Issue 37
Second Quarter 2015
Editor: Paul Richards

ICMA quarterly report

Assessment of Market Practice and Regulatory Policy

ICMA
International Capital Market Association

15 April 2015

A period of unprecedented change

Foreword by Cyrus Ardalan

In the four years since I joined the ICMA Board we have witnessed a period of unprecedented change in our industry as a large body of new regulations have started to be implemented impacting virtually every aspect of the capital markets. ICMA has been uniquely positioned to monitor and respond to these developments.

ICMA provides its members with a unique perspective on the capital markets in their entirety. ICMA's growing membership encompasses all key stakeholders in the capital markets from the sell to the buy side, from the private sector to official institutions and from intermediaries to infrastructure providers. This can best be seen in the creation of three very successful forums representing the public sector, corporate and financial institution issuers. These forums are complemented by our strong regional committees which now include separate regional committees for the Middle East and Africa and a physical presence in Asia. These regional committees provide us a truly global view of market developments and challenges across large and small institutions.

As a self-regulatory organisation ICMA has focused on developing standards and best market practices in support of recent regulatory developments to establish safe, stable, fair and efficient markets. We have continued to focus on our core areas of competence such as the primary and secondary markets and repos and adapting market practices in these areas to the changed regulatory environment. Equally we have also taken important new initiatives. We have taken the lead in the area of green bonds assuming the secretariat to the Green Bond Principles, private placements where we are coordinating the industry working group and infrastructural finance. ICMA was also a principal driver of the changes to collective action clauses which are now becoming the norm for sovereign issuers.

In the past year there has been a growing recognition of the important social and economic role that capital markets must play in promoting an effective intermediation process and fostering growth, particularly in Europe. The EU's initiative to promote a Capital Markets Union has been at the centre of this development. ICMA is and will continue to play an important role in this process through working with key stakeholders on underscoring the role and importance of capital markets in meeting key economic policy objectives. ICMA's focus on market practices and developments has enabled us to build a strong working relationship with key central banks, regulators and policy makers. This has in turn enabled us to better understand and address the concerns of policy makers as well as our members.

The new regulatory environment places much emphasis on the professionalism of staff and how market participants behave in addition to what they do. A key area of focus for us historically has been education through the executive education programme (ICMA EE) internal workshops and a groundbreaking partnership in China. The importance of education and appropriate training in the current regulatory environment has led us to continue to adapt ICMA EE to the needs of our members, large and small, and explore new ways in which we can enhance the role and relevance of our education offering. The results to date have been extremely promising.

The Board and I have been deeply impressed by the work and dedication of the management and staff of ICMA. The Association with modest resources has successfully covered a broad and complex range of issues on a timely basis and gained the respect and confidence of all its stakeholders. It has worked effectively with other trade associations developing partnerships to maximise its leverage and avoid duplication. The Board too has adapted, refocusing its work towards more strategic issues to ensure that ICMA continues to develop in the best interests of its members.

ICMA is positioned well to meet the many challenges that lie ahead and contribute to the evolution of capital markets. Capital markets will need to play a bigger role but also need to adapt. Global markets, domestic needs and a rapidly evolving technological revolution will need to be juxtaposed against a complex regulatory framework to provide for financial stability but also provide for a growing world economy. Our forthcoming AGM in Amsterdam will provide an excellent opportunity to explore some of these issues in greater depth.

Cyrus Ardalan is Chairman of ICMA

Message from the Chief Executive

by Martin Scheck

We are currently making the final preparations for our AGM and Conference in Amsterdam on 4 and 5 June – the invitations are out and registrations are in full swing. We are expecting in excess of 800 delegates to attend. This year's roster of speakers is even more impressive then in former years and includes senior business heads, top regulators, central bankers and politicians. The panels tackle the most relevant issues facing capital markets practitioners in their day-to-day business, and overall this is an industry event not to be missed. Please do take a moment to look at the programme on our website – we would be delighted to welcome you and I am sure you would find it both worthwhile and enjoyable!

As Cyrus Ardalan mentioned in this edition's Foreword, a great deal has changed over the last few years, both at ICMA and also in the way the markets operate. We can sense clearly that the pace of change is accelerating, and looking forward we can already predict that the capital markets of the future, and in particular the landscape of primary, secondary and short-term money markets will not look the same as it does now. In addition, the roles of issuers, intermediaries and investors within the capital markets will be differently configured. ICMA is heavily engaged with the issues which will define these changes and well positioned to contribute to the market's development.

The drivers are clear – new regulation in all areas of the capital markets, and of participants, combined with ultra low interest rates, now increasingly negative following the start of the ECB's quantitative easing programme. Market structures are adjusting and participants are fundamentally reassessing their business models and the way they interact with each other and end-clients. The focus on costs amongst our members, in an environment where risk adjusted revenues are increasingly difficult to generate, has never been more intense.

Much of our work set out in this Quarterly Report is already dealing with the impact of the factors above. Through the myriad of member contacts in our committees and councils spanning all segments of the markets, and through our official sector contacts, ICMA is ideally placed to spot themes and trends early. This is tremendously helpful in defining our own forward-looking agenda.

In the secondary markets the impact on liquidity is already evident – this affects all our members and remains a major focus, not only in the cash bond market but also the important repo and collateral markets. The situation is dynamic, with further threats from the definitions of liquidity in the implementation of MiFID II, from the implementation of the unfortunate mandatory buy-in regime under the CSDR, and from the impact of QE on liquidity. On the other hand, the dearth of liquidity is also driving innovation in the field of electronic trading and is promoting healthy discussion as to how issuers and investors might be able to contribute more to mitigate the problem. ICMA is heavily involved on these topics with our members (and the authorities) through research reports, analyses, consultation paper responses, discussions and events.

Primary markets are also coming under increasing regulatory scrutiny. The UK's *Fair and Effective Markets Review* asked a number of detailed questions on the current processes. The imbalance between supply and demand in the booming primary markets over the last five years has given rise to complaints from investors who have not been able to buy as many bonds as they want. We have welcomed the opportunity to respond to the specific questions in this Consultation Paper since we hope this will increase the level of understanding of the processes amongst issuers and investors. This complements the work we have undertaken over the last few years in reviewing, clarifying and modifying our guidance on the primary market processes to ensure that they are always up-to-date and as effective as possible.

Capital Markets Union (CMU) is another major theme. ICMA is already heavily engaged, and of course will respond to the current Green Paper. Interestingly many of our new initiatives over the last year are very much at the heart of improving market-based finance as espoused in the CMU: our private placement, securitisation, infrastructure financing, covered bonds, and green bond initiatives for example are all well under way, so we are well positioned to contribute.

Against this backdrop of past and future change, ICMA's commitment is unwavering: best market practices; bridging the private and official sectors; thought leadership; education. We are committed to working with all our members, large and small, buy side and sell side to ensure that the international capital markets, in whatever future guise, will be effective in intermediating finance.

This means we need to be nimble – not stuck in our ways, but open to new ideas and continually adapting our approach. Not only does this need in-depth interaction with members, excellent understanding of market practices and first class relationships with regulators, but it also requires a Board which has the expertise, knowledge and energy to guide your Association.

We have been particularly fortunate to have had such a dedicated Board under the Chairmanship of Cyrus Ardalan over these critical last few years. I would like to thank him and the rest of the Board for all they have done in ensuring that ICMA is so well prepared for the future.

Contact: Martin Scheck
martin.scheck@icmagroup.org

QE and capital markets

Quarterly Assessment by Paul Richards

Summary

Given that short-term interest rates in the euro area are already at (or very near) the lower bound, the ECB considers that there is a strong case for introducing QE in the euro area now, as inflation is a long way below its target level. The main concerns in capital markets about the ECB's decision to introduce QE are: that opposition in Germany may dilute its effectiveness; that QE can create the conditions for the resumption of sustainable growth, but is not sufficient on its own to deliver it; that sovereign bond yields are already at historically low levels; and that the exchange rate adjustment that is really needed to improve competitiveness is not so much between the euro area and the rest of the world, but between Germany and most of the rest of the euro area. As 19 governments are involved, QE in the euro area is significantly more complicated to design and implement than in the UK or the US.

Introduction

1 In the euro area, the economic priority is to prevent deflation, both in terms of negative inflation and negative real growth, and to restore real growth on a sustainable basis. The UK and the US appear to have succeeded in stabilising inflation and restoring real growth following extensive use of quantitative easing (QE): QE involves central bank purchases of sovereign bonds on the asset side of the central bank balance sheet, financed by printing money on the liability side. This does not mean that QE is solely responsible for restoring sustainable growth in the UK and the US, but it does appear that QE has been a contributing factor in this sense: by stabilising inflation, it has helped to create the conditions for the resumption of sustainable growth.

2 The ECB Governing Council took the decision on 22 January to introduce a version of QE in the euro area from March through purchases by the Eurosystem (ie the ECB and the national central banks of participating countries) of large amounts of sovereign, supranational and public sector agency bonds in the secondary market in exchange for cash. On 9 March, the ECB launched its Public Sector Purchase Programme (PSPP). This Quarterly Assessment considers how effective QE in the euro area is expected to be, and how the PSPP is intended to work, covering the period up to the end of the first quarter.

Effectiveness of QE

3 Given that short-term interest rates are already at (or very near) the lower bound, the ECB considers that QE is the best remaining option if it wishes to ease monetary conditions further; and that there is a strong case for introducing its version of QE now, as inflation is below zero (ie a long way below the ECB's target level of below, but close to, 2%). Of course, the fall in inflation in the euro area is partly due to the substantial fall in oil prices in the past few months. But inflation would be substantially below target even without this. And while a fall in oil prices would normally help stimulate consumer demand, there is also perceived to be a risk that, unchecked by further monetary policy easing, deflation would lead to a vicious circle in the euro area: eg private investment in the real economy would be delayed; and the level of government debt would increase in real terms.

The ECB considers that there is a strong case for introducing QE now, as inflation is a long way below the ECB's target level.

