for plenary debate on 2 July and a plenary vote on 3 July. ECON's position backs the Commission proposal that the FTT should cover a wide range of financial instruments, be it stocks, bonds or derivatives. At the same time, the adopted text addresses specific concerns, notably the issue of pension funds and their need to be active on the financial markets. ECON's report also says that trades in sovereign bonds should be only taxed at 0.05% until 1 January 2017 and, up until that same date, trades of pension funds would only be taxed at 0.05% for stocks and bonds and 0.005% for derivatives.

In the meantime, as officially reported in the *OJ* on 15 June 2013, the UK has challenged the legality of the decision of 22 January 2013 of the Council to authorise enhanced cooperation on a common framework of FTT and the scope and objectives of the initial commission proposal. This legal challenge has, however, no suspending effect. It is brought on the grounds that the Council decision:

“

The FTT seems likely to deter many financial transactions that have real economic value.

(1) contravenes the Treaty on the functioning of the European Union (TFEU) because it authorizes the adoption of a FTT with extra-territorial effects which will fail to respect the competences, rights and obligations of the Non-Participating States;

(2) is unlawful because it authorizes the adoption of an FTT with extra-territorial effects for which there is no justification in customary international law; and

(3) contravenes the TFEU because it authorizes enhanced cooperation for an FTT, the implementation of which will inevitably cause costs to be incurred by the Non-Participating States.

Reflective of its serious concerns with respect to the Commission's FTT proposal, and as described in more detail in the short term markets section of this edition of Quarterly Report, ICMA has published two papers on the Commission's FTT proposal, the first on 8 April 2013 and the second on 7 May. ICMA and the ICMA ERC are also signatories to a 21 May joint associations' letter sent to EU Finance Ministers. This letter voices serious concerns over the introduction of the proposed FTT and outlines the wider effects it would have across the EU and even beyond. The signatories of the letter, therefore, urge that Ministers reconsider the proposal in light of the detrimental effects that will accrue from its imposition. HM Treasury has published a copy of the UK Chancellor's response, which states that he shares the associations' concerns about this tax "which is "poorly designed" and "badly-timed". " The response concludes by stating that "If this FTT is to proceed then I believe it should be significantly scaled back, with the objective of growth central to the thinking of policymakers in any redesign."

AFME asked Oxera to critically review the Commission's assessment of policy options for, and impacts of, the FTT, commenting on whether the Commission's proposals are consistent with other regulatory objectives. As described in its report dated 20 May 2013, Oxera found that the FTT will make some financial transactions uneconomic, including some activities involved in market making, the trading of government debt, and repurchase agreements. For all of the products and actors considered, the FTT seems likely to deter many financial transactions that have real economic value, resulting in both lower-than-expected FTT revenues and negative economic implications due to the loss of some activity.

A very broad range of other associations, companies and commentators have called the FTT proposal into question, concerned by its design and consequent impact. Significantly this has included influential voices such as those of some central bankers. In a recent example, Dr Jens Weidmann, President of the Deutsche Bundesbank, said during his keynote speech, at the 2013 FESE Convention in Berlin on 27 June: "While a fundamental political consensus has been reached on the introduction of the tax in some countries of the EU, the unintended side-effects have to be considered carefully. In its originally envisaged form, the tax would also cover collateralised money market transactions, known as repo transactions. This would cause considerable harm to the repo market, which plays a key role in the redistribution of liquidity among commercial banks.

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Macroprudential regulation

On 15 April 2013, the IMF published a staff discussion note: *Rethinking Macro Policy II: Getting Granular*. This note explores how the economic thinking about macroeconomic management has evolved since the crisis began. It discusses developments in monetary policy, including unconventional measures; the challenges associated with increased public debt; and the policy potential, risks, and institutional challenges associated with new macroprudential measures.

On 25 April 2013, the European Commission hosted a conference on *The Impact of Ongoing Regulatory Reforms on Financial Integration and Stability*, jointly arranged with the ECB. Keynote speeches were delivered by Olli Rehn, Vice-President of the European Commission and Vítor Constâncio, Vice-President of the ECB. Two new reports were presented:

(1) *European Financial Stability and Integration Report*; and

(2) *Financial Integration in Europe*.

The European Commission's press release in respect of the first of these reports states that:

“

The overall level of systemic risk in EU securities markets decreased throughout 4Q2012.

“Overall, the report shows that despite improvements, the financial crisis continued to exert a significant impact in holding back economic growth in 2012. More specifically, this year’s report:

- Shows that European proposals for the establishment of a banking union stem from the need to deepen economic and financial integration in Europe.
- Covers the main policy initiatives that have been or are being implemented, adopted, presented, or developed in 2012.
- Takes stock of the important debate initiated by governments, international organizations, and, ultimately, the general public to analyse the business models of the financial institutions; in particular, the desirability of adopting structural reforms in the banking sector.
- Describes and takes stock of progress in regulating the over-the-counter (OTC) derivatives markets.
- Underscores the pivotal role the financial sector has in supporting the real economy and in providing jobs and growth for society, by examining the difficulties small and medium-sized enterprises (SMEs) experience in their access to funding.”

The ECB’s press release in respect of the second of these reports states, amongst other things, that:

- “An improvement in financial market integration was observed in the second half of 2012, after a further deterioration in the first half of the year caused by adverse market sentiment, worsened fiscal conditions and bank fragility in some euro area countries. The change in sentiment was triggered by the decision in June 2012 by European leaders to create a single supervisory mechanism as a first step towards a banking union, and by the ECB’s announcement of the Outright Monetary Transactions.”
- “...the climate in the financial markets remains fragile. It is of paramount importance that the momentum towards building a stronger Economic and Monetary Union is maintained. Further progress towards the establishment of a single supervisory mechanism, as well as other components of the banking union, will be a critical factor underpinning financial market performance this year.”
- “There were signs of an improvement in euro area money markets in 2012, but lasting improvements will largely depend on the progress of the various initiatives to strengthen the banking sector which are outside the scope of monetary policy.”
- “The objective of financial integration and consequent further reduction of the still persistent fragmentation can only be achieved by continuing the process of structural and institutional reforms at the national and European levels.”

On 25-26 April 2013, the BIS held a conference, hosted by the Central Bank of Chile in Santiago. A Scientific Committee, led by Stephen G Cecchetti (BIS Economic Adviser and Head of the Monetary and Economic Department), selected papers on the following topics:

- issues in financial stability;
- macroprudential and related policies; and
- exchange rates and monetary policy.

Discussants included researchers from the ECB, IMF, and well-known academics from several universities from Europe and the US.

On 10 June 2013, ESMA published its *Risk Dashboard No.2, 2013*. In summary, ESMA reports that the overall level of systemic risk in EU securities markets decreased throughout 4Q2012, as conditions in equity and bond markets improved. Since mid-December, systemic risk has remained stable. Notwithstanding monetary policy support, the underlying sources of market uncertainty remain in place. Market clustering and fragmentation, funding risk, the low interest rate environment and obstacles to orderly market functioning remained important sources of uncertainty for EU financial stability. The recent restructuring of one national banking sector underlined the continued prevalence of the sovereign debt and banking crisis as a source of risk. On this basis, ESMA's outlook on liquidity, market and contagion risks remains unchanged.

The General Board of the ESRB met on 20 June 2013. Alongside this meeting, the fourth issue of the ESRB *Risk Dashboard* has been published. This reports that: "During the first half of 2013, systemic risk measures have stabilised further."

"Overall, financial market conditions have continued their positive trend. As indicated by the global risk aversion indicator, risk sentiment has remained positive since mid-2012 (indicator 5.1). Price-to-earnings ratios have returned to their long-term average of around 15 (indicator 5.3). Money markets have remained liquid, as indicated by interbank interest rate spreads (indicator 4.1) and by the financial market liquidity indicator (indicator 4.2).

However, volatility has recently increased in short-term interest rate markets for the euro (indicator 5.4) and in the foreign currency markets, particularly against the Japanese yen (indicator 5.6). Similarly, buoyant conditions in equity and corporate bond markets, which have been at record high levels since 2012 (indicator 5.2.a and 3.3), may reflect "search for yield" behaviour with the possible risk of a snapback. Nonetheless, the growth of equity indices has been more moderate in the EU than in other advanced economies."

Nevertheless, "In contrast to the buoyant financial market conditions, the macroeconomic environment has deteriorated further"; and "banks' credit conditions remain weak."

Additionally, the ESRB has made available the 15 June 2013 *OJ* text of the *Recommendation of the ESRB of 4 April 2013 on Intermediate Objectives and Instruments of Macroprudential Policy*. This Recommendation, addressed to macroprudential authorities, Member States and the European Commission, outlines a set of indicative macroprudential instruments aimed at mitigating a possible build-up of vulnerabilities in banks, non-banks and financial infrastructures. The indicative list of macroprudential instruments in table #1 covers a range of items intended to:

(1) mitigate and prevent excessive credit growth and leverage;

(2) mitigate and prevent excessive maturity mismatch and market illiquidity;

(3) limit direct and indirect exposure concentration;

(4) limit the systemic impact of misaligned incentives with a view to reducing moral hazard; and

(5) strengthen the resilience of financial infrastructures.

Addressees are requested to communicate the actions taken in response to this Recommendation, or adequately justify inaction, in accordance with specified deadlines.

On 21 June 2013, the IMF published a staff discussion note, *Macroprudential and Microprudential Policies: Toward Cohabitation*. This note clarifies the essential features of macroprudential and microprudential policies and their interactions, and delineates their borderline. It proposes mechanisms for aligning both policies in the pursuit of financial stability by identifying those elements that are desirable for effective cooperation between them. The note provides general guidance; whilst actual arrangements will need take into account country-specific circumstances, reflecting the fact that that there is no "one size fits all.

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Credit Rating Agencies (CRAs)

On 8 April 2013, the FSB launched a peer review on the FSB *Principles for Reducing Reliance on CRA Ratings* and invited feedback from stakeholders.

In order to support the achievement of the objectives of ESMA, the Board of Supervisors has established the CRAs Technical Committee, which has responsibility for providing advice on policy decisions regarding CRAs to ESMA staff and to the Board of Supervisors. The Technical Committee is chaired by the Executive Director of ESMA; and ESMA published its Terms of Reference on 10 April 2013.

On 13 May 2013, the European Council adopted a Directive and a Regulation amending the EU's rules on CRAs. Adoption of the legislation follows agreement reached with the European Parliament at First Reading on 27 November 2012, and subsequent approval by COREPER on 5 December 2012. The Directive and Regulation amend existing legislation on CRAs in order to reduce investors' over-reliance on external credit ratings, mitigate the risk of conflicts of interest in credit rating activities and increase transparency and competition in the sector. Following publication in the *OJ* on 31 May 2013, these new stricter rules for CRAs entered into force on 20 June.

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Complete harmonization – perfect alignment of rules across jurisdictions – is difficult.

On 31 May 2013, ESMA provided its positive advice to the European Commission in respect of the equivalence between the EU regulatory regime for CRAs and the respective legal and supervisory frameworks of Argentina, Brazil, Mexico, Hong Kong and Singapore (regarding compliance with the EU requirements on endorsement, ESMA has already indicated during 2012 that it considers the legal and regulatory regime for CRAs' supervision of these countries to be "as stringent as" the EU requirements). The European Commission has already published its positive equivalence decisions for the US, Canada and Australia, on 9 October 2012, and for Japan, on 28 October 2010. A positive equivalence determination is required to enable a third country CRA to apply for certification, but other criteria as set out in Article 5(1) of the EU CRA Regulation – including the authorisation or registration of the CRA and its supervision in that third country – also have to be met before any actual certification can be granted.

On 17 June 2013, ESMA announced the publication of its *Guidelines and Recommendations on the Scope of the CRA Regulation*. The *Guidelines* clarify certain aspects of the scope of the CRA Regulation for registered CRAs, market participants operating on the perimeter of this sector and national securities markets regulators. The *Guidelines* focus on a number of areas under the CRA Regulation, which ESMA believes require clarification following its experience of assessing applicants in the registration process and its enforcement of the perimeter under the EU supervisory regime. The areas include enforcement, rating activities, exemptions, branches of registered CRAs outside the EU, and disclosure recommendations.

On 1 July 2013, ESMA announced that it has formally approved, with effect from 1 July, the registration of Spread Research SAS, based in France, as a CRA under Article 16 of the CRA Regulation. Following this decision, there are currently 22 registered and two certified CRAs in the EU. Amongst the 22 registered CRAs, three operate under a group structure, totalling 16 legal entities in the EU, which means that the total number of CRA entities registered in the EU is now 35.

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OTC (derivatives) regulatory developments

On 15 April 2013, the FSB published its fifth semi-annual progress report on *Implementation of OTC Derivatives Market Reforms*. While progress has been made toward meeting the G20 commitments, no jurisdiction had fully implemented requirements by end-2012; and less than half of the FSB member jurisdictions currently have legislative and regulatory frameworks in place to implement the G20 commitments. Nevertheless, FSB member jurisdictions are fully committed to completing the agreed reforms and progress in meeting the G20 commitments is expected to accelerate over the course of 2013.

Jurisdictions will need to resolve a number of outstanding policy issues over the course of this year, including with respect to uncertainties in the application of requirements in cross-border contexts; trade reporting and data access; central clearing and incentives; and organised platform trading. Further international work should take place on remaining issues around authorities' access to trade repository data, such as data standards, and the feasibility of a centralised or other mechanism to produce and share global aggregated data. The FSB will publish a further progress report ahead of the G20 Leaders Summit in St Petersburg in September 2013.