4 However, there are a number of concerns in capital markets, which the euro-area authorities need to address, about how effective QE in the euro area will be:

(i) Political impact

5 First of all, there is a concern in capital markets that opposition in Germany – the largest country in the euro area – to the ECB's decision to introduce QE will dilute its effectiveness by raising doubts about the ECB's commitment. Opposition to QE in Germany – and in some other countries – has arisen for several reasons:

- While Germany was originally the strongest proponent of guaranteeing the ECB's independence from euro-area governments to take decisions, based on the independence of the Bundesbank, there is considered in Germany to be a risk that large Eurosystem purchases of sovereign bonds may have the effect of weakening the ECB's independence from euro-area governments.
- Another risk is that QE will weaken pressure for structural reforms needed in the countries on the periphery of the euro area to improve their competitiveness. It has also been noted that, even in the core of the euro area, France has presented proposals for budget deficits in excess of the 3% limit without criticism from the European Commission.
- A third risk is that German taxpayers will end up paying for other euro-area governments' debts resulting from QE.
- A fourth risk is that QE will artificially drive down interest rates all the way along the yield curve, threatening the financial stability of large insurance companies and pension funds which have guaranteed returns to savers, but are unable to recoup them from their own investments.
- Fifth, there are doubts in Germany about whether QE is necessary at this stage, on the grounds that euro-area inflation and growth are likely to pick up anyway. The ECB itself is projecting inflation in the euro area of zero in 2015, 1.5% in 2016 and 1.8% in 2017, and it is projecting real growth in the euro area of 1.5% in 2015, 1.9% in 2016 and 2.1% in 2017, though only if the QE programme is completed.

6 Finally, there have also been doubts in Germany about whether QE is consistent with the ECB's mandate. The ECB's earlier Outright Monetary Transactions (OMT) programme was challenged in the German Constitutional Court on the grounds that the OMT programme exceeded the ECB's mandate. This challenge has now been dismissed by the Advocate General in the European Court of Justice (ECJ), though the Advocate General's opinion still needs to be confirmed by the ECJ itself. The Advocate General's opinion has also helped to clarify the legal position on implementing QE in the euro area. In addition, the President of the ECB has stated that the Governing Council is unanimous in its view that its asset purchase programme is a true monetary policy tool in a legal sense, and that a large majority of the Governing Council is in favour of triggering it now.

(ii) Economic impact

7 A second concern in capital markets is that QE in the euro area is starting six years later than QE in the US and UK, which was launched in immediate response to the international financial crisis as part of the programme to help stabilise the financial system. Even if QE succeeds in restoring inflation in the euro area, this will not necessarily lead to the resumption of real economic growth on a sustainable basis. That will also depend on whether QE is accompanied by fiscal and other structural reforms by governments in the euro-area countries concerned, and on whether QE succeeds in stimulating demand and investment by the private sector.

There are doubts in Germany about whether QE is necessary at this stage, on the grounds that euro-area inflation and growth are likely to pick up anyway.

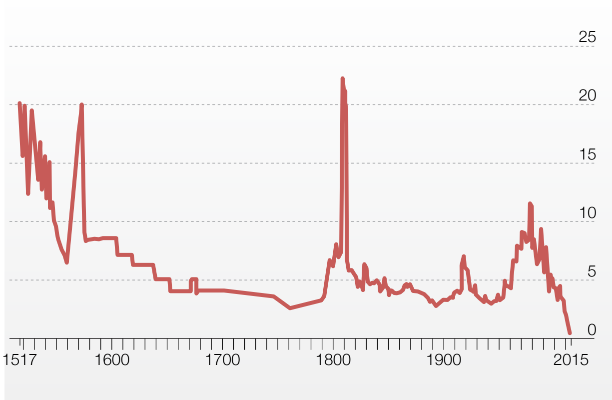
While QE can help create the conditions for the resumption of growth, QE is not sufficient on its own to deliver it.

8 Lack of demand is a particular problem on the periphery of the euro area because the euro area has no cross-border fiscal stabilisers: ie there are no fiscal transfers from stronger regions to weaker regions across borders in the euro area of the kind that help to stabilise regions within most individual countries. Even if cross-border fiscal transfers could be agreed by euro-area governments, they could not be introduced without a change in the EU Treaty. So while QE can help create the conditions for the resumption of growth, QE is not sufficient on its own to deliver it.

(iii) Monetary impact

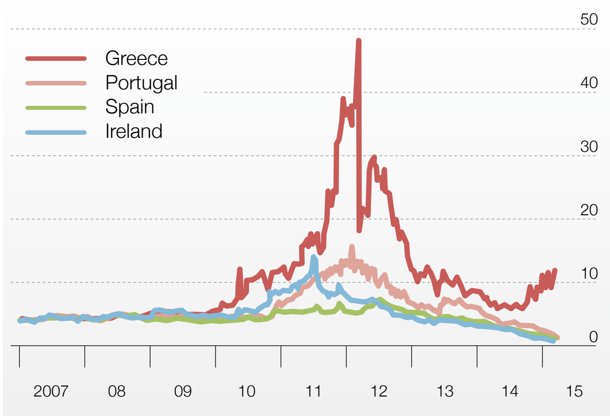
9 A third concern in capital markets is that sovereign bond yields in most euro-area countries are already at historically low levels, and have fallen further recently – in some cases becoming negative – in anticipation of QE (Chart 1). Although sovereign bond yields in the euro area are clearly lower than they would have been if QE had not been introduced, and sovereign yield spreads between the core and the periphery (other than Greece) are narrower, it is not clear what further difference QE will make to sovereign bond yields (Chart 2). And while the spreads between sovereign and investment grade corporate bond yields are already low, it is not clear what impact QE will have on small and medium-sized companies.

Chart 1: Netherlands 10 year bond yield (%)



Sources: Global Financial Data; FT

Chart 2: Selected euro-area government 10 year bond yields (%)



Sources: Thomson Reuters Datastream; Haver Analytics; FT

10 However, QE is not just intended to reduce bond yields. When a central bank buys sovereign bonds from its banks, it also injects cash into the financial system. The critical question in the euro area, where bank financing still represents a much larger proportion of total funding for the private sector than the capital markets, is whether purchases of sovereign bonds from banks in exchange for cash will lead to more bank lending to the private sector; or whether lack of private sector demand, coupled with lack of incentives for banks to lend, will pre-empt this. Banks are still deleveraging their balance sheets in response to regulatory measures to make them safer and more resilient following the crisis. These regulatory measures may also make banks reluctant to sell their holdings of sovereign bonds, though they receive central bank reserves, which are close substitutes, in exchange.

11 An alternative (or more likely in practice, a supplement) to buying sovereign bonds from euro-area banks would be for the Eurosystem to buy more sovereign bonds from non-bank investors in the euro area, though some long-term

It is not clear what further difference QE will make to sovereign bond yields.

“

The exchange rate adjustment that is really needed to improve competitiveness is between Germany and most of the rest of the euro area.

holders may be reluctant to sell, and from banks and non-bank investors outside the euro area. While bank lending to the private sector in the euro area is constrained, there is scope for diversifying risk through the capital markets, which currently represent a significantly smaller proportion of finance for the real economy in the EU than in the US. Developing capital markets across borders in the EU is one of the key aims of EU Capital Markets Union as a means of restoring sustainable economic growth.

(iv) Exchange rate impact

12 Finally, it is important to consider the impact of QE on the euro exchange rate. Given the ECB's commitment to QE in the euro area, on the one side, and the prospect of a tightening of monetary policy in the US, on the other, the euro exchange rate has weakened significantly both in US dollar terms and on a trade-weighted basis over the past few months. The weakness of the euro exchange rate is not an ECB target, but the outcome of ECB monetary policy decisions. A weaker euro exchange rate may itself have the effect of increasing inflation in the euro area. It may also help revive economic activity in the euro area by increasing its economic competitiveness in relation to the rest of the world, though external trade represents only around 20% of euro-area GDP.

13 However, there are three related issues to address. One is that the euro area already runs a trade surplus with the rest of the world. The exchange rate adjustment that is really needed to improve competitiveness is not so much between the euro area and the rest of the world, but between Germany and most of the rest of the euro area. Since inflation in Germany remains very low, this adjustment can only be made within the euro area by internal price reductions in the countries on the periphery on a continuing basis in an attempt to restore their competitiveness. In the absence of fiscal transfers from Germany to the countries on the euro-area periphery, it is clear that, to be effective, QE needs to be accompanied by structural reforms, particularly on the periphery, and should not be regarded as a substitute for them.

14 A second issue is that the weakness in the euro exchange rate has prompted the Swiss National Bank, which three years ago linked the Swiss franc to the euro by capping the exchange rate at CHF1.20/€1, to remove the cap, with the result that the Swiss franc has risen in the exchange market by around 15% in terms of the euro. Such a substantial rise in the exchange rate of the Swiss franc may have a significant deflationary impact on the economy in Switzerland, which already has zero inflation and low growth. It has also led to negative bond yields up to 10 years' maturity for the first time. Following the uncapping of the Swiss franc, there were capital flows into the Swedish krone, where the Riksbank has reduced short-term interest rates and launched its own QE programme, and into the Danish krone, which is pegged to the euro, and where the Danish National Bank has also reduced short-term interest rates.

15 Third, it appears that the decision to remove the cap on the Swiss franc was taken unilaterally without consultation (eg with the IMF). There is an argument that this is the only way to remove an exchange rate cap, otherwise there is a risk that the market will anticipate it and potentially exacerbate the problem. But it can equally be argued that some international coordination of exchange rates at global level would be desirable, both to reduce exchange rate volatility and to remove the risk of "beggar-my-neighbour" exchange rate policies of the kind that exacerbated deflation in the 1930s.

Design and implementation of QE

16 QE is significantly more complicated to design and implement in the euro area than in the UK or the US. Instead of dealing with one government, QE in the euro area involves 19 governments, each with different debt profiles, and some with significantly higher credit ratings than others. There are a number of key questions which the design and implementation of QE must address:

“

QE is significantly more complicated to design and implement in the euro area than in the UK or the US.

(i) Market size

17 The first is why the ECB's Governing Council needs to extend its existing programme of purchasing private sector assets to include secondary market purchases of sovereign bonds. (Buying in the primary market is prohibited by the EU Treaty.) The ECB has been committed for some time to increase its balance sheet by around €1 trillion (ie back to the level it reached in 2012). However, all the other options available to the ECB have not worked on the scale required:

- Targeted Longer-Term Refinancing Operations (TLTROs) are designed to increase ECB lending to the banks for on-lending to the private sector: but the Eurosystem auctions so far have not attracted bank borrowing on the scale required, though the ECB has now reduced its interest rate for TLTRO lending.
- It is already clear that Eurosystem purchases of private sector assets – covered bonds and securitisations – will not be of sufficient size to meet the balance sheet target, as these markets are not large enough to accommodate the scale of bond purchases which the ECB has in mind.
- This would also be the case if the Eurosystem were to purchase corporate bonds, which have not been included in the ECB's purchase programme.
- Large Eurosystem purchases would reduce the level of secondary market liquidity in all these private sector markets, where liquidity is already at a much lower level than before the crisis.

The only market in the euro area which is large enough to accommodate a substantial amount of QE is the sovereign bond market.

(ii) Programme size

18 The second question is whether the ECB's Public Sector Purchase Programme (PSPP) is limited in size or potentially unlimited. On 22 January, the ECB Governing Council decided that, from March 2015 until September 2016, the Eurosystem would purchase assets to the value of around €60 billion per month, of which around €10 billion represents a continuation of the existing programme to purchase private sector assets, and €50 billion represents the sovereign bonds of euro-area countries, including some government agency and supranational issuers. (The starting date for the PSPP was subsequently confirmed as 9 March.)

19 The prospective purchases amount to around €1.1 trillion in total: ie around 20% of total euro-area government bonds (of €4.6 trillion), plus €277 billion for public sector agencies and €400 billion for supranationals. Eurosystem purchases are likely to exceed net sovereign debt issuance of medium and long-term securities (of €200 billion in 2015 in total), especially in Germany, whereas government budget deficits were much larger when QE was launched in the US and UK six years ago.

20 However, the key point is that the ECB's purchase programme is intended to be open-ended. The ECB Governing Council has stated that the purchase programme is to continue until the ECB sees a "sustained adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term".

“

The ECB's purchase programme is intended to be open-ended.

(ii) Eligibility criteria

21 The third question is what the eligibility criteria for Eurosystem purchases of euro-area sovereign, supranational and public sector agency bonds under the PSPP will be:

- Sovereign, supranational and public sector agency bonds under the PSPP are to be purchased in the secondary market. Primary market purchases of all these categories are prohibited under Article 123 of the EU Treaty. There will be a "blackout" period around the issuance of new securities in the primary market.
- Bonds are to be purchased according to the ECB's capital key (ie relating broadly to national shares of euro-area GDP) on a monthly basis. The euro-area wide scope of purchases of sovereign bonds under the QE programme distinguishes it from the OMT programme which, if it were to be activated, would involve purchases only of the sovereign bonds of euro-area countries subject to a financial assistance (ie "bail-out") agreement.
- Bonds to be purchased are intended to have a residual maturity at purchase of between two and 30 years. In addition to fixed-rate securities, inflation-linked and floating-rate securities are included; and bonds are not excluded on the grounds that they have negative yields, as long as the yield is above the ECB's deposit

“

80% is not subject to risk sharing.

facility rate (currently minus 20 basis points). Purchases are intended broadly to match the maturity structure of the nominal value of outstanding two to 30 year bonds in each eligible euro-area country, but with some flexibility to take account of national differences. The Eurosystem's objective is to be market-neutral and to create as little distortion as possible.

- Bonds to be purchased must be investment-grade; and bonds of euro-area governments subject to a financial assistance (ie "bail-out") programme are not eligible when their programmes are being reviewed (as in the case of Greece at present).
- The size of purchases is to be limited by issuer to a maximum of 33% (in the two to 30 year residual maturity range) and to a maximum of 25% of each issue, based on nominal rather than market values.
- A list of the bonds of eligible supranational and public sector agency issuers located in the euro area was published by the ECB on 5 March. Initially, eligible supranationals are: the Council of Europe Development Bank; the European Atomic Energy Community; the European Financial Stability Facility; the European Stability Mechanism; the EIB; the EU; and the Nordic Investment Bank; and eligible public sector agencies are: CADES; UNEDIC; Instituto de Creditor Oficial; KfW; LBW; Rentenbank; and NRW Bank.
- Eligible counterparties for purchases are those eligible for the Eurosystem's monetary policy instruments, and others used by the Eurosystem for investment of its euro-denominated investment portfolios.
- The aggregate amount of securities purchased will be published each week and the residual maturity of securities held in each national jurisdiction each month.

(iv) Risk sharing

22 The fourth question is whether the risk of loss under the PSPP is shared among ECB members (ie mutualised), or taken separately by each national central bank (NCB). Most of the ECB's initiatives to date – such as the Long-Term Refinancing Operation (LTRO) programme and the Outright Monetary Transactions (OMT) programme, if it were ever to be used – involve risk sharing (ie mutualisation). But in the case of QE, while the ECB Governing Council controls the PSPP and coordinates purchases, 80% of the total additional amount of sovereign and public sector agency bonds is to be purchased by each sovereign's own NCB in the Eurosystem, and not subject to risk sharing. Only 20% is to be subject to risk sharing. This 20% share consists of purchases (by a few NCBs) of supranational debt as to 12% and ECB purchases as to 8%.

23 On the one hand, the low proportion of risk sharing reduces the risk of loss to the ECB if a euro-area government has to reschedule its debt, as the risk is borne by the NCB concerned. The low proportion of risk sharing has also allayed some of the concerns about QE in Germany. But on the other hand, the low proportion of risk sharing has raised doubts in capital markets about the ECB's commitment to, and therefore the effectiveness of, the QE programme. And requiring NCBs to increase their exposure by buying the bonds of their own sovereigns represents "wrong-way" risk: dependence of sovereigns on selling bonds to their own commercial banks is widely regarded as having been a contributory cause of the crisis on the periphery of the euro area. As the NCBs are part of the Eurosystem, there is also an outstanding question about whether risk initially taken by NCBs would still be mutualised (eg through TARGET2) in the event of losses occurring (eg if a participating country were to exit the euro area).

(v) Status

24 The fifth question is whether, under the PSPP, the Eurosystem has preferred creditor status (as in the case of some sovereign bond purchases in the past) or whether Eurosystem purchases of sovereign bonds rank *pari passu* with bonds held by other investors. Given the scale of the Eurosystem sovereign bond purchases in prospect, this is a material factor for private sector investors in capital markets. The ECJ Advocate General concluded in the case of the OMT programme, subject to confirmation by the ECJ, that *pari passu* ranking was acceptable so as to disrupt capital markets as little as possible. And the ECB has stated that Eurosystem sovereign bond purchases under the PSPP would be *pari passu* with other investors.

25 But the EU Treaty appears to imply that the ECB should not participate in any debt restructuring; and that, in the case of a restructuring subject to a collective action clause (CAC), the ECB "will always vote against a full or partial waiver of its claims ... thus confirming that the aim of its conduct is not to grant financial advantage to the debtor State." The implication is that the ECB would always vote against a restructuring which could reduce the value of its holdings, as this would count as monetary financing, but that the ECB could be overruled if there were a sufficient majority of bondholders (under a CAC) in favour of restructuring. The ECB has addressed the concern that the Eurosystem's QE purchases could build up a blocking minority by limiting the size of purchases

> A repo/securities lending facility would help to address the problem by putting liquidity back into the sovereign bond market so that it functions efficiently.

by issuer to a maximum of 33% (in the two to 30 year residual maturity range) and imposing an issue limit of a maximum of 25%, based on nominal rather than market values. These limits include any other ECB holdings (eg under the Securities Market Programme).

(vi) Market liquidity

26 In principle, these bond purchase limits should also help to reduce the adverse liquidity effects of large purchases of bonds by the Eurosystem. However, there are two other considerations:

- First, the "free float" is much smaller than the issue size and, in the case of quite a number of issues, is likely to be below the issue limit. This would particularly be the case if, in addition to QE, the OMT facility ever had to be activated by the ECB, or where the Securities Market Programme has been extensively used already (as in the case of Greece). If the sovereign issue limits are reached, euro-area supranational bonds are due to be purchased instead.
- Second, it is possible that the minus 0.2% cap on yields would also act as a constraint on NCB purchases of sovereign bonds, particularly at the short end of the yield curve in the case of sovereigns with a high credit rating. That would drive NCB purchases of sovereign bonds further down the yield curve, increasing the risk of NCB losses if QE is successful and interest rates begin to rise again before the PSPP programme is unwound.

27 The immediate question is how best to address the adverse liquidity effects of the PSPP. The ECB stated on 5 March that marketable debt instruments purchased under the PSPP would be made available for securities lending in a decentralised manner, mirroring the organisation of the PSPP, and further elaborated on this on 2 April. A well constructed Eurosystem repo/securities lending facility would help to address the problem by putting liquidity back into the sovereign bond market so that it functions efficiently. To the extent that bonds lent were exchanged for other bonds rather than cash, the expansionary monetary effect intended as a result of QE would not be offset.

Future exit from QE

28 Finally, the ECB needs to decide how the Eurosystem will exit from its QE programme in due course. Exit may well be a long way off, if the experience of the UK and the US with QE proves to be a guide. But at that stage, the costs of QE – not just in terms of the profit and loss account of the Eurosystem, but also in terms of the longer-term impact of keeping interest rates lower than they would otherwise have been – will have to be weighed against the benefits – in terms of the impact on inflation and the resumption of sustainable growth. By that stage, it should also be clearer whether the authorities in the euro area have used the time provided by QE for further integration or whether the risks of disintegration (eg in the event of a Greek exit from the euro area) remain. In the meantime, communicating to capital markets future changes in the ECB's policy intentions will be a critical factor in assessing the effectiveness of QE.

Contact: Paul Richards
paul.richards@icmagroup.org

Practical initiatives by ICMA

There are a large number of practical initiatives on which ICMA is currently, or has recently been, engaged with, and on behalf of, members. These include:[1]

Capital markets generally

1 *Fair and Effective Markets Review:* ICMA has responded to the Consultation Document on the *Fair and Effective Markets Review* (FEMR), which is being conducted by the UK authorities (HM Treasury, the Bank of England and the FCA). ICMA's response, which was submitted on 14 January, is summarised in the Box. The FEMR conclusions are due to be announced in June.