The OTC derivatives regulators group delivered a report to the G20 meeting of Finance Ministers and Central Bank Governors of 18-19 April 2013. Recognising that coordination among jurisdictions regarding the regulation of cross-border activities should facilitate the implementation of the objectives of the G20 regulatory reform agenda for the OTC derivatives market, the report notes that complete harmonization – perfect alignment of rules across jurisdictions – is difficult. Discussions within the group have identified various potential conflicts, inconsistencies and duplicative requirements; and agreement has been reached on the way forward in a number of areas. The report elaborates on these matters and confirms that the group will carry out further work.

EMIR entered into force on 16 August 2012, following which stipulated regulatory technical standards were prepared and entered into force on 15 March 2013. With respect to the continuing implementation of EMIR, ESMA published an updated *Questions and Answers* document on 6 June 2013. ESMA's information page on EMIR exists to provide access to the key documents and information about the regulation.

With the objective of improving the rigour and uniformity of standards applied in assessments of CCP interoperability arrangements, on 11 June 2013, ESMA published its *Guidelines and Recommendations for Establishing Consistent, Efficient and Effective Assessments of Interoperability Arrangements*. These *Guidelines and Recommendations* apply to national competent authorities (NCAs), defining what they should analyse in assessing an interoperability arrangement and therefore on what aspects of the interoperable arrangement the relevant CCPs will need to focus their attention. They do not introduce new requirements for CCPs in addition to the ones specified in EMIR or the relevant technical standards; however, they do specify how those requirements should be met for the purpose of establishing robust and stable interoperability arrangements.

On 14 June 2013, the European Commission sent a letter to ESMA extending the 15 June deadlines for ESMA's advice on the equivalence of third-countries under EMIR. ESMA's advice on the US and Japanese regimes is now due on 1 September 2013, and its advice for other third countries on 1 October 2013.

On 28 June 2013, the BCBS released two consultative papers, for comment by 27 September, on the treatment of derivatives-related transactions under the capital adequacy framework. First, the *Non-Internal Model Method for Capitalising Counterparty Credit Risk Exposures* outlines a proposal to improve the methodology for assessing the counterparty credit risk associated with derivative transactions; and second, *Capital Treatment of Bank Exposures to Central Counterparties* sets out proposals for calculating regulatory capital for a bank's exposures to central counterparties (CCPs).

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The ESFS review

By Katie Kochmann

Background to the ESFS review: The European System of Financial Supervision (ESFS) brings together the European Supervisory Authorities (ESAs) which include the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). From the beginning of 2011, these authorities were set up to complement existing national competent authorities in order to carry out microprudential surveillance, while at the same time preparing and implementing harmonised technical standards and guidelines on new and revised financial regulation. Additionally, the ESAs also support the work of the newly established European Systemic Risk Board (ESRB) which, by statute, provides macroprudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability.

What is the purpose of the ESFS review? The legislative acts establishing the ESFS framework provide for a review by the European Commission of the ESRB by 17 December 2013 and of the ESAs by 2 January 2014. The associated public consultation will run until 19 July 2013 and is designed to give all stakeholders alike a chance to contribute their views on the achievements and shortcomings of the ESAs and the ESRB and how they have fared over the past two years. While the ESAs and the ESRB have undertaken useful work, one of the difficulties with a review after just two years is that judgments are somewhat premature. The ESAs and the ESRB need more time to show their worth and finish important tasks, recruit more manpower and establish themselves as credible contributors to the overall effectiveness of the EU financial regulatory system.

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by Ruari Ewing
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Primary Markets

Prospectus Directive review

There have been many developments concerning the PD regime over the past quarter, including several quite significant ones.

ICMA's response of 8 April 2013 to the consultation on *Primary Market Bulletin No. 5* relating to certain of the UK Listing Authority's technical and procedural notes was briefly noted in the 2Q2013 edition of this Quarterly Report (at page 31). The response covered various points. Notably:

(1) it *generally* noted (i) the need for clarity and consistency of individual regulator approaches to the PD regime, (ii) the need for PD amendments to be interpreted according to both the spirit of the regime and efficient markets and (iii) the value in regulators blacklining proposed changes when consulting on them;

(2) concerning the *UKLA's eligibility review process*, it welcomed the UKLA's clarifications;

(3) concerning the *PD audited accounts requirement*, it noted issuers can seek formal derogations where the guarantor's accounts are sufficient;

(4) concerning *supplements*, it (i) welcomed paragraphs 22-24 of the ESMA consultation reported below (in particular the statement that "significance or materiality should be assessed according to the same qualitative and/or quantitative criteria used when drafting the prospectus"), (ii) emphasised that the supplement test is for issuers to make, as it is they who bear liability for prospectus accuracy, (iii) noted that offer reasons and proceeds use can be included in final terms and so therefore would not generally need to be considered in the context of supplements and (iv) suggested that the UKLA policy that supplements for PD-exempt offers need not include "walkaway rights" legends should be set out in the relevant technical note;

(5) concerning *risk factors*, it (i) noted the lack of clarity as to what extent "key" risks in summaries differ from "material" risks in prospectuses (or should, as matter of policy, do so), (ii) emphasised that the "key" test is for issuers to make as it is they who bear liability for summary accuracy;

(6) concerning *final terms* (FTs), it (i) noted that the (valuable) inclusion of drafting notes in prospectus forms of FTs is not prohibited by PD legislation, (ii) noted that segregating PD-exempt provisions is not required by item 49 of the current ESMA Q&A on Prospectuses (see

below) and is excessively burdensome given that forms of pricing supplement can be appropriately legended, (iii) emphasised that requiring wholesale FTs to include an issue-specific summary (ISS) has no clear legislative basis, (iv) requested clarification that ISSs do not need to include generic programme information that is not specific to the issue concerned, (v) emphasised that base prospectuses should be permitted to include distinct base prospectus summaries and pro-forma ISSs, (vi) noted that low denominations do not necessarily equate to PD non-exempt offers and (vii) noted that inclusion of worked examples in FTs may sometimes be misleading rather than necessarily being the most effective way of explaining complex securities, such that inclusion of worked examples should be an issuer choice (as it is they who bear liability for FTs' accuracy); and

(7) concerning *derivative securities disclosure*, it (i) welcomed the UKLA's confirmation that zero coupon securities maturing at par are not within Annex XII or XX(12) of the Prospectus Regulation (PR) and (ii) requested confirmation that securities not linked to an underlying, though maturing at an amount other than par, also fall outside such disclosure requirements.

ICMA also submitted on 28 June 2013 a response to the ESMA consultation concerning supplements described in the 2Q2013 edition of this Quarterly Report (at page 31). In responding to the specific questions raised by the consultation, ICMA generally commented on the direct and indirect costs of supplements and more specifically noted that:

(1) issuer solvency, rather than profitability, is relevant to debt investors and this may affect the analysis as to whether certain events require supplements to debt prospectuses;

(2) programme base prospectuses may be supplemented outside non-exempt offer periods or specific admission applications (to bring base prospectuses to the same "starting gate" as a hypothetical "standalone" prospectus being approved at that time);

(3) listing specific situations as supplement triggers risks creating moral hazard and in any case the specific situations suggested by ESMA do not currently face legal uncertainty or lack of harmonised approach in practice;

(4) it is indeed for issuers to decide whether the PD supplement trigger has been met, as they have the best understanding and bear the liability for prospectus accuracy and there should be no systematic supplement triggers for debt issuers;

(5) rather, ESMA should include in its Q&A on *Prospectuses* the points made in paragraphs 22-24 of the consultation that the test for supplement disclosure is the test for prospectus disclosure and could in this respect also include in its Q&A on *Prospectuses* guidance setting out specified situations where issuers should consider whether or not they should publish a supplement;

(6) it is not clear how the ESMA proposed technical standards (RTS) will fit with the Prospectus Directive and Prospectus Regulation and it would make sense if the RTS were to amend the Prospectus Regulation rather than exist as a separate regulation;

(7) there is ongoing market uncertainty relating to the extent to which "securities note" disclosure can be updated by way of a supplementary prospectus (though PD Article 16 is not, on its face, limited to registration document disclosure) and it would be helpful if ESMA were to clarify within its *Q&A on Prospectuses* that it considers this indeed to be possible;

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The supplement test is for issuers to make, as it is they who bear liability for prospectus accuracy.

(8) there is also ongoing market uncertainty as to whether withdrawal rights apply to supplements for exempt offers and it would be helpful if ESMA were to clarify within its *Q&A on Prospectuses* that it considers this not to be the case and that accordingly no "walkaway rights" legends are required;

(9) finally, there is an ongoing debate on what constitutes "information to be disclosed on taxes withheld at source" concerning "host" countries where offers are made or admissions sought, with item 45 of ESMA's *Q&A on Prospectuses* conflicting with the Prospectus Regulation (which only requires disclosure on withholding "at source" on payments by issuers or their legally-appointed agents and not on any withholding that may occur "downstream" in subsequent on-payments by third parties). This could ultimately threaten the existence of a pan-EEA securities market, so it would be helpful if ESMA were to clarify within its *Q&A on Prospectuses* that it considers that the information to be disclosed does not necessarily extend to host countries.

ESMA has published a 19th version of its *Q&A on Prospectuses,* including four new Q&A, of which two have particular relevance to bond prospectuses (Q&A 84 and Q&A 85). Q&A 85 is helpful in clarifying that a financial intermediary's expenses do not need to be disclosed in summaries. Q&A 84 seems to indicate that draft financial information is a "profit estimate" only until it is formally published after approval, whilst fourth quarter unaudited whole year information is "interim" financial information.

ESMA has published a report comparing liability regimes in Member States in relation to the Prospectus Directive. The report distinctly analyses administrative sanctions, civil and criminal liability and also government liability aspects. Most of the findings should hopefully not come as a surprise to practitioners, though it may be interesting to note that five countries impose civil, as well as administrative, responsibility on a strict liability basis and a few Member States impose criminal liability for simple negligence. Generally, ESMA found EEA Member States apply either entirely general provisions or a combination of specific provisions supported by general provisions to address the four liability areas and that there are areas of commonality as well as a wide range of possible approaches (none of which are more or less correct than the other). ESMA notes, particularly concerning cross-border transactions, that jurisdictional diversity might make it difficult for market participants to assess their risks and rights. However, market participants do not try to adjust their professional diligence in preparing prospectuses by reference to the specific national liability regime that is applicable. The existence of any form of significant and commonsensical liability regime is sufficient to ensure issuers are suitably focussed when preparing prospectus disclosure. Consequently, a harmonisation of, or other minor changes to, the individual jurisdictional liability regimes would seem unnecessary (as well as being beyond the EU's jurisdiction). ESMA has not analysed the reasons underlying the national differences as this was outside its mandate and in any case would require significant further research covering also cultural, political and historical aspects.

ESMA has also published a report containing data on prospectuses approved and passported between January and December 2012.

The European Commission published at the end of April 2013 a proposed third amending Regulation to the Prospectus Regulation concerning convertible and exchangeable debt securities. As reported in the 4Q2012 edition of this Quarterly Report (at page 29), ICMA did not respond to the ESMA consultation concerning this Regulation, as its focus is on exchangeable and convertible bonds that are more closely linked to the equity markets than to the debt markets. The proposed Regulation is subject to an objection period at the European Parliament.

Euromoney's 4th Prospectus Directive Conference is taking place in London on 24-25 September, with participating regulators including ESMA, France's AMF, The Netherlands' AFM, the Central Bank of Ireland and Germany's BaFIN.

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Packaged Retail Investment Products

ICMA continues to focus on the Packaged Retail Investment Products (PRIPs) initiative, particularly from the vanilla debt securities' perspective, with several developments in recent months.

The European Council has adopted, as a General Approach, a 24 June Presidency compromise proposal (subject to a reservation by Italy concerning life insurance and administrative sanctions). This follows an earlier 28 May compromise proposal, which seemed slightly better.

Scope: The General Approach seems still to limit the scope of the proposed PRIPs Regulation to "packaged" products, excluding vanilla debt securities. However, this seems subject to Member States' power to extend the scope on a national basis and also continues to be subject to a four-year review clause for the possible extension of scope. It is therefore important to continue focussing on how aspects of the proposed Regulation can inhibit vanilla bond issuance.

Jurisdiction: It seems that the scope itself of the Regulation may be a minimum harmonisation element, so that individual Member States can either impose national requirements on out-of-scope products or extend the scope to cover such products – presumably only if sold or advised on in their territories. However, it seems the European Commission would expect the content and format of the PRIPs KID to be a maximum harmonisation element. This would certainly be essential if one wishes to support the single European market philosophy. In this respect, the Regulation should include a provision similar to the Prospectus Directive (PD) Article 17.1, to the effect that host competent authorities should leave it to the competent authority of the PRIP manufacturer's home jurisdiction to decide to challenge a particular KID's conformity to the Regulation and should not be able to impose any additional procedures. Otherwise, issuers are likely to have to prepare up to 30 different KIDs for each product. However, the General Approach provides that the competent authorities in the jurisdictions where a product is marketed will have the right to suspend the marketing of a PRIP "in cases of non-conformity with this Regulation". This needs to be clarified further. At the very least, the suspension power should be clearly limited to actual distribution (ie contractual offers) and not merely to the communication of information (the PD offer definition) – otherwise the PD pan-European passport itself will have been undermined.