2 *Capital Markets Union Commissioner:* ICMA representatives had a meeting on 26 January in Brussels with the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, on Capital Markets Union.

3 *Capital Markets Union Green Paper:* Following publication on 18 February of the European Commission's Green Paper on *Building a Capital Markets Union,* ICMA will be responding by the deadline of 13 May. ICMA is holding regular conference calls, jointly with AFME, to share information on Capital Markets Union with other trade associations across Europe.

Short-term markets

4 *Quantitative easing:* In response to the ECB Governing Council decision on 22 January to launch quantitative easing (QE) in the euro area, the ICMA European Repo Council (ERC) has been in regular contact with the ECB to stress the importance of an associated repo/securities lending facility and to propose ideas on how such a facility could most effectively be developed.

5 *Data collection and aggregation:* The ERC has responded to the FSB's Consultative Proposals on *Data Collection and Aggregation*, taking account of the ERC's own practical experience in collecting repo data from its member firms.

6 *European repo survey:* The 28th ICMA ERC European repo market survey, based on repo business outstanding on 10 December 2014, has been published. The new survey sets the baseline figure for market size at €5,500 billion, which represents a small decline from the figure recorded in the June 2014 survey.

Primary markets

7 *Prospectus Directive:* The European Commission has launched a Consultation Paper on the Prospectus Directive (PD), alongside its Green Paper on Capital Markets Union. ICMA will be responding to the PD consultation.

8 *CoCos:* ICMA submitted a response, by the deadline of 29 January, to the UK FCA Consultation Paper on restrictions on the retail distribution of regulatory capital instruments.

9 *Credit ratings:* ICMA submitted a response, by the deadline of 31 March, to ESMA's Call for Evidence on the functioning of the credit rating industry, focusing on whether mandatory rotation should be extended to asset classes other than re-securitisation.

10 *ICMA Primary Market Handbook:* The overall review and revision of the ICMA Primary Market Handbook is nearing completion. In addition, revised recommendations have been agreed on: joint leads without responsibility for the order book; and pricing references for new sterling Eurobonds.

Secondary markets

11 *Secondary market liquidity:* Following the publication of his ICMA study on *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market*, taking account of 38 interviews with market experts, comprising issuers, intermediaries and investors, Andy Hill participated at IOSCO's request in a meeting with regulators in Delhi on 29 January to discuss the conclusions of the study and the way ahead, and has participated in a number of other ICMA seminars on the subject.

12 *CSD Regulation Level 2:* ICMA has responded to the ESMA Consultation Paper on the CSD Regulation (CSDR) Level 2, explaining why mandatory buy-ins are unworkable; and ICMA has published an impact study on mandatory buy-ins under the CSDR. ESMA is seeking an 18 month delay on implementation from the European Commission.

13 *MiFID II Level 2:* ICMA responded to the latest ESMA Consultation Paper on MiFID II Level 2, which calibrates pre- and post-trade transparency, by the deadline of 2 March.

Asset management

14 *Securitisation:* The ICMA Asset Management and Investors Council (AMIC) set up a buy-side Working Group in October last year to coordinate ICMA buy-side members' views on the debate about securitisation. The Securitisation Working Group is currently considering the European Commission's Consultation Paper on Securitisation.

15 ICMA has responded, jointly with others, to the EBA's consultation on *Simple, Standard and Transparent Securitisations*; and to BSCBS/IOSCO's consultation on *Simple, Transparent and Comparable Securitisations*.

Capital market products

16 *Private placements:* The Pan-European Private Placement Working Group, which ICMA coordinates, launched its *Pan-European Private Placement Guide* on 11 February. The Working Group also submitted a response, by the deadline of 27 February, to HMRC's Technical Note on *Deduction of Income Tax from Payments of Yearly Interest: Private Placements.*

17 *Infrastructure finance:* The Infrastructure Working Group, in which ICMA works with AFME and others, is preparing a *Guide to Infrastructure Financing – through Bank Loans, Private Placements and Public Bonds.*

18 *Green bonds:* As the Secretariat of the Green Bond Executive Committee, ICMA published the updated Green Bond Principles ahead of the Green Bond AGM and Conference, which took place in London on 27 March. The Conference was attended by around 350 delegates.

Other meetings

19 *Official groups:* ICMA continues to be represented, through its Chief Executive, on the ECB Bond Market Contact Group; through its President, on the ESMA Securities and Markets Stakeholder Group; and through the Chairman of its European Repo Council, on the ESMA Secondary Markets Working Group and the ECB Contact Group on Euro Securities Infrastructures.

20 *Japan Securities Summit:* The Japan Securities Dealers Association (JSDA) and ICMA jointly organised the Japan Securities Summit at the Mansion House in London on 12 February. The Summit was attended by a significant number of senior representatives from the financial industry and capital markets in Europe and Japan.

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

Fair and Effective Markets Review: ICMA's response

Key points in ICMA's response to the Consultation Document issued by the Secretariat of the UK's *Fair and Effective Markets Review* include the following:

Market microstructure: A recent ICMA study suggests that, while there is scope for more trading activity to migrate to electronic trading venues, this is not a substitute for the liquidity provided through the traditional market-making model.

From the point of view of corporate issuers, the treasury function is under a corporate governance obligation to manage its funding in the best interests of the company's business.

Corporate borrowers today mostly choose to issue international corporate bonds on a syndicated book-built basis. Borrowers hire a syndicate of banks (lead managers) to help them collect orders and then to price the issue to demand.

Borrowers, who are also financial market "end-users", have a strong interest in deciding which investors will receive bonds on issuance. An auction process does not enable a borrower to decide this.

Lead managers seek to account for the interests of their borrower clients when allocating bonds on new issues. Borrowers may choose to rely entirely on their syndicate's proposal, suggest amendments or even elaborate their own allocation plan.

Allocation is an art and not a science. Specific allocation considerations include early, proactive and useful feedback on what the transaction size/yield could be; track record of investing in the borrower, sector or type of issue concerned; likely holding horizon; and any apparent order size inconsistency with assets under management or prior investment history (which might indicate order inflation).

It is relatively common today, though by no means universal, for lead managers to make deal statistics available to investors. These itemise the transaction's distribution by geographic segments and by investor type. However, going beyond that to the publication of individual allocations raises questions of statutory or contractual confidentiality in relation to both investors and borrowers that would need to be addressed (notably under MiFID client-facing rules).

When considering alternative issuance processes, it is important to ensure they work in changing market environments and for under-subscribed bond issues as well as for over-subscribed ones.

ICMA believes that there are significant risks in case well intentioned regulation inadvertently leads to undesirable effects on the functioning of fixed income markets.

Conflicts of interest and information flows: Any conflicts of interest need to be appropriately managed (as required *inter alia* by MiFID), and confidential information also needs to be appropriately managed (as required *inter alia* by MiFID and MAD).

Competition and market discipline: Eurobond borrowers can and frequently do change the lead managers that participate in their underwriting syndicates, without any investor or market reaction or comment (though borrowers do see an advantage in having relationship firms in the syndicate who already have a good understanding of their needs).

The ICMA Primary Market Handbook was created to promote intra-syndicate efficiency in the context of Eurobond issues. It does so by non-exhaustively recognising industry consensus around salient good practice by ICMA member lead managers, notably regarding transparency and timeliness. The Handbook is not technically binding, and ICMA's Primary Market Practices Committee is not an enforcement body.

Benchmarks: ICMA considers that much has already been done in a short space of time to improve the robustness of benchmarks and notes that further adjustments are already in train. It appears reasonable to believe that some time is now needed to allow all this to become more fully bedded down and any further action should only then be based upon observation of the new regime which leads to the identification of any remaining shortcomings.

Standards of market practice: ICMA's experience is that, beyond formal rules and requirements, there is a highly valuable role that can be fulfilled by the market itself drawing up practice guides, which should fill in any gaps in the formal framework, and help to make clear how market activities can efficiently and effectively be conducted within the applicable formal framework.

Surveillance and penalties: ICMA considers that there should be effective supervision of market participants and that this should reflect a consistent approach to the oversight of market behaviour. In this regard, ICMA is highly supportive of the role of IOSCO as a purveyor of internationally agreed market standards and considers that more should be done to leverage these as a basis for a common set of market standards.

Contact: Paul Richards
paul.richards@icmagroup.org

Regulatory Response to the Crisis

by David Hiscock

Global financial regulatory reforms

On 23 January 2015, the BCBS announced its work programme for 2015 and 2016, which is structured around four themes: (i) policy development; (ii) ensuring an adequate balance between simplicity, comparability and risk sensitivity across the regulatory framework; (iii) monitoring and assessing implementation of the Basel framework; and (iv) improving the effectiveness of supervision.

Concerning policy development, the BCBS will continue to pursue its post-crisis reform agenda, with a focus on restoring confidence in capital ratios, including: revisions to existing methods of measuring risk-weighted assets; a capital floor based on standardised approaches; consideration of simple, transparent and comparable criteria for securitisations; the fundamental review of the trading book; interest rate risk in the banking book; and the adequacy of loss-absorbing capacity of G-SIBs in resolution. In addition to existing policy initiatives, policy-related issues which the BCBS is undertaking are: (i) assessing the interaction, coherence and overall calibration of the reform policies; (ii) reviewing the regulatory treatment of sovereign risk; and (iii) assessing the role of stress testing in the regulatory framework, in light of national developments.

Also on 23 January, the BCBS issued a second progress report on banks' adoption of the BCBS's principles for effective risk data aggregation and risk reporting. Published in 2013, these principles aim to strengthen risk data aggregation and risk reporting at banks to improve their risk management practices and decision-making processes. Firms designated as G-SIBs are required to implement these principles in full by 2016.

On 28 January, the BCBS issued the final standard for the revised Pillar 3 disclosure requirements, which will enable market participants to compare banks' disclosures of risk-weighted assets. The revisions focus on improving the transparency of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements; and the revised requirements will take effect from end-2016.