The General Approach provides for Member States to designate competent authorities "to supervise the requirements this Regulation places on PRIP manufacturers and the persons advising on or selling PRIPs", adding such authorities should be "consistent" with those "appointed with competence for the marketing under an existing passport". Concerning securities, the overlapping application of the Prospectus Directive (including its thus entirely superfluous issue specific summary) is maintained and would seem to be a basis for any "passport" for offering PRIPs that are debt securities. This would seem to imply that PD competent authorities would be designated as PRIPs competent authorities. However, one may query whether other passports (for example concerning the MiFID reception and transmission of orders) might also be relevant, in which case there could be some ambiguity as to who would be the PRIPs competent authority (at least in jurisdictions where responsibilities are not centralised within one regulator). Further clarity may be needed in this respect.

Filing: Member States in which PRIPs are marketed may require the *ex-ante* notification of KIDs.

Duration/updating: It seems the KID obligation "will apply as long as the PRIP is traded on secondary markets", though it is unclear if such trading needs to involve the manufacturer/issuer. This could potentially result in due course (if vanilla securities are brought into scope) in European real-economy corporate issuers having to maintain updated KIDs on a 24/7 basis until maturity of their bonds – which could be decades or even more. Presumably this would strongly incentivise such issuers to avoid European retail issues.

Publication: This would have to be on the manufacturer/issuer's website, which may also prove challenging for many European real-economy corporate issuers, given the potential need to account for, eg third country rules on deemed directed selling efforts.

> A critical point is to ensure that the PD regime exemptions, created to protect the wholesale markets from retail restrictions, are replicated in the PRIPs Regulation.

Purpose: The KID purpose is stated as being "to help [investors] understand the nature, risks and rewards of [the] investment product and to help [them] to compare it against other investment products." Whilst an improvement on other "informed investment decision basis" renditions (discussed in prior editions of this Quarterly Report), it could be further clarified that KIDs can only act as an introduction to either a full reading of the prospectus (for the minority of investors who are able and allowed to do so) or to regulated intermediation under MiFID (where the intermediary is required to know the product as well as its client in order to establish suitability/appropriateness).

Liability: The civil liability standard has been amended so that it is now stated as not being applicable "unless the KID is inconsistent with pre-contractual or contractual documents [...] or is misleading or inaccurate." This is inconsistent with the PD summary and UCITs KID liability standards (where liability only arises if the KID is *"misleading, inaccurate or inconsistent when read together with [the prospectus]")* and applies an administrative liability standard to civil liability – which may have a further chilling effect on European real-economy corporate issuers considering whether to engage with European retail investors.

Other changes: These include the apparent deletion of specific ADR provisions, nuances on distance communication and product options available to investors.

Unchanged aspects of the Council's drafting have been previously commented upon in the 1Q2013 edition (at page 32) of this Quarterly Report; whilst ICMA's concerns about the PRIPs debate more generally have been articulated most recently in the 2Q2013 edition (at pages 32-34) of this Quarterly Report. Pervasive concerns relate to (i) purpose/liability, (ii) distributors, who act independently of (and are even unknown to) manufacturers/distributors, causing such manufacturers/distributors to incur substantial liability, (iii) the inability of manufacturers to include distributor-level information in their KIDs and (iv) the adequacy of synthetic risk indicators. A critical point is to ensure that the PD regime exemptions, created to protect the wholesale markets from retail restrictions, are replicated in the PRIPs Regulation – it would be absurd for a KID to be imposed where no prospectus is required under the PD.

The Council's General Approach will be its starting point for the expected trilogue negotiations with the European Commission and the European Parliament (EP), which has not yet adopted its own position in this respect. However, internal opinions were adopted in April by the EP's LIBE and IMCO committees. These reiterate many points previously noted, though also raise some new aspects, notably: (i) responses to complaints having to be in the same language as the complaint (with no qualification on the range of languages envisaged), (ii) reference having to be made to appropriate "risk-free" and comparable benchmarks (the existence of which may be debatable), (iii) publication of KIDs having to be on websites investors are "familiar" with (which may be highly subjective) and (iv) KIDs having to include disclosure on money laundering laws.

In the background to all this, the three European Supervisory Authorities have hosted a joint Consumer Protection Day, which involved lively, and hopefully fruitful, debate and is expected to be replicated in 2014.

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Asset encumbrance

by Katie Kelly

As reported in the Second Quarter 2013 edition of this Quarterly Report, on 25 March 2013 the European Banking Authority (EBA) launched a consultation on *Draft Implementing Technical Standards (ITS) on Asset Encumbrance Reporting,* which set out reporting templates (and corresponding user instructions) for reporting asset encumbrance. The consultation came about as a result of the mandate under Article 95a of CRR for the EBA to develop reporting templates for asset encumbrance and of the ESRB *Recommendations on Funding of Credit Institutions,* which task the EBA with developing guidelines on market transparency requirements for credit institutions on asset encumbrance.

While a lot of data already exists on encumbrance, that data tends to be fragmented and provided under different reporting requirements. One consequence of the EBA asset encumbrance reporting exercise under the ITS is expected to be harmonisation of the available information at a European level in order to provide comparable information across all firms, albeit between firms with different funding models and in different jurisdictions.

The EBA held a public hearing relating to the ITS on 2 May 2013, which consisted of a presentation followed by a question and answer session. A full copy of the ICMA response to the consultation is available to view on the ICMA website. However, a summary of the salient points follows.

The relevant reporting information is required to be reported under the ITS to the national authorities on the basis of individual institutions, and should only be required on a consolidated basis for institutions with a centralised funding and liquidity operation: ie at group level on a consolidated basis. While the reporting requirement may be an information-gathering exercise, it is however important to ensure that the information is put to the correct use and considered as part of a range of variables in order to reach a correct, qualitative analysis of asset encumbrance levels. For example, consideration should be given to the different sources of encumbrance, the reasons and context for certain levels of encumbrance and differing business models.

The templates themselves capture two different sets of variables: first, information regarding subordination of the balance sheet (much of which can be gathered from the accounting systems set up to provide such information as required under IFRS); and second, information regarding liquidity capabilities (which is not dissimilar to LCR/NSFR information, and is a function of a bank's treasury department). Mixing the two sets of required information is a very complex operation for the banks and it is unclear what value can be derived, and what can be concluded, from such a mix of information.

Further, the templates assume a single allocation of encumbered assets to be matched against specific liabilities, which is not reflective of the balance sheet position in practice. In order to take account of this disparity, reporting should be required on an aggregated cover pool level as opposed to an individual loan level.

The ITS prescribe certain stress-testing to be carried out to evaluate contingent encumbrance. Due to national stress test requirements, this may lead to double stress-testing and an overlap with the recovery plans set out in the Recovery & Resolution Directive. This additional stress-testing of encumbrance levels may put a lot of pressure on a bank's treasury team.

Banks currently report by different asset classes using a number of valuations, so capturing the additional information required by the templates may require costly new IT systems, and the administrative burden of the reporting could outweigh the funding advantage of issuing certain instruments. Additionally, reporting on unencumbered assets that are eligible to be encumbered from across the whole balance sheet could pose a massive burden on the banks.

This cost/benefit analysis is particularly relevant to those institutions which do not consistently reach or exceed the required thresholds of total assets or material asset encumbrance, or which do occasionally reach the material asset encumbrance threshold, and for whom full reporting templates may therefore be too complex. That said, it would be unwise to assume that only the larger institutions which consistently exceed the thresholds are the only ones capable of being troubled, so in order to maintain a level playing field, smaller institutions should remain subject to reporting requirements, albeit on the basis of simplified measures and additional proportionality criteria.

Reporting is expected to commence from May 2014. However, given the complexity of reporting, the end of 2014 is considered to be a more realistic time-frame for institutions to put their systems in place.

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Own funds

The European Banking Authority (EBA) published on 5 June 2013 near-final *draft Regulatory Technical Standards (RTS) on Own Funds* covering, among others, areas such as common equity Tier 1, additional Tier 1, deductions from common equity and from own funds in general and transitional provisions on grandfathering. In particular, the RTS elaborate on provisions relating to additional Tier 1 instruments and, more specifically, on write-up and write-down mechanisms.

The RTS follow-on from the EBA's consultation on *Own Funds (Part 1)* launched on 4 April 2012, to which the ICMA submitted a response on 3 July 2012. In that response, the ICMA emphasised the need for a balance between regulatory requirements for a capital conservation instrument, and an ability to market it to fixed income investors without them being subordinated to common equity holders. Alternatives were proposed to the effect that either distributions should not be payable on common equity or additional Tier 1 capital in either a temporary or a permanent write-down situation, or distributions should still be able to be made on the reduced amount not subject to the temporary write-down. The EBA has acknowledged in the RTS the potential inversion of the capital hierarchy, and has stated in its final proposal with regard to these points raised by the ICMA (and others) that the full cancellation of distribution payments during the write-down period will be no longer mandatory in the case of temporary write-downs, and that institutions may elect to pay a distribution on a reduced nominal amount or write-up the instrument subject to certain restrictions.

With respect to write-ups, the ICMA suggested that banks should have full discretion to write up an instrument (and at a more accelerated rate than proposed) and to manage their own capital, which includes granting them the maximum flexibility for payments of distributions on a temporary write-down in order to satisfy their fixed income investors and allow their positions to recover. However, the EBA maintains its view in the RTS that no acceleration of the write-up mechanism should be allowed.

Although the draft RTS reflect the current proposal of the EBA in the aforementioned areas, they remain of a preliminary nature pending the publication of the final CRR in the *Official Journal.* The draft RTS are being published at this juncture, before their submission to the European Commission, on an exceptional basis to provide institutions with an early insight into the views of the EBA relating to capital instruments under the new regulatory framework and to give feedback on the way comments on the original consultation have been addressed. To this end, the EBA has provided a helpful summary of the key issues raised by all the respondents to the original consultation, together with their responses thereto, in the accompanying documents to the RTS.

Against this background, institutions that decide to issue capital instruments pursuant to these near-final draft RTS, in the run-up to the adoption and entry into force of the final RTS, need to be aware that the final rules may differ from the preliminary draft.

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Other primary market developments

In other developments, the revised Transparency Directive (TD) has reportedly been approved by the European Parliament, but not, as of the time of writing, published in the EU's Official Journal. There have been no major concerns for the new bond issuance process arising previously out of the TD review, and as reported in the 3Q2012 edition of this Quarterly Report (at page 36), ICMA has only focussed on the review of the TD insofar as it exclusively impacted bond issuance.

Separately, on 26 June, the COREPER approved a trilogue compromise text reached with the European Parliament on the proposal for a Market Abuse Regulation (MAR). The agreement remains subject to technical alignment following the outcome of the trilogue negotiations on the revised MiFID and MiFIR. The published text has technical errors and so a corrected version is awaited.

Finally, the Joint Associations Committee on Retail Structured Products (JAC) that ICMA supports submitted (i) on 10 May 2013, a response to the UK FCA on CP13/9 concerning the implementation of AIFMD, reiterating that it should be clear that structured issues fall outside the scope of the AIFMD; and (ii) on 13 June 2013, a response to the IOSCO Consultation Report on the Regulation of Retail Structured Products, which was launched by IOSCO in order to better understand and analyse trends and developments in the retail structured product market and develop guidance where appropriate.

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by David Hiscock

Short-Term Markets

European repo market

FTT: In its press release of 8 April 2013, ICMA highlights that the proposed EU Financial Transaction Tax (FTT) would cause the short-term repo market in Europe to contract by an estimated amount of at least 66%, with serious negative consequences for other financial markets and the real economy; and hence the ICMA European Repo Council (ERC) calls for the exemption of repo transactions from FTT.

This press release announced the publication of an ICMA ERC study, *Collateral Damage: the Impact of the Financial Transaction Tax on the European Repo Market and its Consequences for the Financial Markets and the Real Economy,* authored by Richard Comotto, Senior Visiting Fellow at the ICMA Centre, Henley Business School, University of Reading.

This study lays out the current scope and aims of the proposed FTT and then describes how the FTT would impact repo transactions. The study next quantifies the cost impact of the FTT proposal on the European repo market and analyses how this cost would change the European repo market. The study then goes on to identify repercussions from the impact of the FTT on the repo market on: the money market; the implementation of monetary policy; the securities market; financial stability and regulation; the real economy; and some possible unintended consequences.

The study concludes: "As it is unlikely that the FTT will be abandoned or replaced by an alternative such as financial activity tax, realistic modifications need to be proposed that would avoid the extreme outcomes of the present proposal. These modifications should include:

- the exemption of secured financing transactions such as repo and securities lending from the FTT, and all movements of securities during the term of a transaction pursuant to the management of collateral (eg substitution), in order to support the collateralisation of the financial market;
- the exemption from the FTT of primary dealers and market makers in fixed income securities markets, in order to preserve the efficient pricing and distribution of capital."

Discussions prompted by the publication of this study highlighted the need to further explain the importance of collateral, how repo serves to facilitate collateral movements and the consequent implications of the FTT proposal for collateral. Consequently, on 7 May 2013, ICMA published *A Supplementary Note on the Systemic Importance of Collateral and the Role of the Repo Market,* also authored by Richard Comotto. This concludes: "Given the systemic role of collateral, it should be a matter of the greatest concern for regulators, central banks, financial intermediaries, and investors and borrowers (not least governments) that, under the current proposal by the European Commission for a Financial Transaction Tax in 11 of the Member States of the European Union, movements of collateral through the repo market, as well as supplementary movements in support of efficient collateral management (optimisation and possibly margining), would be taxed at a flat rate that would extinguish the repo and securities lending markets."

Leverage ratio: On 12 April 2013, the ICMA ERC wrote to the European Commission and the Parliament to draw urgent attention to the ERC's serious concern as to the consequences of a late amendment made in the text of the Capital Requirements Regulation (CRR) as approved by COREPER on 27 March. A technical amendment to Article 416 of the CRR, introduced late on in the technical trilogues, appeared likely to result in an interpretation whereby appropriate netting of payables and receivables would be prohibited for repurchase transactions and other securities financing arrangements. This would have significantly increased the capital required to maintain required leverage ratios and significantly discourage repo and securities lending activities. Reassuringly, the significance of these concerns was promptly recognised and just a few days later the actually adopted CRR text was changed to allow for the appropriate recognition of netting in the new leverage calculations.

On 26 June 2013, the BCBS published its *Revised Basel III Leverage Ratio Framework and Disclosure Requirements* for consultation, with a comment deadline of 20 September. The working assumption is for a minimum 3% leverage ratio requirement, based on Tier 1 capital divided by the defined exposure measure (quarterly numbers will be required, derived as the average of the three month-end leverage ratios over the quarter). The consultation paper includes a section headed *Securities Financing Transaction (SFT) Exposures* (on pages 10-11). In general this states that the exposure measure for SFTs will be the sum of the gross SFT assets (with no accounting netting) plus a measure of counterparty credit risk calculated as current exposure without an add-on for potential future exposure. This current exposure calculation recognises the effect of "qualifying master netting agreements" (which are specified in paragraphs 12 and 13 on page 21). The ERC is currently reviewing this text.

Shadow banking: On 11 April 2013, the CPSS and IOSCO published for public comment, by 10 May, a consultative report entitled *Authorities' Access to Trade Repository Data*. The purpose of this consultative report is to provide guidance to trade repositories (TRs) and authorities on the principles that should guide authorities' access to data held in TRs for typical and non-typical data requests. The report also sets out possible approaches to addressing confidentiality concerns and access constraints. Accompanying the report is a cover note that, besides inviting general comments, lists eight specific issues on which the CPSS and IOSCO sought comments during the public consultation period.

Whilst considering that there was little specific feedback which the ERC should uniquely deliver in response to the consultation, anticipating the forthcoming move to a more detailed phase of work in respect of potential repo TRs, it was considered important that the ERC is seen to be visible and collaborative in relation to official initiatives in this topic area. Accordingly a short ERC response was submitted. The one specific point commented on in this response is the need to develop a technologically efficient solution, for the mutual benefit of reporting firms and the public authorities. The ERC Operations Group has formed a new sub-group to focus on the TR topic area, which has held two meetings. Prospectively this will provide a valuable channel to focus the ERC's efforts in this area, as we progress towards delivery of the enhanced repo market transparency which the public authorities seek.

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The future of the repo market

On 11 June 2013, an audience of almost 200 attended a sell-out ICMA organised event, kindly sponsored and hosted by Thomson Reuters, on *The Future of the Repo Market – an International Conference of Academic Experts, Regulators and Market Practitioners.*

This ICMA event was devised as a conference of experts from academia, regulatory agencies and the market to reassess the role of repo in the financial crisis, consider whether proposals for macro-prudential regulation of the repo market will achieve their aims, and weigh the impact of new regulation, economic and financial constraints and emerging technologies on the structure and efficiency of the repo market in Europe and beyond.

Following introductory remarks, the opening keynote address, entitled The *Future of Repo:"Too Much" or "Too Little"?*, was delivered by Andrew Hauser, Head of Sterling Markets Division, Bank of England. Subsequent keynote addresses were delivered by Francesco Papadia, Chairman of the Board of the Prime Collateralised Securities (PCS) and former Director General, Market Operations, ECB; and Manmohan Singh, Senior Financial Economist, IMF.

Interspersed between these speeches there were three expert panel sessions:

- What actually happened in the repo and other financial markets in 2007-2009?
- Is repo an unstable source of funding? The issues of procyclicality of leverage, interconnectedness, asset encumbrance, collateral reuse and fire sales.
- The future market for collateral and the prospect of systemic shortages.

All speakers' contributions were well received and ICMA is grateful for the time and expertise which they contributed, as well as to Richard Comotto for his orchestration of this successful event.

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ECP market

FTT: As described in the previous issue of Quarterly Report, the European Commission has proposed an FTT for adoption by 11 of the EU's Member States. Given the flat rate basis of the proposed FTT charges, the impact will be dramatic in case FTT costs do come to be imposed in a way which bears upon the ECP market. This is because the effective economic impact of the FTT charge is strongly amplified when the flat rate cost is put in the context of short term financing activities. There are three distinct ways in which the FTT's cost could bear upon ECP:

(1) in case it should be applied to the origination activity – although this should not be the case, since the Capital Duties Directive 2208/7/EC is understood to prohibit the imposition FTT in such a case;

(2) in case it should be applied to any secondary market ECP – since it would render such secondary market activity completely uneconomic, with consequent highly adverse implications for origination activity as buyers would be forced to assume the need to always hold to maturity; and

(3) in case it should be applied to associated derivatives activity – which is highly significant since market conditions have made it economically attractive for issuers seeking euro funding to issue ECP denominated in US dollars and swap the proceeds back to euro; and much issuance would no longer be economic with FTT on the swap.

Given the importance of ECP funding, any FTT that is adopted needs to be carefully designed to ensure that its costs do not create any unrealistic burdens on the market.

Money market funds (MMFs): On 5 June 2013, the US SEC voted unanimously to propose rules (open for public comment until 90 days after publication in the Federal Register) that would reform the way that money market funds operate, with the intention of making them less susceptible to runs that could harm investors. The SEC's (698 page) proposal document includes two principal alternative reforms:

(1) require a floating net asset value (NAV) for prime institutional money market funds; and/or

(2) allow the use of liquidity fees and redemption gates in times of stress.

The proposal also includes additional diversification and disclosure measures that would apply under either alternative. The opening statement given at the 5 June SEC open meeting by SEC Chairman Mary Jo White has been published, alongside statements delivered by other SEC Commissioners.

Meanwhile, in Europe the Commission is currently expected to publish its proposal for an EU MMF Regulation by the end of July 2013. The proposed Regulation will rely on the existing authorisation and/or registration procedures for funds subject to the UCITS Directive or the AIFM Directive. Hence managers will continue to be regulated by either the UCITS or AIFM Directive but funds falling under the scope of the MMF Regulation will have to comply with this additional layer of specific MMF product rules. These new uniform rules are intended to safeguard the integrity of the internal market and increase its robustness to minimise the effects of any new crisis. The Commission hopes that investors will gain awareness over the risks attached to these regulated products; managers will benefit from harmonized product rules all over Europe; and issuers of money market instruments will profit from a more stable environment that will preserve the role of MMFs as a financing tool.

> **This important channel for bringing investor funds to meet the financing needs of ABCP issuers will be cut off.**

Notwithstanding these worthy intentions, there are inevitably concerns attached to the introduction of new regulation. In this case one key cause for significant concern is the indication that the Commission will propose that EU MMFs be prohibited from taking exposure to a securitisation, including any exposure to ABCP. Given the importance of ABCP funding this is a big problem because, whilst ABCP represents a relatively small proportion of the total assets held by MMFs, easily the largest class of investor in ABCP is MMFs. Hence this important channel for bringing investor funds to meet the financing needs of ABCP issuers will be cut off if such a proposal is adopted. This would appear contradictory to today's economic requirements and inappropriate given the relatively safe risk profile that is in fact presented by the ABCP assets in question. Furthermore, even when considering the totality of the ECP market, MMFs represent a significant proportion of the investor base. As such, there is also a more general point of concern that, in case the MMF regulation precipitates a contraction of the MMF sector, this would itself serve to constrain an important channel for the financing of economic activity.

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ECP and ABCP

The ECP market is a professional short-term debt market which offers opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. ECP is the largest and most liquid CP market in Europe, with ICMA's ECP Committee representing the main dealers in the ECP market.

ECP has been designed from the beginning to integrate European money markets and has offered a pan-European documentation model for more than twenty five years. There have been no scandals or accusations of improper ECP dealing since market inception in the mid-eighties. ECP dealers are well capitalised and highly regulated banks and securities firms. On 27 October 2005, ICMA released a standard information memorandum and a dealer agreement which were developed by an ICMA Working Group in cooperation with three prominent international law firms, using the experience of the most prominent ECP practitioners, and is regarded as a market standard of best practice.

ABCP is a particular form of CP issuance which has benefits for both issuers and investors; and whilst it forms a relatively small proportion of the total ECP market it is currently the source of €30 billion of relatively cheap funding. In terms of benefits for issuers, these include cost-effective financing of both client-driven assets and securities investments; capital relief (in some cases) and capital-efficient financing; flexibility to fund in varying amounts and currencies to match current business volume needs, and also to provide short-term loan or securities warehouse financing prior to ABS term issuance. Issuers also benefit from having access to both European and US ABCP investor markets as well as a diversified investor base with high geographical and type differentiation. In many cases this form of funding is considerably cheaper than other longer term alternatives; and in the absence of the ABCP sector there is no certainty that these users could achieve similar financing terms.

ABCP investor benefits include incremental spread over many corporate CP programmes, a wider investment product offering and diversification; the ability to invest in instruments with a defined purpose, structure, and strategy which can be analysed in detail if desired; a large amount of continuous supply; and flexible maturities.

ABCP issues can be made in a variety of structures, the most prevalent of which (>50% of European issues) is the multi-seller structure. It is important to note that, even throughout the period of the financial crisis, investors have not suffered defaults on multi-seller Asset-Backed ECP or USCP. Defaults associated to ABCP in the crisis came from SIVs, which did not have 100% backstops and relied on the sale of assets to repay non-rolling CP, which was not possible in distressed markets. Fundamentally, SIVs are a different product which is no longer marketed.

ICMA believes that ECP, including in the form of ABCP, plays an important role in providing much needed funding to the benefit of issuers and investors. With the economy currently in clear need of access to sufficient sources of funding, as efforts continue to stimulate economic growth, the case for an efficient and effective CP market is more evident than ever.

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LIBOR and other benchmarks

On 16 April 2013, IOSCO published a consultation paper on *Principles for Financial Benchmarks.* Specifically considering the ICMA's previous work in this area, the aspect of this consultation which is of most direct interest to the ICMA is the strong emphasis that IOSCO's proposed principle #7 on Data Sufficiency (at page 17 of the consultation report) places on the use of transactional data. Accordingly on 16 May 2013 ICMA submitted a short response to this consultation, which draws attention to ICMA's earlier 11 February 2013 response to IOSCO and restates key points therefrom. In relation to this latest consultation, IOSCO's press release of 3 June 2013 announced that more than 40 responses were received, which have now been made these public.

On 11 February 2013, ICMA submitted a *Response to ESMA-EBA's joint consultation on Principles for Benchmark-Setting Processes in the EU.* In relation to this consultation ESMA's press release of 6 June 2013 announced the publication of the finalised *ESMA-EBA Principles for Benchmark-Setting Processes in the EU.* These Principles are designed, in a manner which is stated to be consistent with the work being done by IOSCO, to address the problems identified with benchmark-setting processes and their application will also help in the transition to any potential future EU legal framework for benchmarks. ESMA-EBA consider it important that these Principles are implemented by all market participants and anticipate reviewing the Principles' application after 18 months. Whilst the finalised Principles have been adapted to make clear that actual market transactions should be used where appropriate for Benchmark Calculations, leaving the flexibility to also use quote-based approaches, further work on possible transaction-based alternatives will be carried out by ESMA and the EBA in the near future.

> **"Input data which is not transaction data may be used in addition to transaction data, provided that such data is verifiable.**

Meanwhile the European Commission is working on a draft Regulation on Benchmarks. In respect of ICMA's key concern, about the need to retain flexibility in order to support the legal certainty of existing contracts, draft Article 6 provides that "...input data which is not transaction data may be used in addition to transaction data, provided that such data is verifiable." As has been widely reported, this draft suggests that ESMA will take on an important new role as the competent authority in respect of "critical Union benchmarks".

Following its 24 June 2013 plenary meeting, the FSB announced its decision to establish an Official Sector Steering Group of regulators and central banks to coordinate consistency of reviews of existing interest rate benchmarks. The Group will also convene and guide the work of a Market Participants Group which will review options for robust reference rates that meet the needs of the private sector, and any potential transition issues. The Steering Group will examine whether the governance and processes around these benchmarks meet agreed international standards, including those being developed by IOSCO. The Group will be broadly representative of the national or regional authorities that are home to each major reference rate: and will be chaired by Martin Wheatley, Managing Director of the UK FCA, and Jeremy Stein, Governor of the US FRB.

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Publication of ICMA's 2011 GMRA Protocol

ICMA has published the *2011 Global Master Repurchase Agreement Protocol (Revised)* to enable the parties to a GMRA 1995 or a GMRA 2000 to amend the terms of each such agreement to reflect certain provisions of the GMRA 2011, as published by ICMA, and also to insert a definition of euro into each such agreement.

By adhering to the Protocol, a party shall effect the relevant amendment(s) to the existing GMRAs between it and any other adhering Party, in each case on the terms and subject to the conditions of the Protocol and the relevant Adherence Letter (as defined in the Protocol). This allows parties to effect such amendments on a multilateral basis, providing for greater efficiencies when updating documentation.

Adherence to the Protocol will be evidenced by the execution and delivery of two copies of the Adherence Letter to ICMA. A list of adhering parties will be maintained on ICMA's website.

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by John Serocold

Secondary Markets

The MiFID II package: recent developments

This article reports on the current stage of Level 1 negotiations and next steps.