In 2013, the Joint Forum of the BCBS, IOSCO and the IAIS surveyed supervisors and firms in the banking, securities and insurance sectors globally in order to understand the current state of credit risk management given the significant market and regulatory changes since the 2008 financial crisis. 15 supervisors and 23 firms from Europe, North America and Asia responded to the survey. Based on the responses and subsequent discussions with firms, the Joint Forum made four recommendations for consideration by supervisors; and, on 5 February 2015, the Joint Forum released its consultative report (for comment by 4 March 2015), *Developments in Credit Risk Management Across Sectors: Current Practices and Recommendations*.

In a 4 February 2015 letter to G20 Finance Ministers and Central Bank Governors, the FSB Chair sets out the FSB's work programme to advance the goals set in Brisbane during the Turkish G20 Presidency in 2015. In brief:

- *full, consistent and prompt implementation of agreed reforms:* the FSB supports the determined efforts of its members through enhanced monitoring of implementation across all jurisdictions, regularly reporting its key findings to the G20. This year the FSB will publish its first annual report on the implementation of the reforms and their effects;
- *finalising the design of remaining post-crisis reforms:* further work on the design of reforms is needed in three areas: (i) completion of the capital framework for banks; (ii) measures to help end too-big-to-fail; and (iii) initiatives to make derivatives markets safer; and
- *addressing new risks and vulnerabilities:* closing data gaps and sharing analysis and policy choices will be vital to allow national authorities to understand and react to risks effectively and promptly. In addition, the FSB will focus on coordinating efforts to address two specific emerging vulnerabilities, namely market-based finance and misconduct.

A *communiqué* was issued following the G20 Finance Ministers and Central Bank Governors meeting, held on 9-10 February 2015, in Istanbul. Paragraph 10 of this *communiqué* specifically covers matters regarding financial regulatory reform, including a commitment to finalize the remaining core elements this year. Critical steps remain to be taken especially in addressing the too-big-to-fail problem, notably finalizing the proposed common international TLAC standard for G-SIBs by the Antalya Summit. The methodology for identifying SIFIs beyond the banking and insurance sector will be finished by the end of 2015 and policy measures to be applied thereafter will be designed. The importance of timely, full and consistent implementation of agreed reforms is recognised. In particular, there is a commitment to implementing the Key Attributes of Effective Resolution Regimes for all parts of the financial sector that could be systemic in the event of failure.

Cross-border cooperation will be enhanced to enable regulations to be more effective, particularly in the areas of resolution and OTC derivatives markets reforms, where swift implementation is required. Jurisdictions are encouraged to defer to each other when it is justified in line with the St. Petersburg Declaration. The FSB is called upon to continue monitoring and addressing new and evolving financial risks, many of which may arise outside the banking system. In this regard, the updated shadow banking roadmap agreed in Brisbane will be implemented to further improve the oversight and regulation of shadow banking, appropriate to the systemic risks posed to ensure resilient market-based financing. There is concern about market misconduct and the recent trend of financial institutions terminating and restricting business relationships with categories of customers, so these developments will be closely monitored in view of their potential impact on financial inclusion and stability.

The annex to the *communiqué* highlights the welcome delivery of a series of reports ahead of the meeting; and outlines issues for further action, which include requests to the FSB to:

- prepare a report, coordinating the inputs of the IMF, OECD, BIS, IOSCO and World Bank Group, by September – preceded by an interim report to the June Deputies meeting – to examine the factors that shape the liability structure of corporates focusing on its implications for financial stability;
- examine with the World Bank and other relevant bodies, the extent of withdrawal from correspondent banking and its implications for financial inclusion, as well as possible policy responses as needed;
- work with CPMI, IOSCO and BCBS to

"The roadmap agreed in Brisbane will be implemented to further improve the oversight and regulation of shadow banking, appropriate to the systemic risks posed.

develop and report in April on a work plan for identifying and addressing any remaining gaps and potential financial stability risks arising relating to CCPs that are systemic across multiple jurisdictions and for helping to enhance their resolvability.

Also, the IMF is asked to report back on progress on the inclusion of the strengthened collective action and *pari passu* clauses (as promoted by ICMA) in international sovereign bonds and on the Fund's efforts in actively promoting their use.

In a 13 February 2015 press release, it was reported that the Board of IOSCO met in Seoul to push forward IOSCO's work on securing strong, safe and efficient securities markets, which are drivers of global economic growth. On policy issues, the Board discussed its priorities for 2015 and:

- progressed IOSCO's important work with the FSB on Non-Bank Non-Insurance SIFIs and discussed the timing of implementation of margin requirements for non-cleared OTC derivatives;
- discussed IOSCO's mainstream role and contributions to FSB priorities in 2015, including CCPs, asset management and conduct risk;
- supported development of new mandates on secondary bond market liquidity and order routing incentives;
- discussed current risks in capital markets; and provided direction on a proposal to identify the risks and vulnerabilities in market-based financing and a proposal to develop tools for identifying data gaps and eliminating barriers to data gathering;
- discussed IOSCO's important work on cyber resilience, investor protection, credible deterrence, IOSCO's Enhanced Multilateral Memorandum of Understanding (MMOU) on cooperation and the exchange of information and cross-border regulation;
- received updates from the UK Financial Conduct Authority about its *Fair and Effective Markets Review* and the opportunities for IOSCO to better understand the role IOSCO might play in the important global dimensions of that work;
- discussed a forward plan for IOSCO's Assessment Committee to monitor and assess implementation of IOSCO's Principles and Standards.

On organizational and strategic issues, the Board heard updates on a project to agree, resource and fund a Strategic Direction to 2020; moved forward on shaping IOSCO's future capacity building, significantly including in principle Board agreement to establish pilot IOSCO regional capacity-building hubs hosted by member jurisdictions; and invited the Bank of Russia and the Financial Services Commission of Jamaica to become signatories of the MMOU.

On 24 February 2015, IOSCO published the final report, *A Comparison and Analysis of Prudential Standards in the Securities Sector*, which makes a high level comparative analysis of the key prudential/capital frameworks for securities firms, seeking to highlight similarities, differences and gaps among the different frameworks. IOSCO´s objective is to update its 1989 report on *Capital Adequacy Standards for Securities Firms*, based on the issues identified in this final report. The new report´s comparative analysis focuses on the Net Capital rule approach, in particular the US approaches, and the EU Capital Requirements Directive, which is founded on the BCBS approach. While focusing on those two main prudential frameworks, the report also recognises relevant national variations. The report highlights prudential regulatory and supervisory areas that might be considered in an update of the 1989 report.

On 3 March 2015, the BCBS published the results of its latest Basel III monitoring exercise. A total of 224 banks participated in the current study, comprising 98 large internationally active banks ("Group 1 banks", defined as internationally active banks that have Tier 1 capital of more than €3 billion) and 126 Group 2 banks (ie representative of all other banks). The results of the monitoring exercise assume that the final Basel III package is fully in force (ie they do not take account of applicable transitional arrangements), based on data as of 30 June 2014.

These data show that all large internationally active banks now meet the Basel III risk-based capital minimum requirements; and, moreover, capital shortfalls relative to the higher target levels have been further reduced. The average Common Equity Tier 1 capital ratios under the Basel III framework across the same sample of banks are 10.8% for Group 1 banks and 11.8% for Group 2 banks. Basel III's Liquidity Coverage Ratio (LCR) came into effect on 1 January 2015. The weighted average LCR for the Group 1 bank sample was 121% on 30 June 2014, up from 119% six months earlier; and for Group 2 banks, the weighted average

“Market participants need to be mindful of risks of diminished market liquidity, asset price discontinuities, and contagion across markets.

LCR was 140%, up from 132% six months earlier.

Basel III also includes a longer-term structural liquidity standard – the Net Stable Funding Ratio (NSFR) – which was finalised by the BCBS in October 2014. Given data collected as part of the end-June 2014 reporting period was obtained prior to the release of the revised standard, the report provides analysis of results under the consultative document issued in January 2014. The weighted average NSFR for the Group 1 bank sample was 110% while for Group 2 banks the average NSFR was 114%. As of June 2014, 80% of the 212 banks in the NSFR sample reported a ratio that met or exceeded 100%, while 92% of the banks reported an NSFR at or above 90%.

On 4 March 2015, as discussed in further detail in the Asset Management Section of this ICMA Quarterly Report, the FSB and IOSCO published for second public consultation, *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions* (NBNI G-SIFIs). The proposed methodologies for identifying NBNI G-SIFIs complement the methodologies for identifying G-SIFIs that currently cover banks and insurers; and aim to identify NBNI financial entities whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity at the global level.

On 12 March 2015, the FSB made available the latest version of the *Handbook for FSB Peer Reviews*. This Handbook was originally prepared in December 2009 by the FSB Standing Committee on Standards Implementation (SCSI) to develop a framework for FSB peer reviews. In 2011, the SCSI conducted a review of experience with FSB peer reviews in order to identify lessons drawn from reviews undertaken and to make recommendations to improve the functioning of the peer review programme. These recommendations have been incorporated in this document, which was also revised in January 2014 and February 2015 in response to SCSI members’ suggestions on ways to further enhance the functioning of peer reviews.

The FSB reported on its plenary meeting in Frankfurt, in a 26 March 2015 press release. In brief, amongst the points covered are the following:

- *Emerging Markets Forum:* the FSB discussed issues related to implementation, home-host, proportionality and sequencing raised by emerging market and developing economies in a Forum held the previous day.
- *Vulnerabilities in the financial system:* recent market portfolio adjustments and asset re-pricing have occurred in response to the divergence in economic growth and policy expectations in the global economy. Whilst market adjustments to date have occurred without significant financial stress, the risk of a sharp and disorderly reversal remains given compressed credit and liquidity risk premia. As a result, market participants need to be mindful of risks of diminished market liquidity, asset price discontinuities, and contagion across markets.
- *Market liquidity and asset management:* while the trend towards greater market-based intermediation through asset management entities is welcome and should contribute to the overall resilience of the financial system by providing alternative sources of funding, it is important to ensure that any financial stability risks are properly understood and managed. The FSB agreed a work plan to identify financial stability risks associated with market liquidity in fixed income markets and asset management activities in the current conjuncture, as well as longer-term structural financial stability issues that may arise. The FSB will discuss the initial findings at its next meeting in September.