Current state of negotiations, and next steps: Since our last report in Issue 2 of the Quarterly Report, on 21 June the ECOFIN Council reached a General Agreement on the MIFID II package (ie MiFID II and MiFIR). The Council's text of the proposed Directive is available here and the Council's text of the proposed Regulation is available here. Since the European Parliament agreed its position on the Directive and Regulation on the European Commission's proposal last October, the Council's agreement means that trilogue negotiations can now begin between the Council, Parliament, and Commission. There are important differences between the Council's and Parliament's text and the Commission's original 2011 proposal (which comprised a Directive and Regulation) so the trilogue process may be protracted, though there is likely to be political pressure to proceed quickly, in order to fulfil certain G20 commitments, and before next year's European Parliament elections. Parliament will rise in March 2014 and is not expected to return until June.

The trilogue process will yield a Level 1 legislative text. Thereafter, and before the MIFID II package can come into force, the European Commission, advised by ESMA, will need to produce more detailed Level 2 legislation, and ESMA will have to prepare technical standards, in a large number of areas specified in Level 1. The bulk of this technical work will probably be done next year, with final implementation of the new legislation probably in 2015.

As ever, the timetable remains uncertain. Although Markus Ferber MEP, the lead rapporteur for MiFID II in the European Parliament, believes a final text will be agreed by the end of the year, some others have suggested this estimate is optimistic, because talks may take longer on important issues, such as the inclusion of equities in OTFs. Assuming agreement is reached by the end of the year, 2014 will be the year of the technical standard, as there are approximately 50 areas where a requirement for technical standards or other implementing measures have been identified. An additional measure of uncertainty is introduced by the fact that the Directive requires implementation in Member States, whereas the Regulation becomes part of the body of European law once it is passed.

The MIFID II package will have important implications for the structure, practices and regulation of fixed income markets in Europe and of the international markets. As regards both (1) the development of detailed Level 2 legislation and technical standards, and (2) member firms' practical preparations for the new regime, ICMA expects to play a part, helping the market develop its views, communicating them to the authorities, and participating in technical discussions.

In the priority areas that ICMA members have identified, the position at this stage is broadly as follows:

Organised Trading Facilities (OTFs): The OTF category is important to the international capital markets because it will offer an additional way of bringing multilateral trading on to organised trading venues. The European Parliament proposes to restrict OTFs to non-equity markets; to prohibit a firm from deploying its own capital in an OTF that it operates, even to facilitate client business; and to narrow the scope of non-transparent OTC business. The Council proposes to retain the Commission's broader scope for OTFs, encompassing equities as well as non-equities; it proposes to allow matched principal trading within OTFs for non-equities only. In a late amendment, the Council proposes to allow a broader range of principal trading to facilitate liquidity for illiquid sovereign bonds: a welcome recognition of the importance of the principle of enabling intermediaries to facilitate liquidity, which we hope can be extended also to corporate bonds, which are often less liquid than sovereigns, and are crucial to help fund economic recovery and support the Commission's long-term investment strategy.

Price transparency: It remains crucial that the proposed new requirements on pre-trade transparency and post-trade reporting of fixed income and other non-equity trades are carefully calibrated to reflect the different characteristic of the asset classes which are in scope. The liquidity profile of the different instruments is a key feature that needs to be taken into account, there is a need to protect the orderly functioning of the debt markets including the sovereign bond markets, and post-trade publication requirements need to take account of the impact on market makers. We hope it will be possible for the trilogue to consolidate the elements of the Council's and Parliament's texts which reflect these principles.

Third country firms: The Council proposes to remove the Commission's proposed ESMA registration requirement for third-country firms operating in wholesale markets, whereas the Parliament proposes to retain it. The Parliament tightens several aspects of the Commission's proposed restrictions on third country firms' access to EU markets, though it also proposes important improvements to the transitional arrangements for the Commissions' proposed condition that only third-country firms based in countries with "equivalent" regulation and supervision be permitted to participate in European markets. If an "equivalence" regime is introduced, it is essential that it works in a way that facilitates the smooth continued participation of third country investors and issuers in international and EU markets.

Clearing access: The basis on which Central Clearing Counterparties (CCPs) are required to provide clearing services to trading platforms, and can obtain from the trading platforms feeds of the data relating to the trades which they are being asked to clear, was one of the most complex in the Council discussions, reflecting the difficulty of reconciling two models of market structure in Europe: the "vertical" model, common in derivatives, in which the trading platform and CCP are tightly coupled, and there is only one CCP per market place, though a CCP may clear for more than one market place; and the "horizontal" model, increasingly common in cash equities, under which CCPs compete to provide clearing services for a market place. This design principle will be important as trading of international bonds migrates to electronic order books. Such order books are typically anonymous, so that a CCP is needed to manage counterparty risk, even for the relatively short period of three business days between the trade date and the due date for settlement. The Council's text proposes a general right of access, but with a number of caveats and transitional exemptions. The Parliament proposes to limit access to money market and cash instruments.

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Central Securities Depositaries Regulation

In Issue 29 of the Quarterly Report, we summarised the principal provisions of the proposed EU Central Securities Depositaries Regulation (CSDR), provided an update on the progress of the CSDR in the European Parliament and Council, and identified a potentially difficult policy question. In this article, we report on discussions in the European Council and explain our remaining concerns.

The outgoing Irish Presidency, which was succeeded by the Lithuanian Presidency on 1 July 2013, reported on progress to the Permanent Representatives Committee (COREPER) on 20 June. COREPER was asked to take notice of progress, including the Presidency compromise proposal discussed on 11 June; and to invite the incoming Lithuanian Presidency to continue work on the basis of this compromise proposal in order to reach agreement on a general approach in the near future. The file is regarded as being close to maturity for a Council general approach.

As previously reported, it seems that the CSDR is critical for the timely completion of the T2S project for a number of reasons, including the fact that the Regulation includes provisions relating to the outsourcing of settlement to a public sector institution.

The report to COREPER notes a large measure of agreement on the proposal and identifies five open areas on which it appears that further technical debate is necessary before seeking guidance at a political level on the options to be followed. These areas include two areas of crucial importance to the international bond markets and the associated financing markets.

First, the issue of settlement discipline. Readers will recall that the CSDR proposed a regime of mandatory buy-ins, which we believe would be disproportionate and costly. It could also have a material adverse impact on the provision of liquidity in the secondary market and on the efficient operation of the repo market. The European Parliament understands these concerns and has proposed that buy-ins should continue to be carried out at the option of the receiver of securities. We continue to believe that this is the right approach. We will continue to make our views known to policy makers and are gathering additional evidence to support our case.

The second area relates to the authorisation of CSDs to provide banking services. This is of crucial importance to the international bond market, as the two traditional ICSDs (and the new ICSD being set up by Bank of New York Mellon) offer settlement in commercial bank money, as do a small number of national CSDs in Europe. The main outstanding issue is the process by which a CSD is authorised to provide banking services. Some delegations oppose the authorisation requirements being placed on CSDs which provide banking services and there is also opposition form a number of delegations regarding final authorisation resting with ESMA. We remain hopeful that these issues can be resolved in a way which allows the advantages of the existing operating model to be retained, while enhancing the safety and soundness of these essential facilities.

The three remaining areas relate to:

- third-country regimes, where a small number of Member States would prefer this to be an area of national competence, rather than being regulated at European level;
- the authorisation and definition of links between CSDs, where further discussion is required at working level on the level of risk, which would require a link to be pre-authorised; and
- conflict of laws, where a few Member States would prefer the retention of the relevant article.

The issue of links between CSDs relates to the question of the access and interoperability provisions in CSDR. Similar provisions in the European Market Infrastructure Regulation (relating to the central clearing of standardised OTC derivatives contracts) and in the proposed Markets in Financial Instruments Regulation (relating to the trading and clearing of financial instruments) have already proved controversial. While the EU-wide “passport” is relatively uncontroversial, the provisions enabling competition between CSDs may be difficult to settle, particularly given the connection to the policy question of how best to deal with the ICSD structure. It seems that these provisions are being settled in the MiFID framework and will be carried across to the CSDR.

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Secondary market liquidity

In our contacts with market participants this quarter, concerns about liquidity in the secondary market have been a consistent theme. As so often, there is a variety of views about the underlying causes. This article presents a summary of these views.

First, it is clear that the profitability of secondary market trading is affected by the current interest rate environment. The absolute levels of rates, the term structure and spreads for corporate bonds over government bonds all have a part to play. The second area affecting liquidity is the relationship between spreads, coupons and the propensity to trade. In a low-coupon environment, the same bid-offer spread will be a more significant factor than it is in a higher rate environment. This in turn acts as a brake on the propensity to trade, rendering markets less liquid, as the market environment moves further away from the model in which uncorrelated buyers and sellers appear in the market at different times.

It seems that dealers, in aggregate, have continued to reduce the inventories they hold and to be less inclined to absorb selling pressure and to smooth the timing differences between buyers and sellers. While this is in part a result of the perception that market making is not as profitable as it was, it seems likely that developments in the regulation of bank capital and discussions about the structural separation of trading businesses from the rest of the bank will also be a factor.

Another factor affecting secondary market liquidity has been the homogeneity of order books in the primary market. As the primary market becomes more institutional and more wholesale, and institutions themselves become more homogeneous, the likelihood of "one-way markets" emerging is increased. A wide range of market participants, buying and holding bonds for different investment reasons and over different time periods, contributes significantly to a well functioning, liquid secondary market. An additional factor here is the reform of the financial regulation of the insurance industry in Europe, known as Solvency II, which has increased demand for safe assets as opposed to riskier assets and may also have led to an increased tendency to value bonds on a "hold-to-maturity" basis and for investment behaviour to follow valuation policy.

A subsidiary theme in our discussions has been the application of market automation techniques and the arrival of publicly available, electronic order matching systems. These developments are discussed in more detail in the article by Professor Brian Scott-Quinn later in this Quarterly Report. Broadly, these developments are likely to have both positive and negative effects. On the positive side, by lowering the frictional costs of trading, including search costs, they could lower the price at which immediacy is offered and allow more people to identify, participate in and profit from trading opportunities. But against that must be set a risk that trade sizes may fall; that daily volumes may not hold up and that the ability to exit a relatively large position may be reduced.

Recent market developments following the announcements by the Federal Reserve about the data they will be examining when deciding whether or not to reduce the rate of asset purchases under the quantitative easing programme tend to confirm this view. Financial markets, rightly, have a different attitude to reabsorbing credit risk, so that what begins as rate risk tends to remain rate risk. Some commentators have suggested that this increases the risk of markets "overshooting". It seems likely that commentators and market participants will continue to discuss whether the recent period of low rates, combined with a wide range of broad and deep reforms of the financial sector, have strengthened or weakened the markets' structure.

While it is too early to draw broad policy conclusions from recent events, we shall remain watchful and continue to discuss market developments with market participants, with commentators and with policy makers.

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Preventing the next crisis

Personal view: Godfried De Vidts, Chairman of the ICMA European Repo Council and member of the ICMA Board

Since 2008 under the direction of G20 leaders new regulations have rained down on the financial markets. Many of these proposals are justified, although the blame for the latest meltdown should be shared by all participants. Inevitably many of the proposals focus on what happened in the past, although it is generally expected that the next crisis in the financial markets will be different. This short article considers three regulatory initiatives that risk unintended consequences and which, if not corrected now, could contribute to a new crisis. Ultimately the real economy could pay the price, but we can avoid this happening if we apply rigorous forethought to the issue.

MiFID II

MiFID II negotiations are moving towards trilogue after months of discussions in the Council. Widening the scope of MiFID from mainly equities to include fixed income and derivatives is an ambitious undertaking. Unfortunately many legislators under Level 1 operate under the mistaken belief that rules for equities can simply be applied to fixed income. Regulators will struggle with this as they have to provide rules under Level 2, which does not allow flexibility in rule making due to the Meroni principle, as embedded in the Maastricht Treaty (see box). To illustrate this let me give an example. The EMIR legislative initiative has rightly focussed on measures to make sure a build-up of outstanding transactions does not create excessive risks, and therefore promotes compression of OTC derivatives to eliminate offsetting outstanding positions. Repo market positions are moving from very short-term to longer tenors due to liquidity rules and may, over time, benefit from similar compression, hence making liquidation risk (operational risk) less prominent. In current discussions at Level 1 in MiFID II, compression is also mentioned. Thinking ahead it would be sensible to ensure that regulators have the flexibility to make timely changes at Level 2, by widening the scope in today's Level 1 discussion to capture other types of valuable risk mitigation services which may be developed in the future. This is an opportunity to think outside the box and trust the regulatory community as they accumulate expert knowledge, not least because of their constant dialogue with the banking community.

CSD Regulation

The events of 2008 were well managed by the "back office" (ie clearing and settlement), though not without challenges. Despite this, the need for fine tuning of the market infrastructure in Europe has been clear since the Giovannini barriers were first identified, but actions have so far resulted in limited progress. It is puzzling that the debate is still largely focussed on equity markets although the volume of fixed income and OTC derivatives is bigger and they are also important to the real economy. The CSDR initiative is welcome as it will clarify many of the crucial services that, due to the push towards centralised clearing and the focus on collateralisation, will need to cope with the expected increase in volumes driven by margin needs across both centralised and bilateral clearing. The ICMA European Repo Council (ERC) has always focussed on further development of market infrastructures, including the use of triparty to cope with the wide range of collateral used in these innovative markets. Triparty has proven its usefulness, hence instigating rules which would force change in the European triparty model would be a mistake – do not discard what is not broken.

Another part of the CSDR proposal concerns mandatory buy-ins for fixed income. Clearly based on the equity experience this particular piece of legislation, if endorsed as currently proposed, will reduce overall liquidity in the system and hence increase fails, instead of remedying what is wrong in today's settlement arena. MiFID I already served to open up the fixed income market to more competition. Many different trading platforms (MTFs) compete for business, Europe has a number of CCPs in the fixed income area, and it is hoped that the CSDR will destroy the national protectionism so embedded in the CSD world. The proposal for mandatory buy-ins by CCPs, CSDs and trading platforms ignores the fact that the fixed income community has the right to buy and sell bonds (both government and corporate) in a wide variety of ways. The ERC has provided many recommendations to make sure that both technical and real failures to deliver have an adequate framework to deal with such events by the recipient. If failure to deliver is due to an insolvency/voluntary choice of a party to the trade, the GMRA has adequate protection and procedures in place to remedy such events. Yet most of today's fails are due to the inadequate CSD patchwork (sustained by lack of competition and protectionism of post-trade services), hence CSDR itself should remedy most of these failures to deliver. Statistics show that today's fail rate is less than 0.5% of daily volume; and the ERC is currently working on an updated fails document, as today's current near zero or negative rates environment calls for strengthening of such measures to prevent disorderly events. Let us first implement CSDR in all its facets and provide a basis at Level 1 for future fine-tuning by ESMA. But leave the decision to buy in to the disappointed purchaser, instead of a counterproductive automatic mechanism.

FTT

In an early response to the proposal of DGTAX regarding the FTT, the ERC explained the many reasons why a tax on repo/security lending/collateral movements would be detrimental to the drive towards a more secure financial system. The Basel framework has called for more secured lending, the central bank community has embraced secured lending as the way to transmit monetary policy, and EMIR has seen calls for more collateral that is sourced through the repo market. The damage that the current proposal would do to the real economy, not only in the 11 participating EU Member States but to Europe as a whole, is clear to see. The result of the current experiment in a country like France which has already implemented an FTT on equity markets is clear. Not only have a number of shares experienced a reduction in liquidity, thus reducing appetite to invest in these securities, but there has been a decrease in revenue from other taxes that would normally be levied on profitable share trading. It has also resulted in decreased volumes on the markets that list these shares. If Europe is serious in its aim to move from a bank-funded economy to a real European capital market, clearly the FTT is going to be a serious impediment. It is desirable that Europe's leaders shift to focus on increasing the income of all Member States with the aim of producing balanced budgets in a less intrusive way, taking into account the new regulatory environment.

Conclusion

These examples illustrate how well intentioned reforms may constrain the use of improved risk management techniques, impede market liquidity and hence make markets less efficient; and hinder essential financial activities to the detriment of the economy. Many in the industry, including the ERC, are ready to help design a better outcome. Although somewhat controversial, we should remember that the best gamekeeper is a former poacher. Many ex-bankers have found new employment in regulatory agencies. Allow them to use their expertise and openly exchange ideas with the banking community. All, but in particular the real economy, will benefit as thoughtfully controlled innovation can truly create a better European competitive environment where growth will return and as a consequence contribute positively to the well-being of the European citizen.

“Thoughtfully controlled innovation can truly create a better European competitive environment.

The Meroni principle

In the landmark 1958 Meroni case judgement the ECJ clarified the circumstances under which the regulatory powers of the European Commission could be delegated to new agencies, effectively restricting the creation of new regulatory agencies with full implementing powers. The post-crisis establishment of the ESFS, which included the formation of ESMA, was carefully crafted in light of this constraint.

In a test of these new arrangements, a current case brought by the British Government is invoking the Meroni principle to challenge the legitimacy of ESMA having been delegated the power to limit, or to ban, short selling of certain financial instruments in Europe in an emergency, arguing that unforeseen discretionary powers have been granted to ESMA.

The EU system of legislation involves a number of layers. The Commission proposes EU legislation. Level 1 involves the directly elected European Parliament approving EU legislation together with the Council (the governments of the 27 EU countries). At Level 2, ESMA (and the other ESAs), acting in conjunction with the Commission in order to conform with the Meroni principle, provides the technical implementation process for the legislation, creating a set of rules which (subject to conformity with Level 1) can be changed relatively quickly and refined where necessary.

by Annika Wahlberg

Asset Management

Long-term financing of the European economy

In March 2013, the European Commission published a *Green Paper on the Long-Term Financing of the European Economy*.

ICMA's response to the Green Paper was led by the Asset Management and Investors Council (AMIC). The response highlighted the importance of asset managers as substantial long-term investors in Europe, whose large asset pools and long-term liabilities make them a key plank of the stable financing of the European economy. The response also identified the consistency between the Commission's vision of long-term investment and the arguments in ICMA's March 2013 paper on the *Economic Importance of the Corporate Bond Markets*.

The Commission's consultation covered a broad range of issues, including how to increase the supply of long-term finance in the face of contraction in bank lending; the role of institutional investors; the impact of regulatory reform; the efficiency and effectiveness of financial markets in facilitating long-term finance; the impact of taxation, accounting, corporate governance, and financial reporting arrangements; and the special funding needs of small and medium-sized enterprises (SMEs).

ICMA's response welcomed the Commission's initiative. Given the range of topics and possible policy responses covered, we suggested the Green Paper should be the beginning of a broad-ranging and technical discussion of the policy approaches needed, and the Commission should not proceed too hastily to specific proposals, especially in the light of continued challenging market conditions.

We identified three particular aspects of long-term financing which it is important to keep distinct: the need for a thriving bond market as a source of term funding and investment; the need to sustain the market in infrastructure and other very long-term assets; and the question of how to limit the impact on term funding of opportunistic short-term trading. We also stressed the importance of distinguishing between long-term investment and shadow banking, and ensuring that EU policy on the latter does not inadvertently impinge on the Commission's long-term financing agenda.

In our comments on accounting and reporting we drew on AMIC's previous work on valuing illiquid investments and managing asset managers' clients' expectations; and the Financial Reporting Council's Stewardship Code.

We stressed the importance of a policy approach and regulatory framework in Europe that supports investors' appetite for judicious risk-taking through what can be relatively illiquid investments, whilst also enhancing liquidity and activity in well-regulated European markets. We urged a reevaluation of investment restrictions, tax barriers, legal and regulatory barriers with this objective; and examination of the scope for development of markets in structured products and securitised or collateralised obligations. We suggested that the question of how best to support non-bank financing of SMEs should be examined in depth separately from the question of long-term financing, which is more relevant for larger enterprises.

ICMA and AMIC look to continue to draw on members' input and expertise as our discussion of these topics with the European Commission develops.

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ICMA Private Wealth Management Charter of Quality

One of the initiatives currently undertaken by ICMA relates to a particular segment of our members' activities, namely wealth management. ICMA has a large number of private banking members throughout Europe, and beyond, whose main business is wealth management, and a significant proportion of our other members have wealth management divisions amongst their activities. This encompasses onshore activities and cross-border wealth management.

Within the ICMA Asset Managers and Investors Council (AMIC), a Working Group – including a number of national associations whose members are involved in wealth management – has over the past two years developed the ICMA Private Wealth Management Charter of Quality. This Charter brings together, into one easy-to-read document, the guiding principles of wealth managers: integrity; transparency; and professionalism. The purpose of the Charter is to explain – and demonstrate – to policy makers, regulators, politicians, counterparts and the public at large the high standards in the wealth management industry. Our objective is to encourage wealth managers to sign up to the Charter to signify that they adhere to it.

ICMA launched the Charter in Luxembourg in October 2012 jointly with the Luxembourg Bankers Association (ABBL). The Luxembourg regulator (the CSSF) expressed strong support for the Charter and recommended that Luxembourg banks to sign up to it on a "comply or explain" basis. Almost every bank/wealth manager in Luxembourg is now a signatory. The Liechtenstein Bankers Association also signed the Charter in December 2012. A list of the ICMA members who have signed up to the Charter is available on the ICMA website.

We are planning to hold a number of events in Europe in the autumn of 2013 to familiarise our membership with the Charter. In addition to wealth managers themselves, we hope that their national associations will also sign the Charter.

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ICMA AMIC and CBIC events

The ICMA Asset Management and Investors Council (AMIC), chaired by Robert Parker, its Chairman and Senior Adviser at Credit Suisse, held its second meeting and seminar on 23 April 2013 at the Banque de France in Paris. The meeting was introduced by Denis Beau, Director General of Operations at the Banque de France. The agenda is available from the ICMA website. An article on *The Future of the Savings Industry*, by John Nugée, Head of Official institutions at State Street Global Advisors, based on the presentation he gave at the AMIC meeting, is available in the events section of the website.

The ICMA Covered Bond Investor Council held its second annual conference on 16 May 2013 in Frankfurt, together with *The Covered Bond Report.* The keynote address was given by Ulrich Bindseil, Director General Market Operations at the ECB. The agenda and presentations are available in the past events section of the ICMA website.

Both events were well attended, with positive feedback. At the CBIC conference, Claus Tofte Nielsen, Head of Position Management Allocation Strategies at Norges Bank Investment Management (NBIM), who has chaired the CBIC since its inception in 2009, announced that he was stepping down as Chairman. Andreas Denger of Munich Re has been appointed as Acting Chairman.

If you are interested in participating in AMIC's work programme, please contact the Secretary of AMIC, Annika Wahlberg

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by Nicholas Pfaff

Private placement markets for medium-sized European corporates

Following the article on *Market Financing for Smaller Corporates* in the previous Quarterly Report, we have conducted additional research primarily through a series of interviews with key industry representatives from all concerned parties – issuers, intermediaries and buyers – in order to form as much as possible a comprehensive view on the question of private placement markets for medium-sized European corporate, drawing in particular on the model of the US private placement market (USPP).

USPP

Our research confirms that the USPP represents an important destination for European issuers providing near $20 billion in debt finance in 2012. However, issuer appetite as well as buyside liquidity and the search for yield are already driving in parallel in Europe both the creation of new private placement markets (eg the Euro PP) and the expansion of existing ones (eg the Schuldschein market).

We focus here first on further information concerning the USPP and comparable private placement markets in Europe. Then the key ingredients for a possible new European private placement market – eg market recognised credit scoring, regulatory compatibility, and documentation standardisation – are reviewed. Finally, we comment on the actual likely

In brief

- European issues on the USPP and comparable domestic private placement markets in Europe (Euro PP and Schuldschein) reached nearly €30 billion in 2012, indicating the potential for a new European private placement market.
- Key ingredients would be market recognised credit scoring (drawing on USPP model), regulatory compatibility at EU and national level, and documentation standardisation.
- This new market would especially benefit European medium-sized corporates, as well as project finance especially with respect to energy and infrastructure.
- ICMA will continue dialogue with market participants to formulate the basis of a proposal for a buy side-driven initiative, including with its own AMIC and other industry associations.

> It is perhaps in the area of formalised credit assessment and its interaction with regulatory capital allocation that there are the most important lessons for Europe.

beneficiaries of such a market, and on ICMA's next steps for such an initiative.

The USPP is an idiosyncratic private bond market involving unlisted notes that are physically settled and use standardised documentation (maintained by the American College of Investment Counsel). These notes do not trade but there is limited liquidity through transfers among investors.

Based on latest figures, the USPP market reached $55 billion in total issuance volumes in 2012 (a 20% increase over 2011). The average deal size grew to $290 million (up by 25%). Foreign issues continued to dominate and represented 57% of the total. European issuers represented the bulk of foreign issuers at 40% of total USPP issues.

The market remained in 2012 overwhelmingly investment grade or assimilated (ie having received from the US National Association of Insurance Commissioners (NAIC) a NAIC 1 or 2 credit score), but the unrated portion of issues was in excess of 50%. The market served primarily industrial (33%) and energy and utility companies (26%), while project finance and structured transaction reached 24% of total market volume.

The USPP is currently an important source of medium and long-term debt finance for European issuers who represent more than a third of funds raised in this market. The draw of the USPP is that it offers long duration (above 5 years), flexible, competitive US dollar funding. This comes from US insurers (primarily life) with an appetite for long term investment grade (or assimilated) credit risk. Conversely, European investors and their direct subsidiaries (representing less than 10% of the buyside of this market) are deterred by a number of factors (e.g. market illiquidity; credit assessment and monitoring requirements).

Euro PP and Schuldschein

The Euro PP is a recent initiative mainly in France to develop a form of hybrid private placement market. This initiative has met with some success raising in excess of €2.1 billion through 20 issues in 2012. It involves the private placement of debt notes to French insurers with the use of bond documentation incorporating loan style financial covenants. The issues are also formally listed, but rarely trade. The rationale for this structure is the need to accommodate French legal requirements that dictate a form of listing and nominal liquidity for insurers' investments.

The Schuldschein market is an important private placement market that traditionally provided long term debt finance from domestic banks, insurance companies and investment funds to the German public sector. It is estimated to represent overall approximately €12 billion of financing per annum.

A Schuldschein is a bilateral, unregistered and unlisted loan agreement under German law with a typical maturity of 2-10 years. It can be in senior or in subordinated format. Schuldschein investors have a preference for investment grade credit, but will also consider unrated and non investment issues. There is a secondary market with transfers by novation.

The Schuldschein market has broadened its appeal to corporate and foreign issuers. The latter are however predominantly from the Sovereign, Supranational & Agency (SSA) sector. Both the Euro PP and the Schuldschein provide funds to medium to large European companies that have also generally otherwise met the criteria for equity listing.

Assessing the USPP and European PP markets

Assessing the USPP versus these European markets, it is perhaps in the area of formalised credit assessment and its interaction with regulatory capital allocation that there are the most important lessons for Europe. USPP investors are overwhelmingly US life insurance companies that have built up over the years real credit assessment and monitoring capabilities that are comparable in many respects to the resources that lending banks possess. In this context, the NAIC credit scoring serves as both a back-up credit and rating assessment tool (with industry standards to establish equivalences between these scores and formal credit ratings) and as a confirmation of regulatory capital requirements.