- *Market-based finance:* the FSB reviewed the consultative responses received on the proposed application of numerical haircut floors to non-bank-to-non-bank SFTs. The standards will be finalised by September 2015. Members also endorsed the results of an initial information-sharing exercise among jurisdictions on their implementation of the FSB's high-level policy framework for shadow banking entities. The FSB will conduct a comprehensive information-sharing exercise, which will be peer-reviewed, in 2015.
- *Ending too-big-to-fail:* the FSB took note of the responses to its public consultation on policy proposals to enhance the TLAC of G-SIBs in resolution and reviewed progress in impact assessment studies under way. The new standard will be finalised by the time of the G20 Summit in November. The FSB also reviewed next steps to finalise the FSB's guidance on statutory and contractual approaches to the cross-border recognition of resolution actions, following the recent public consultation. Work is under way to promote broad adoption of contractual recognition clauses to make temporary stays of early termination rights effective in a cross-border context. To fully realise the financial stability benefits of clearing through CCPs, the FSB plenary agreed a work plan to promote CCP resilience, recovery planning and resolvability. The work will be taken forward in close coordination between CPMI, IOSCO, BCBS and the FSB.
- *Market conduct issues:* misconduct in financial institutions has the potential to create systemic risks by undermining trust in financial institutions and markets. To address misconduct risks, the FSB reviewed a work plan that will examine several applicable issues.
- *Implementation monitoring:* the FSB discussed the draft outline of the consolidated annual report to the G20 on the implementation and effects of financial regulatory reforms. The report will be published at the time of the Antalya Summit. Members also discussed the draft thematic peer review report on supervisory frameworks and approaches for systemically important banks. The report, which will be published in April, examines how authorities are implementing the FSB recommendations for a more intensive and effective approach to supervision, particularly for G-SIBs.
- *Data gaps:* the FSB considered a proposal for the third and final phase in the implementation of its initiative to collect data on G-SIB exposures and funding through a common data template. From 2016, granular balance sheet data would be collected on a quarterly basis covering five dimensions: instrument, counterparty jurisdiction and sector, maturity and currency. Data is shared between home supervisors, central banks and, from 2016, selected data will be shared with international organisations with a financial stability mandate such as the BIS, FSB and IMF.

On 2 April 2015, the FSB announced that it has appointed the chairs of three of its Standing Committees following expiration of the previous two-year terms on 31 March 2015: Glenn Stevens, Governor of the Reserve Bank of Australia (RBA), has been appointed as Chairman of the Standing Committee on Assessment of Vulnerabilities, succeeding Agustin Carstens, Governor of Banco de México; Daniel Tarullo, Governor, US Federal Reserve Board, has been reappointed for a second two-year term as Chairman of the Standing Committee on Supervisory and Regulatory Cooperation; and Ravi Menon, Managing Director, Monetary Authority of Singapore, has been reappointed for a second two-year term as Chairman of the Standing Committee on Standards Implementation. It was also announced that the FSB has extended its membership to include the Ministry of Finance of Argentina, the Indonesian Ministry of Finance, the Ministry of Finance of Saudi Arabia, the South African Reserve Bank, and the Undersecretariat of the Treasury of Turkey; and that each of these five emerging market and developing economy jurisdictions will now have a second plenary seat.

On 7 April, IOSCO published two consultation reports (for comment by 6 June 2015) aimed at further enhancing the ability of financial markets and intermediaries to manage risks, withstand catastrophic events, and swiftly resume their services in the event of disruption. The consultation on *Mechanisms for Trading Venues to Effectively Manage Electronic Trading Risks and Plans for Business Continuity* provides a comprehensive overview of the steps trading venues take to manage the risks associated with electronic trading and the ways they plan for and manage disruptions through business continuity plans; whilst *Market Intermediary Business Continuity and Recovery Planning* proposes standards and sound practices that regulators could consider as part of their oversight of the business continuity and recovery planning by market intermediaries. A key objective of the reports is to address possible weaknesses or gaps in the business continuity plans and recovery strategies of trading venues and market intermediaries.

Contact: David Hiscock
david.hiscock@icmagroup.org

ICSA's contribution to global capital markets

by Ian C.W. Russell and Peter Eisenhardt

In the past 20 years or so, the credit markets and OTC derivative markets expanded rapidly across the global capital markets. In response to this financial globalization, the International Council of Securities Associations (ICSA) was established in the late 1980s by a group of securities associations from Europe, Asia and North America to provide a forum to develop common regulatory positions to promote more integrated capital markets, and exchange views on market intelligence and industry best practices. While the rule-making process was driven by individual domestic jurisdictions, IOSCO played an increasingly important role providing policy direction to independent jurisdictions in such areas as the regulation of credit rating agencies, product disclosure and regulation of market conduct. ICSA has engaged actively with IOSCO staff and its Standing Committees over the years to provide an industry perspective on IOSCO policy positions and the direction of future proposals. ICSA has also engaged cooperatively with the OECD and the Basel Committee on Banking Supervision proposals on certain regulatory initiatives.

The ICSA role as interlocutor for the global securities industry expanded dramatically in the years following the 2008 financial crisis. The G20 directions for reform, beginning in 2009, and the formation of the Financial Stability Board, set the direction and stepped up the tempo of regulatory reform, notably in OTC derivatives markets following the seize-up in short-term repo and securities lending markets, the collapse in the asset-backed securities markets, the lack of adequate disclosure of derivative products and absence of centralized clearing and settlement. The G20 and FSB also focused on measures to mitigate systemic risks in the banking and shadow banking systems.

ICSA coordinated discussion and developed a consensus view among member firms on the trading and clearing reforms on OTC derivative reform in Europe and the United States. ICSA was one of the first global organizations to urge greater cooperation and coordination in rule-making across jurisdictions to mitigate blockages in cross-border transactions from conflicting and duplicative regulation. Once it became evident these regulations related to trading and clearing in OTC markets were evolving in a disjointed manner and contributing to market fragmentation, ICSA endorsed remedial solutions such as regulatory recognition and jurisdictional deference, substituted compliance and passporting, as solutions to lower regulatory barriers and lower costs.

As a priority initiative, ICSA assisted in the formation of a global financial consultation group, referred to as the Cross-Border Regulation Forum (CBRF), providing the Secretariat for the Forum, in response to the IOSCO decision to set up a Task Force on Cross-Border Regulation to develop proposals to alleviate barriers to capital flows from regulatory inconsistencies. The Regulation Forum published two papers, one in mid 2014 setting out a fundamental position on cross-border reform and a second in early 2015 responding to a formal IOSCO consultation paper. ICSA and the global industry associations and financial institutions participating in the CBRF are hopeful IOSCO will fashion a mechanism to streamline cross-border regulation, even without binding authority over member regulators.

ICSA makes its influence felt not just in policy development through its Standing

Committee on Regulatory Affairs, but through the work of the Emerging Markets Committee. The Emerging Markets Committee has had much success on a number of fronts, such as setting out a framework for building functional credit markets in emerging countries.

For the past year, ICSA has been engaged in a restructuring exercise to improve its effectiveness as a global trade association. It has hired a new Secretary General, based in London, Peter Eisenhardt, and is reorganizing as a non-profit corporation to provide better governance and greater transparency. ICSA is actively recruiting new member associations to broaden its constituency, with efforts focused on Latin America, the Middle East and South-East Asia.

ICSA will have an active agenda in future years. It will remain engaged assisting IOSCO to design mechanisms for better regulatory coordination and build a toolbox of measures to promote regulatory recognition. ICSA will also look forward to a role assisting in bilateral and multilateral discussions to streamline the regulatory framework in global markets for improved access and enhanced market liquidity. ICSA will also help regulators in reaching agreement on common proficiency standards across jurisdictions, and the development of accepted best practices and standards for fairer and more effective capital markets.

Ian C.W. Russell (irussell@iiac.ca) is President and CEO of the Investment Industry Association of Canada and Chairman of the International Council of Securities Associations (ICSA)

Peter Eisenhardt (peisenhardt@iiac.ca) is Secretary General of the International Council of Securities Associations (ICSA)

The ICSA website is at www.icsa.bz

European financial regulatory reforms

Latvia, for the first time, assumed the Presidency of the Council of the EU from 1 January to 30 June 2015, taking over from Italy and afterwards handing over to Luxembourg. The *Priorities and Programme of the Latvian Presidency*, which will focus on three overarching priorities, Competitive Europe, Digital Europe and Engaged Europe, were published. Amongst other things, in the first section of the Latvian Presidency programme it is stated that "the Presidency will prioritise work on strengthening the Single Market" and that "the Presidency's guiding principle will be Better Regulation and the wider use of competitiveness proofing".

Focussing on financial regulatory matters, in the subsequent section of the programme, on economic and financial affairs, it is stated:

- Anticipating the submission of a contribution from the Commission towards Capital Market Union later in the year, the Presidency is ready to ensure a broad exchange of views on the issue.
- The Presidency will continue the work that is taking place on financial sector regulatory reform in order to improve the resilience, transparency and supervision of the financial sector.
  - The proper and timely implementation of requisite measures, both legal and political, that are aimed at ensuring the smooth functioning of newly operational Banking Union mechanisms will be among the Presidency's priorities.
  - Regarding the Banking Structural Reform, as a matter of priority the Presidency will further the discussion on the reform of the banking structures, which is aimed at fostering financial stability and resolving problems that are associated with the biggest and most complex banks.
  - The accompanying measures that are aimed at increasing the transparency of certain transactions, which complement the overarching reforms that have already been undertaken in order to strengthen the EU financial sector, will also be addressed.
  - The Presidency aims at finalising discussions and reaching agreement with the European Parliament on the Benchmarks Regulation, thereby restoring confidence in the integrity of benchmarks.
  - In the area of insurance, the Presidency will take forward the work on the Insurance Distribution Directive, aiming to reach an agreement with the European Parliament.
  - The Presidency will support the work on the proposal for a Council Directive that will implement enhanced cooperation in the area of financial transaction tax.