There is no comparable European system. Investors in the nascent Euro PP market, in the absence of a credit rating, rely on mitigating factors such as an existing listing in an equity market, financial covenants (modelled on banking standards) and contingent liquidity (through a listing on some form of regulated bond market).

To date there appears to have been limited investment by the buy side in Europe in credit assessment/monitoring capabilities with only a small group of lead investors with real resources. However, these investors are providing investment management and credit assessment services to third parties and see this as a route for these skills to spread. It is also not clear if costs would be a major constraint if the opportunity represented by a new European private placement market crystallised.

In our discussions, the development of a European regulatory credit scoring system along the lines of the one provided by the NAIC is viewed as desirable, but challenging in the near term in light of the persistence of national regulatory treatment in Europe and the absence of a European equivalent to the NAIC. It was suggested however that the buyside could aim to agree on a credit scoring framework that would be compatible with Solvency II and designed to provide certainty on capital treatment.

Continuing with regulatory issues, and without going into the detail of the legal and regulatory constraints for buy-side investors in various European countries, the key issues for investors are indeed the treatment under Solvency II, and national regulations for investment restrictions, valuation and capital requirements.

“A new European private placement market would strongly benefit medium-sized companies.

For example, it is clear from our contacts with intermediaries and buyside actors that minimal liquidity or, at least, some form of listing (even with little prospect of trading) remains often a key issue for many Continental buyers due to national regulations. This was specifically identified as the reason for the low participation of European buyers (less than10%) in the USPP. It is also the reason why Euro PP issues use bond documentation and are nominally listed (even if illiquid).

Similarly, the appeal of Schuldschein loans is in part due to favourable valuation treatment (no mark to market). As discussed above, the USPP provides a successful model with NAIC credit scoring on how to provide certainty on capital allocation guidance.

With respect to wall crossing, some Investors have mentioned that participating in a new European private placement market could lead to issues with Material Non-Public Information (MNPI) leading to restrictions on other lending activities, while others have been less concerned and see it as a manageable resource issue.

Standardised documentation is a key feature of the success of the USPP. The lack of similar standard was repeatedly highlighted as a problem with deals taking place in Europe with very different forms of documentation. It is also important to note that form and documentation can also determine tax treatment with this being the case in the UK and Ireland, with quoted Eurobonds benefiting from a specific withholding tax exemption. It is noteworthy that the Euro PP market uses modified Eurobond documentation (generally under French law).

A new European private placement market

Contrary to some speculation and based on the financing track record of the USPP and existing private placement in Europe, there is little evidence that the development of a European private placement market would provide a breakthrough financing channel for European SMEs as officially defined (ie with less than 250 employees and a turnover inferior to €50 million).

It is, however, very likely that a new European private placement market would strongly benefit medium-sized companies by providing long term finance to potentially unrated corporations that may often already be equity listed, but cannot otherwise source this type of funding from the bank loan or bond markets. The risk profile of these companies would also be assimilated to investment grade or very close to this benchmark.

A quarter of 2012 USPP transactions were long term structured and project finance issues, a number of which were European. Corporate and SSA issues dominate existing European private placement markets, but this USPP precedent provides good grounds to expect that a future common European private placement market could also provide over time a viable alternative to bank funding for project finance especially with respect to energy and infrastructure. This is indeed an area where a number of key European buyside investors see important future demand and an interesting opportunity for long term investment.

Going forward there does therefore appear to be scope for the development of a new European private placement market. The volume of European issues on the USPP, as well as on the Euro PP and the Schuldschein – altogether approximately €30 billion – are strong indicators of the underlying demand. It is also apparent that there is potential to work towards a federated approach in the European debt markets in the context of a number of ongoing initiatives in the UK, France and the Netherlands.

Following a recent review by AMIC's Executive Committee, ICMA will continue its dialogue with market participants with a view to formulating the basis of a proposal for a buy side-driven initiative to progress key aspects such as credit scoring, regulatory compatibility and documentation. Contacts will also be developed with other industry associations working on comparable or related initiatives in order to avoid overlap and to maximise efficiency.

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European corporate bond trading: role of the buy side

Personal view: Professor Brian Scott-Quinn and Deyber Cano

Corporate bond markets are being radically changed by a confluence of factors – new Basel III capital and liquidity rules, the MiFID requirements on transparency in bond markets and the availability of innovative new platforms based on equity and FX market technology. These factors have already led to a reduction in capital commitment by dealers even prior to the regulatory implementation of Basel III. The shift from voice to electronic trading and from capital facilitation by dealers to agency facilitation are well established trends but RFQ mechanisms are likely to continue to be necessary due to the clear differences between equities and FX on the one hand and most corporate bonds on the other. A key question is whether the largest institutional investors themselves might now choose to commit capital to replace that which has been withdrawn by dealers and to do this by making prices through order-driven and RFQ platforms. This would enable them to buy at the bid and sell at the offer thereby taking out the spread. An increasing number of platforms are now All-to-All, thus enabling the buy side to act as capital providers. Our paper examines this important issue.

Institutional large-in-scale (LIS) crossing networks for bonds, such as Liquidnet provides for equities, and using a reference price should enable investment institutions to transact with each other without broker-dealer, MDP or SDP intermediation. However under recent draft proposals for MiFIR, European regulators have introduced a *volume cap mechanism* that may have a dramatic effect on dark trading in Europe – whether in equities or, in the future, in bonds. Regulatory control will be based on a (low) cap on the percentage of trading that can go through mechanisms using a reference price. This would seem to us to be only the most recent of a number of retrograde steps taken by the EU in terms of its implications for market liquidity.

The combination of Basel and EU regulation certainly has the potential to counter all the efforts of individual governments and the G30 to encourage corporations to raise finance for economic expansion through bond markets rather than through fragile banking systems in order to reduce systemic risk. At this stage it is too early to say if higher costs and reduced position taking by broker-dealers in response to regulatory change will result in higher funding costs for issuers of corporate bonds in Europe or if the innovations we discuss in the paper may be able to offset at least some of these additional regulatory costs. Certainly at the moment, there is little sign on this side of the Atlantic that regulators are heeding the sentiment of SEC Commissioner Daniel Gallagher, who hoped that "we will understand the differences and interplay amongst the equities, debt and credit markets so that we can be a more sophisticated regulator of those markets".

The full text of this article can be found on the ICMA website.

Professor Brian Scott-Quinn is Chairman and Director of Banking Programmes at the ICMA Centre. Deyber Cano is currently a research assistant to Professor Scott-Quinn at the ICMA Centre.

Market Infrastructure

by David Hiscock

Market infrastructure developments

ECB: Contact Group on Euro Securities Infrastructures (COGESI)

The latest semi-annual COGESI meeting was hosted by the ECB in Frankfurt on 14 May 2013. The first agenda item was collateral harmonisation developments. The group was informed on the progress made by the *ad hoc* COGESI on collateral harmonisation. The report of the *ad hoc* COGESI on collateral eligibility requirements is close to finalisation for publication; and further work could also be launched on the quantification of the eligible collateral across the different frameworks, as well as on analysing haircuts and on collateral transformation services. Meanwhile, the work of the *ad hoc* COGESI on the efficient functioning of the repo market is at an early stage of elaboration; and, regarding triparty interoperability, work should continue to identify the items that should be implemented to support the efficient functioning of the market. The agenda next considered the BCBS report, *Monitoring Tools for Intraday Liquidity Management,* which was developed in consultation with the CPSS. The final agenda item was a presentation of the CPSS-IOSCO report, *Authorities' Access to Trade Repository Data.*

ECB: Money Market Contact Group (MMCG)

A regular quarterly meeting of the MMCG was held in Frankfurt on 17 June 2013. The agenda comprised: (1) a review of market developments; (2) developments in the secured money market; (3) update on money market benchmarks, the ongoing reform process and transaction-based data collection exercise; (4) LCR and its impact on bank funding and (5) update on the Financial Transaction Tax.

ECB: Bond Market Contact Group (BMCG)

The ECB's Bond Market Contact Group (BMCG) is a recently established forum for discussing issues related to the euro-area bond market. The BMCG's second meeting took place in Frankfurt on 9 April 2013. The agenda comprised: (1) review of recent bond market developments; (2) market access; (3) market functioning issues; (4) future demand for high-quality liquid assets; (5) impact of recent regulatory changes and other structural issues; and (6) the Financial Transaction Tax. Of particular interest, the summary report of the meeting notes that (under agenda item #4) Christoph Rieger of Commerzbank analysed the structural changes in market practices, central bank operations and regulation, which will shape the future demand for euro-area government bonds and high quality assets in general. This was supported by his presentation, *Putting Scarcity Scares into Perspective.* The third BMCG meeting is scheduled for 9 July, with an agenda which includes discussions on the subjects of bond market liquidity and euro-area financial integration.

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X-MAP is mandated to analyse known or potential issues with respect to the impact on cross-border settlement efficiency in T2S.

ECB: TARGET2-Securities (T2S)

A T2S Info Session was held in Ljubljana on 10 April 2013. This included presentations of T2S project status update and next steps; and 4CB project status update; along with insight sessions regarding euro liquidity management in T2 and T2S – covering functional, operational and legal aspects.

In addition, a dedicated T2S Info Session, *T2S User Testing and Migration: an Urgent Matter,* was held in Frankfurt on 3 July 2013. Following the introduction, the T2S Programme Office presented the activities and the organisation that will underpin the user testing and migration of the T2S community. There was then a two-part presentation under the overall heading of *"Business decisions are needed now to shape your preparation to T2S";* and finally a panel discussion during which representatives of the T2S community discussed how they are cooperating in order to successfully migrate to T2S.

On 22 April 2013, the ECB announced that it was making available the new edition #15 of T2S OnLine. The main focus of the issue is post-trade harmonisation, with articles about the publication of *the Third T2S Harmonisation Progress Report* and the joint ECB-European Commission conference on post-trade harmonisation and financial integration held in March. An interview with the European Commission on the importance of the CSD Regulation is also included. Marc Bayle, T2S Programme Manager, offers a comprehensive overview of the status of the project, and Ignacio Terol, new Head of the T2S External Stakeholder Management Section, explains the revised T2S migration plan.

The T2S Advisory Group (AG) provides advice to the Eurosystem on T2S-related issues, to ensure that T2S is developed and implemented according to market. The AG met in Malta on 18-19 June 2013 and will next meet on 19-20 November 2013. At this latest AG meeting, there was a report on the main topics discussed during the latest T2S Board meeting; a report on 4CB activities and a discussion regarding client readiness monitoring. Considering policy-related matters, there was a discussion regarding possible new sources of revenue for T2S and a presentation concerning directly connected participants (DCPs); and there was a report on the T2S harmonisation workstream. Technical matters under discussion comprised a report on the activities of the change review group; an update on the dedicated link solution; and an update on T2S testing and migration. A dedicated link workshop was held on in Frankfurt on 22 April.

The T2S Harmonisation Steering Group (HSG), which is supporting the AG in formulating its harmonisation agenda, met in Brussels on 10-11 June 2013. Following the Chairman's introduction and members' updates, the agenda covered the CSD Regulation (CSDR); standards definition process and standards monitoring process. The T2S programme office then presented an outline of the *Fourth Harmonisation Progress Report* planned for publication in early 2014; and provided an update on the work of the follow up structure to the T-FAX – the T2S Cross-border Market Practice Sub-group (X-MAP).

X-MAP was formally set-up by the HSG in May 2013. X-MAP is mandated to analyse known or potential issues with respect to the impact on cross-border settlement efficiency in T2S and to propose T2S best market practices to the HSG regarding these topics. The first X-MAP meeting was held in Frankfurt on 11 April, to consider its mandate and organisation and to conduct some initial brainstorming on specific topics. The second X-MAP meeting was then held in Frankfurt on 28 May. This meeting started with a debriefing regarding the meeting of the European Post-Trade

Group (EPTG) of 21 May. There were then discussions concerning T2S rules and restrictions; and the usage of non-mandatory matching fields.

From 17 May 2013 the T2S Community has an additional member. The recently established BNY Mellon CSD has signed the T2S Framework Agreement, thus becoming the 23rd CSD to have committed to T2S.

On 20 June 2013, JPMorgan kindly hosted an ICMA members-only event entitled *TARGET2-Securities (T2S) is Coming, Get Ready!* Following the introductory remarks Robert Mason, Head of EMEA Securities Operations RBS Markets, provided an overview on work of the T2S Working Group which he chairs; and which has been formed as a sub-group of the ICMA ERC Operations Group. Giovanni Costantini, Senior Sales for Post Trade, London Stock Exchange Group, then contributed an informative presentation, following which John Serocold, Senior Director, ICMA, moderated a panel session. The event was very well attended and feedback makes clear the value it provided. ICMA anticipates organising further similar events as the timeline to T2S implementation unfolds.

During its meeting on 21 March 2013, the Governing Council of the ECB approved the plan for four migration waves of CSDs to T2S. Further details on the migration waves and the participating CSDs can be found in the table below:

European Post Trade Group: (EPTG)

The EPTG, which has been set up as a joint initiative between the European Commission, the ECB, ESMA, and industry, held its most recent meeting on 21 May 2013. EPTG's members are representatives of the key players involved in post-trade issues. To allow for free, non-binding contributions based on professional experience, the members participate as experts and do not necessarily represent their constituencies. The EPTG's published action list identifies the following seven issues where the group would have a direct active role:

- diversity of communication protocols (medium priority);
- intraday settlement, operating hours/deadlines (medium priority);
- pre-settlement processes harmonisation (high priority);
- cross border shareholder transparency and registration procedures (medium priority);
- withholding tax procedures (medium priority);
- transaction tax procedures (high priority); and
- Exchange Traded Funds (ETFs) (medium priority).