Participants in the US-EU Financial Markets Regulatory Dialogue (FMRD) met in Washington D.C., on 12 January 2015, to exchange information on regulatory developments as part of their ongoing dialogue, and discuss their strong cooperation and shared interests in continuing to implement and enforce robust standards. Participants held productive discussions on an extensive agenda, including topics related to those commitments made by the G20 Leaders: implementation of Basel III capital, leverage, and liquidity rules; implementation of OTC derivatives reforms (including a discussion of cross-border issues); and recent policy developments on cross-border resolution. Participants also exchanged views on bank structural measures, securitization, MMFs, alternative investment fund managers, benchmarks, information sharing for supervisory and enforcement purposes, the implementation of UCITS reforms, and audit cooperation and macroprudential oversight. The next

FMRD meeting will take place in Brussels, in July 2015.

On 28 January 2015, the European Commission kicked off its project to create a Capital Markets Union (CMU) for all 28 EU Member States, with a first orientation debate at the College of Commissioners. The CMU is one of the flagship projects of this Commission and ties in with the ambition to boost jobs and growth in the EU, being designed to help businesses to tap into diverse sources of capital from anywhere in the EU and offer investors and savers additional opportunities to put their money to work. It aims to create a single market for capital for all 28 EU Member States by removing barriers to cross-border investment and lower costs of funding within the EU. Well-functioning capital markets will also facilitate the mobilisation of private financing in the context of the Investment Plan for Europe. The orientation debate in the College was very positive and supportive of the concept, and focused on the key challenges and priorities for the integration of capital markets.

Then, on 18 February 2015, the European Commission publicly launched its landmark CMU project. To progress the project, the Commission published a Green Paper for comment by 13 May 2015. Following this public consultation, the Commission will adopt an Action Plan this summer setting out its roadmap and timeline for putting in place the building blocks of a CMU by 2019. In particular, on the basis of the outcome of this consultation, the Commission will identify the actions that are necessary to achieve the following objectives:

- improve access to finance for all businesses and infrastructure projects across Europe;
- help SMEs raise finance as easily as large companies;
- create a single market for capital by removing barrier to cross-border investments; and
- diversify the funding of the economy and reduce the cost of raising capital.

The Green Paper identifies the following key principles which should underpin a Capital Markets Union:

- it should maximise the benefits of capital markets for the economy, growth and jobs;
- it should create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets;
- it should be built on firm foundations of financial stability, with a single rulebook for financial services which is effectively and consistently enforced;
- it should ensure an effective level of investor protection; and

“

It should create a single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU.

- it should help to attract investment from all over the world and increase EU competitiveness.

Building a genuine CMU will be a long-term project. However, the Investment Plan adopted by the Commission in November 2014 identified some areas for action in the short term. These include the implementation of the European Long-term Investment Funds (ELTIF) Regulation, high-quality securitisation, standardised credit information on SMEs, private placement, and the review of the Prospectus Directive. On two of these areas, securitisation and the Prospectus Directive, the Commission has decided to launch specific consultations, in conjunction with the Green Paper on the CMU.

On 23 February 2015, ESMA published its revised Work Programme for 2015. In a short accompanying letter to the EU Institutions, ESMA explains that, following the adoption of the EU budget, ESMA's 2015 expenditure budget is €33,601,402 (plus an additional €3,100,000 from assigned revenues for tasks delegated from NCAs) with an Establishment Plan of 137 posts. Accordingly, ESMA's Board of Supervisors has approved a revised work programme, as compared to the one presented on 30 September 2014 (prior to agreement of the EU budget), to account for the difference of €5 million and 10 Establishment Plan posts, representing a 15% reduction compared to the planned ESMA budget and 7% of its Establishment Plan. ESMA reports that it will, therefore, lack sufficient resources to execute all the tasks that were initially planned for 2015.

The work programme explains the areas where reprioritisation had to take place, including the risk that ESMA will not fully meet its legal obligations, for instance due to the delay of delivery compared to legally set timetables; and a summary of the deprioritised tasks is annexed to the work programme. Amongst other things, this includes: "Delayed development of technical standards and technical advice on some regulations and limited cost benefit analysis, particularly for Benchmarks Regulation, CSDR, and MiFID/R"; and "Postponement to 2016 of the launch of IT projects implementing CSDR and Transparency Directive".

Subsequently, on 25 March, ESMA published its revised Regulatory Work Programme (RWP) for 2015. The RWP provides more detail on ESMA's single rulebook work as set out in ESMA's Annual Work Programme for 2015. The RWP has been revised in light of the budget constraints that ESMA will operate under in 2015, as a result of which the deadlines associated with some guidelines have been delayed, however all scheduled standards, guidelines and technical advice are still included in the RWP.

On 3 March 2015, EBA published its seventh report of the Basel III monitoring exercise on the European banking system (run in parallel with the BCBS exercise at a global level), which monitors the impact of the transposition of the Basel III requirements on EU banks (assuming full implementation and using data as of June 2014 under a static balance sheet assumption). A total of 148 EU banks participated in the exercise on a voluntary and confidential basis, of which 40 banks belong to Group 1 (with a Tier 1 capital exceeding €3 billion and internationally active) and 108 banks belong to Group 2 (all other banks). Results show that the Common Equity Tier 1 (CET1) of the Group 1 banks would be on average 10.8%; and that none of the Group 1 banks would face a CET1 capital shortfall to achieve the minimum requirement of 4.5%, whilst they would be short of €2.8 billion to reach the 7.0% level (minimum CET1 of 4.5% + capital conservation buffer of 2.5%).

Results also show that the average LCR of Group 1 banks would have been 113%, with approximately 82% of the total sample of banks already having met the final 100% Basel III requirement to be reached by 2019, whilst the exercise reveals a shortfall of liquid assets of €115 billion for Group 1 banks. Furthermore, the average fully-implemented NSFR for Group 1 banks would have been 102% and 111% for Group 2 banks, with the NSFR figures showing that the need for more stable funding would amount to €324 billion, approximately 1.3% of total assets of all banks participating in the exercise. Finally, the average fully-implemented leverage ratio (LR) would be 3.9% for Group 1 banks, assuming the joint compliance with the 6% Tier I capital requirement. The shortfall for Group 1 banks due to the implementation of the provisions relating to LR would be €2.4 billion.

Contact: David Hiscock
david.hiscock@icmagroup.org

Credit Rating Agencies

On 3 February 2015, ESMA issued a Call for Evidence concerning competition, choice and conflicts of interest in the credit rating industry, with responses required by 31 March 2015. Following from this, by September 2015, ESMA will produce Technical Advice on the functioning of the credit rating industry and the evolution of the markets for structured finance instruments. In addition to the assessment of a number of specific provisions of the CRA Regulation, in order to determine whether they are effective or whether they should be amended or extended, general issues to be considered are: (i) the appropriateness of existing and alternative remuneration models for CRAs; (ii) choice of and competition between CRAs; (iii) whether it is necessary and appropriate to propose further measures to stimulate competition between CRAs; and (iv) the impact of market concentration levels on the overall stability of the financial sector. Some specific work being performed by ICMA in relation to this Call for Evidence is outlined in the Primary Markets Section of this ICMA Quarterly Report.

On 4 February 2015, it was announced that the Board of IOSCO has approved a project specification for its Committee 6 on CRAs (C6), to gain a better understanding of the credit rating industry and in particular of certain other products or services (Other CRA Products –

which may include, for example, private ratings, confidential ratings, expected ratings, indicative ratings, prospective ratings, provisional ratings, preliminary ratings, one-time ratings, regional ratings, national ratings, point-in-time rating, scoring, credit assessments, rating assessments, assessments, or research). To begin work on this project, C6 is undertaking a series of successive information gathering exercises. In the first stage, C6 is asking issuers of Other CRA Products and services to answer a questionnaire, to provide information to serve as a base for discussions between C6 members, issuers of Other CRA Products and other interested parties. The second stage will focus on gathering information on how issuers and investors and, more generally, users of the Other CRA Products and services utilize and understand them.

On 16 February 2015, ESMA published its Annual Report on the direct supervisory activities carried out by ESMA during 2014 regarding CRAs and TRs within the EU. This sets out ESMA's key areas of action during 2014 and outlines its main priorities for 2015. The key priorities are to tackle the systemic risks posed by CRAs, by seeking to minimise conflicts of interest in the rating process; and the improvement of the quality of the data reported to the registered TRs.

Under date of 26 February, the ESMA SMSG provided advice to the Joint Committee of the ESAs on the Discussion Paper on *The Use of Credit Ratings by Financial Intermediaries Article 5(a) of the CRA Regulation.* The SMSG highlights four points which it believes the Joint Committee must take into consideration when it produces its Consultation Paper: (i) is there evidence that intermediaries do over-rely on credit ratings?; (ii) due consideration must be given to the risks associated with alternative risk indicators/ assessments; (iii) where contractual references to credit ratings are to remain, these should be to ratings from "any authorised CRA", not a specific named CRA; and (iv) the effect that a move to alternatives will have on smaller intermediaries and market participants.

On 23 March, ESMA published its final report of *Guidelines on Periodic Information to be Submitted to ESMA by CRAs*. Following the translation of the Guidelines in Annex 1 into all the official languages of the EU, the final texts will be published on ESMA's website; and the guidelines will become effective two months after their publication on ESMA's website in all the official languages of the EU. The Guidelines set out the information that should be submitted by CRAs to enable ESMA's ongoing supervision of CRAs on a consistent basis. The Guidelines also clarify ESMA's expectations of the information that should be submitted to ESMA for the calculation of supervisory fees and CRAs market share. These Guidelines do not apply to certified CRAs. In light of these Guidelines, CESR's guidance on the enforcement practices and activities to be conducted under Article 21.3(a) of the Regulation (ESMA/2010/944) of 30 August 2010 will no longer apply.

On 24 March, IOSCO published the final report on *Code of Conduct Fundamentals for CRAs*, which includes significant revisions and updates to the existing IOSCO Code of Conduct for CRAs (IOSCO CRA Code). The revisions are designed to strengthen the IOSCO CRA Code and to improve its clarity. The new IOSCO CRA Code is intended to work in harmony with CRA registration and oversight programmes, and to continue operating as the international standard for CRA self-governance. The revisions result, in part, from the experience of IOSCO members in supervising CRAs, and are also informed by the work of the IOSCO Committee on CRAs, including the survey report describing the key risk controls established by CRAs to promote the integrity of the credit rating process and the procedures established to manage conflicts of interest.