First wave* *22 June 2015	***Second wave* *28 March 2016***	***Third wave* *12 September 2016***	***Fourth wave* *6 February 2017***
Bank of Greece Securities Settlement System (BOGS)	Euroclear Belgium	Clearstream Banking (Germany)	Centrálny depozitár cenných papierov SR (CDCP) (Slovak Republic)
Depozitarul Central (Romania)	Euroclear France	KELER (Hungary)	Eesti Väärtpaberikeskus (Estonia)
Malta Stock Exchange	Euroclear Nederland	LuxCSD (Luxembourg)	Euroclear Finland
Monte Titoli (Italy)	Interbolsa (Portugal)	Oesterreichische Kontrollbank (Austria)	Iberclear (Spain)
SIX SIS (Switzerland)	National Bank of Belgium Securities Settlement Systems (NBB-SSS)	VP Lux (Luxembourg)	KDD - Centralna klirinško depotna družba (Slovenia)
		VP Securities (Denmark)	Lietuvos centrinis vertybinių popierių depozitoriumas (Lithuania)

Global Legal Entity Identification (LEI) Numbers

On 17 April 2013, the LEI ROC published a statement regarding the launch of the Global LEI System. This explains that, as endorsed by the G20, the Global LEI System will have three tiers: a top-level regulatory oversight body, the Regulatory Oversight Committee, designed to oversee the system; a middle-level Central Operating Unit governed by a foundation, the Global LEI Foundation, that operationally coordinates the system; and a bottom level of registrars, called Local Operating Units, that assign LEIs. Furthermore, the statement reports that good progress has been made in the development and implementation of the Global LEI System at each of the three levels of the system.

46 authorities from around the world participated in the ROC's second plenary meeting in Mexico City, Mexico, on 11-12 June, hosted by the Bank of Mexico. Following from this, a 19 June LEI ROC statement reports both progress in the establishment of the Global LEI System and key decisions for the interim global system.

Collateral

On 12 April 2013, the Joint Committee of the ESAs published its first report on *Risks and Vulnerabilities in the EU's Financial System.* Amongst the risks the EU financial system is facing, the report identified increased reliance on collateral. With respect to this risk, the report's Executive Summary states the following:

"The financial crisis has increased financial institutions' attention to counterparty credit risk, and loss of trust in implicit guarantees and credit ratings have led to *increased reliance on collateral.* This increasing demand for collateral has been reinforced by regulatory initiatives, including mandatory central clearing of some derivatives (EMIR) and bank capital rules (eg CVA charges), as well as the need for banks to hold high-quality liquidity buffers and use of securities for access to central bank funding. Collateral safety and liquidity is increasingly being priced, incentivising more efficient use of collateral through collateral transformation (eg liquidity swaps) and reuse, leading to increased financial sector interconnectedness and cross-sectoral contagion risks, encumbrance and risks of pro-cyclical effects in response to shocks to market prices or ratings of either market participants or collateral. The ESAs need to ensure that prudential rules keep up with the evolution of market practices and encourage practices which are both macro- and micro-prudentially sound, and contribute to efficient, fair and stable markets."

Collateral safety and liquidity is increasingly being priced.

On 27 May 2013, the CGFS published a report on *Asset Encumbrance, Financial Reform and the Demand for Collateral Assets*. The Executive Summary starts by stating: "The use of collateral in financial transactions has risen in many jurisdictions in the aftermath of the financial crisis, and is likely to increase further. This is driven by both market forces and regulatory changes, and has triggered concerns about real or perceived collateral scarcity and excessive asset encumbrance. Taking a system-wide perspective, this report examines how greater collateral use and asset encumbrance may impact the functioning of the financial system and draws lessons for policy makers." In summarising "Implications for policy", the Executive Summary concludes with the statement: "Concerns over procyclical demand for collateral assets lend support to efforts targeting strict standards for collateral valuation practices and through-the-cycle haircuts." Section 6 of the report lays out the full "Implications for policy", with section 6.2 including a segment entitled "Strengthening standards in securities financing markets". This particularly refers to the familiar topics under consideration in the FSB's shadow banking workstream on securities lending and repos.

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ICMA AGM and Conference in Copenhagen

This year's AGM and Conference at the Tivoli Hotel and Conference Centre in Copenhagen on 23-25 May was attended by over 700 members and guests. The Conference featured a series of panels on capital market themes, and keynote speeches by, among others:

- **Per Callesen,** Governor, Danmarks Nationalbank;
- **Benoît Coeuré,** Member of the Executive Board, European Central Bank;
- **Erkki Liikanen,** Governor, Bank of Finland; and
- **Stanislas M Yassukovich CBE,** Chairman, Cayzer Continuation PCC Limited.

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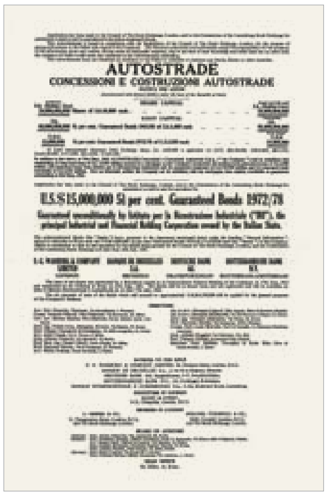
The Eurobond Market at 50

It is generally accepted that the Eurobond market began in July 1963 with the US$15 million Autostrade issue for the Italian motorway network. For 50 years, the cross-border debt capital market has continued to bring together borrowers and investors from all over the world to meets the funding needs of governments, supranational organisations, financial institutions and companies.

ICMA – first as the Association of International Bond Dealers, then as the International Securities Market Association and the International Primary Market Association – is very proud to have been at the centre of this market almost from its beginning.

At a special event in June 2013 organised by ICMA to celebrate the 50th anniversary, 350 representatives from the market over the past five decades heard distinguished speakers delivering their perspectives on the growth and development of the market and its key role in financing economic growth.


AUTOSTRADE
CONCESSIONI E COSTRUZIONI AUTOSTRADE

U.S.$15,000,000 5½ per cent. Guaranteed Bonds 1972/78

diary

ICMA organises over 100 market-related events each year attended by members and non-members. For full details see www.icmagroup.org

18-20 SEP

Global Master Agreements for Repo and Securities Lending Workshop, Paris, 18-20 September

These two separate master agreements are the essential legal underpinnings for repo and securities lending markets respectively. The workshop includes a detailed review of both agreements and their application, including coverage of the GMRA 2011, together with case studies; and the operational and basic legal characteristics of the repo and securities lending markets.

Register here

01 OCT

6th Annual bwf/ICMA Capital Markets Conference, Frankfurt, 1 October

The 6th Annual Capital Markets Conference, organised in collaboration with Bundesverband der Wertpapierfirmen e.V. (bwf), will include discussions on recent regulatory and structural changes in the European securities market. A copy of the agenda will be available soon.

18 NOV

SAVE THE DATE

7th Annual ICMA Primary Market Forum, London, 13 November

The annual Primary Market Forum is a half-day conference designed to bring together borrowers, syndicate banks, investors and law firms, to discuss the business issues and regulatory developments affecting the issuance of international debt securities.

SAVE THE DATE

Save the date for events in 2014
ICMA Ski Weekend, Zermatt, 10-12 January 2014
ICMA AGM and Conference, Berlin, 4-6 June 2014

SAVE THE DATE

ICMA Gulf Chapter

ICMA's regional structure was put in place in 1974 to support the geographically diverse global membership of the Association. Its configuration continues to evolve in response to the growth of capital market participation in specific regions. With the emergence of financial centres in Qatar, Dubai and Abu Dhabi and a corresponding increasing in numbers of ICMA members, a Gulf Chapter was launched in early 2011 out of ICMA's Middle East, Far East and Africa region.

The ICMA Gulf Chapter consists of ten members from across the region and is represented by a committee of members chaired by Saeed Wajdi, General Manager at the National Bank of Abu Dhabi. Since the formation of the committee, ICMA has gained insights into the current state of the GCC markets and how it can assist its members and the development of their capital markets; likewise ICMA has provided updates on regulatory and market practice developments in the international capital markets to local authorities and market participants.

ICMA has increased its activities in the region, having organised a number of events in Dubai, most notably a repo seminar and a conference on practice in the international capital markets in association with the Emirates Securities and Commodities Authority (ESCA). ICMA and ESCA have signed a Memorandum of Understanding to enhance coordination on topics of international concern related to the capital markets. ICMA is also in discussions with other authorities in the GCC to see where ICMA can assist, particularly in the areas of best market practice and internationally recognised qualifications for capital market practitioners.

The Primary Market Certificate Course, part of ICMA's suite of Executive Education courses, was held in Dubai for the first time last year. This course, tailored to the Sukuk market, will now be offered in Dubai on an annual basis. Training in financial markets is seen as a priority by GCC participants so demand for in-house ICMA Executive Education has increased among members and non members in the region. A number of members have also endorsed ICMA's International Fixed income Certificate Programme as required training for their fixed income staff.

The number of applications for ICMA membership continues to increase given that more and more institutions are tapping the international capital markets from the GCC. ICMA will continue to strengthen its links both with the authorities and market participants in the GCC.

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ICMA Executive Education

Register now for these ICMA Executive Education Courses. Check the ICMA website for the full 2013 course schedule and detailed course descriptions.

Level I: Introductory Programmes

Financial Markets Foundation Course (FMFC)
Luxembourg: **23-25 September 2013**
London: **6-8 November 2013**

Securities Operations Foundation Course (SOFC)
London: **11-13 September 2013**
Brussels: **13-15 November 2013**

Level II: Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Next residential course:
Barcelona: **27 October-2 November 2013**

Primary Market Certificate (PMC)
London: **25-29 November 2013**

Level III: Specialist Programmes

Collateral Management
London: **4-5 November 2013**

Credit Default Swaps (CDS) - Operations
London: **29 November 2013**

Credit Default Swaps (CDS) - Pricing, Applications & Features
London: **27-28 November 2013**

Inflation-linked Bonds and Structures
London: **24-25 October 2013**

Securitisation - Structuring and Valuation
London: **7-8 October 2013**

ICMA Executive Education Skills Courses

Mastering Mandates
London: **23-24 September 2013**

Successful Sales
London: **2-3 December 2013**

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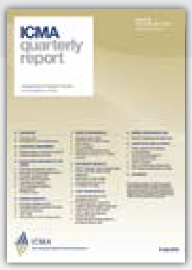
Glossary

ABCP	Asset-Backed Commercial Paper
AFME	Association for Financial Markets in Europe
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
APCIMS	Association of Private Client Investment Managers and Stockbrokers
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BRRD	Bank Recovery and Resolution Directive
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CGFS	Committee on the Global Financial System
CICF	Collateral Initiatives Coordination Forum
CIF	ICMA Corporate Issuer Forum
CoCo	Contingent convertible
COGESI	Contact Group on Euro Securities Infrastructure
COREPER	Committee of Permanent Representatives (in the EU)
CPSS	Committee on Payments and Securities Settlement
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depositary
CSDR	Central Securities Depositary Regulation
DMO	Debt Management Office
D-SIBs	Domestic systemically important banks
EACH	European Association of CCP Clearing Houses
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Redevelopment
ECB	European Central Bank
ECJ	European Court of Justice
ECPC	ICMA Euro Commercial Paper Committee
ECOFIN	Economic and Financial Affairs Council (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Financial Stability Facility
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
ERC	ICMA European Repo Council
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
EURIBOR	Euro Interbank Offered Rate
Eurosystem	ECB and participating national central banks in the euro area
FASB	Financial Accounting Standards Board
FATCA	US Foreign Account Tax Compliance Act
FCA	UK Financial Conduct Authority (from April 2013)
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FSA	UK Financial Services Authority (until March 2013)
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FTT	Financial Transaction Tax
G20	Group of Twenty
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
HFT	High frequency trading
HMT	HM Treasury
IASB	International Accounting Standards Board
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositaries
IFRS	International Financial Reporting Standards
IMCO	Internal Market and Consumer Protection Committee of the European Parliament
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
ITS	Implementing Technical Standards
KfW	Kreditanstalt für Wiederaufbau
KID	Key information document
LCR	Liquidity Coverage Ratio (or Requirement)
L&DC	ICMA Legal & Documentation Committee
LEI	Legal entity identifier
LIBOR	London Interbank Offered Rate
LTRO	Longer-Term Refinancing Operation
MEP	Member of the European Parliament
MiFID	Markets in Financial Instruments Directive
MiFID II	Proposed revision of MiFID
MiFIR	Proposed Markets in Financial Instruments Regulation
MMF	Money market fund
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NSFR	Net Stable Funding Ratio (or Requirement)
OTC	Over-the-counter
OTF	Organised Trading Facility
OJ	Official Journal of the European Union
OMTs	Outright Monetary Transactions
PD	EU Prospectus Directive
PR	PD Implementing Regulation
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority (from April 2013)
PRIPs	Packaged Retail Investment Products
PSI	Private sector involvement
PSIF	Public Sector Issuer Forum
QMV	Qualified majority voting
RFQ	Request for quote
RM	Regulated Market
RPC	ICMA Regulatory Policy Committee
RTS	Regulatory Technical Standards
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SLL	Securities Law Legislation
SME	Small and medium-sized enterprise
SMPC	ICMA Secondary Market Practices Committee
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
T2S	TARGET2-Securities
TD	EU Transparency Directive
TRs	Trade repositories
USPP	US private placement



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

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