Contact: David Hiscock
david.hiscock@icmagroup.org

"Key priorities are to tackle the systemic risks posed by CRAs, by seeking to minimise conflicts of interest in the rating process.

OTC (derivatives) regulatory developments

On 8 January 2015, ESMA published a peer review report on its participation in the supervisory colleges set up under the EMIR to authorise and supervise EU-based CCPs. This report is focused on the supervisory activities of competent authorities in relation to the authorisation of CCPs under EMIR and is based on the experience of ESMA in the CCP colleges formed pursuant to Article 18 of EMIR. This review is not based on the usual peer review methodology but on the experience of ESMA in the initial phase of the college process, namely their establishment, their review of CCP applications for authorisation under EMIR, their review of the competent authorities' risk assessments, and their adoption of the joint opinions on CCP authorisations. ESMA's review has not identified any issues in respect of which it should issue guidelines and recommendations pursuant to Article 16 of the ESMA Regulation, or any other form of legal instrument.

On 28 January, IOSCO published the final report, *Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives*, which sets out nine standards aimed at mitigating the risks in the non-centrally cleared OTC derivatives markets. To reduce counterparty credit risk and limit contagion, IOSCO and the BCBS published a framework in 2013 which established minimum standards on margin requirements for non-centrally cleared OTC derivatives. This latest set of risk mitigation standards, which are developed in consultation with the BCBS and the CPMI, will further strengthen the non-centrally cleared OTC derivatives market, by encouraging the adoption of sound risk mitigation techniques to promote legal certainty over the terms of the non-centrally cleared OTC derivatives transactions, fostering effective management of counterparty credit risk and facilitating timely resolution of disputes. These risk mitigation standards cover the following key areas: (i) trading relationship documentation and trade confirmation; (ii) process and/or methodology for determining valuation; (iii) portfolio reconciliation; (iv) portfolio compression; and (v) dispute resolution.

On 29 January, ESMA published an Opinion on the *Draft RTS on the Clearing Obligation on Interest Rate Swaps*, responsive to the European Commission's notification of 18 December 2014 of its intention to endorse, with amendments, the draft RTS submitted by EMSA on 1 October 2014 (as discussed in Issue 36 of ICMA Quarterly Report). This opinion explains ESMA's support of the Commission's intention to extend the initial approach with the objective of postponing the start date of the frontloading obligation, as this should provide counterparties with sufficient time to determine whether their contracts are subject to the frontloading obligation. However, the opinion also raises some concerns on the process envisaged to exempt non-EU intragroup transactions from the clearing obligation – ESMA is ready to provide technical advice on this particular issue, if requested.

Subsequently, on 9 March 2015, ESMA published a revised opinion on the draft RTS on the clearing obligation for interest rate swaps. This takes account of points raised in the *corrigendum* letter sent to ESMA by the European Commission, on 29 January 2015. There are some points among the changes that the European Commission intends to introduce that ESMA considers should be reviewed or improved – these have been reflected in the second version of the draft RTS submitted to the Commission with this revised opinion.

On 3 February, the European Commission published a report that recommends granting pension funds a further two-year exemption (current EU law provides for a temporary exemption which is set to expire in August 2015) from central clearing requirements for their OTC derivative transactions. This extension would take the form of a Delegated Act that would need to be adopted by the College of Commissioners. The report, which is based on an extensive study requested by the European Commission, concludes that CCPs need this time to find technical solutions for pension funds. Ultimately, the objective is that pension scheme arrangements (PSAs) – which encompass all categories of pension funds – should use central clearing for their derivatives transactions, as is the case for other financial institutions. Under

“

This will further strengthen the non-centrally cleared OTC derivatives market, by encouraging the adoption of sound risk mitigation techniques.

current arrangements, PSAs would have to source cash for central clearing; but, since PSAs hold neither significant amounts of cash nor highly liquid assets, imposing such a requirement on them would require very far-reaching and costly changes to their business model.

On 4 February, ESMA published a Feedback Statement on its consultation on the clearing obligation for non-deliverable forwards (NDF) which it had to conduct under the EMIR. Based on consultation feedback received, ESMA is not proposing a clearing obligation on the NDF classes at this stage, believing that more time is needed to appropriately address the main concerns raised during the consultation. This decision is without prejudice to the possibility for ESMA to propose a clearing obligation on the NDF classes (by the submission of a final report to the European Commission including a draft RTS) at a later point in time, in order to take into account further market developments.

On 11 March, the CPMI and IOSCO announced that they are undertaking a review of stress testing by CCPs. The PFMI, published by the CPMI and IOSCO in 2012, require CCPs to carry out rigorous stress testing to determine the financial resources they need to manage both credit and liquidity risk, including a wide range of stress scenarios covering a variety of extreme but plausible market conditions. Since the systemic importance of CCPs is growing substantially, not least due to the drive for standardised OTC derivatives to be centrally cleared, the CPMI and IOSCO believe that a review of CCP stress testing is timely in order to identify how the relevant PFMI standards are being implemented and whether additional guidance in this area is needed.

On 18 March, the BCBS and IOSCO released revisions to the *Framework for Margin Requirements for Non-Centrally Cleared Derivatives*. The framework was originally published in September 2013, after two public consultations; but, recognising the complexity of implementing the framework, the BCBS and IOSCO have agreed to delay the implementation of requirements. Relative to the 2013 framework, the revisions delay the beginning of the phase-in period for collecting and posting initial margin on non-centrally cleared trades from 1 December 2015 to 1 September 2016. The full phase-in schedule has been adjusted to reflect this nine-month delay. The revisions also institute a six-month phase-in of the requirement to exchange variation margin, beginning 1 September 2016.

On 16 January 2015, ESMA and the Hong Kong Securities and Futures Commission (SFC) announced their conclusion of a Memorandum of Understanding (MOU), effective as of 19 December 2014. This MOU establishes cooperation arrangements between the signatory authorities regarding CCPs that are established in Hong Kong and have applied for recognition under EMIR. On 24 February 2015, ESMA announced that it had concluded a Memorandum of Cooperation (MOC), effective as of 18 February 2015, with the Financial Services Agency of Japan (JFSA). This MOC establishes cooperation arrangements regarding CCPs that are established in Japan and have applied for recognition under EMIR. Then, on 9 March 2015, it was announced that ESMA and the Monetary Authority of Singapore (MAS) have concluded a MOU, effective as of 10 February 2015, which establishes cooperation arrangements regarding CCPs that are established in Singapore and have applied for recognition under EMIR. ESMA is working closely with other third-country authorities on similar cooperation arrangements.

On 5 March 2015, it was announced that ESMA and the Reserve Bank of Australia (RBA) have concluded a MOU, effective as of 18 February 2015, which will allow RBA to have access to data held in EU Trade repositories according to its mandate; whilst ensuring that guarantees of professional secrecy exist. The ESMA-RBA MOU is the second cooperation arrangement established under EMIR Article 76, which at ensuring that third-country authorities that do not have any trade repository in their jurisdiction may access the information on derivatives contracts held in EU trade repositories which is relevant for their mandates. The first MOU of this kind was concluded in November 2014 between ESMA and the Australian Securities & Investments Commission (ASIC).

ESMA is maintaining a list of CCPs that have been authorised to offer services and activities in the EU, in accordance with EMIR. ESMA updated the list to include: extended activities and services provided by CME Clearing Europe Ltd, on 9 January 2015; Nasdaq OMX Clearing AB on 25 February; and LCH.Clearnet Ltd on 27 March; and the authorisation of Athens Exchange Clearing House, on 22 January. There are now 16 CCPs authorised under EMIR (EMIR requires EU-based CCPs to be registered and non-EU CCPs to be recognised in the EU). ESMA is also maintaining the related public register of cleared derivative classes. ESMA is also publishing Questions & Answers regarding the implementation of EMIR, an updated version of which was made available on 31 March 2015.

Contact: David Hiscock
david.hiscock@icmagroup.org

Financial Transaction Tax

Following various reported discussions, on 27 January 2015, a Joint Statement was issued by Ministers of EU Member States participating in enhanced cooperation in the area of FTT (ie Austria, Belgium, Estonia, France, Germany, Italy, Portugal, Slovakia, Slovenia and Spain. Greece did not participate as a consequence of its very recent change of Government). This statement opens with a renewed commitment to reach an agreement on the proposal of a Directive implementing an enhanced cooperation in the area of a FTT. It goes on to report that:

- on substance, it was decided that the tax should be based on the principle of the widest possible base and low rates, while taking full consideration of the impacts on the real economy and the risk of relocation of the financial sector; and

- on procedure, it was decided to streamline future work methods in order to ensure operational effectiveness of the enhanced cooperation procedure.

Willingness to create the conditions necessary to implement the European FTT on 1 January 2016 was reiterated and it was noted that progress will be reported on at one of the next meetings of the ECOFIN Council.

Contact: David Hiscock
david.hiscock@icmagroup.org

Financial benchmarks

On 25 February 2015, IOSCO published *Review of the Implementation of IOSCO's Principles for Financial Benchmarks* (Principles), which sets out the findings of IOSCO's review of the implementation of the Principles by a sample of administrators of financial benchmarks across a range of geographical areas and asset classes. It was prepared by a Review Team, constituting members of the IOSCO Board-level Task Force on Financial Market Benchmarks. The review indicated that there has been a significant market reaction to the publication of the Principles, with widespread efforts being made to implement them by the majority of the administrators surveyed. Responses from administrators also show that the benchmarks industry is in a state of change, as seen from the reported levels of administrators continuing to work towards compliance with the Principles as well as examples of benchmarks being transitioned to new methodologies and administrators. The report notes that IOSCO may need to take further future steps; however, it is too early to determine what those steps should be.

On 13 February 2015, the Permanent Representatives Committee agreed, on behalf of the European Council, a negotiating stance on new rules aimed at ensuring greater accuracy and integrity of benchmarks in financial instruments; and asked the Latvian Presidency to start, as soon as possible, negotiations with the European Parliament so as to enable adoption of the Regulation at first reading. The draft Regulation introduces a legally binding code of conduct for contributors (of data) requiring the use of robust methodologies and sufficient and reliable data. In particular, it calls for the use of actual transaction input data where possible, but other data may be used if the transaction data is insufficient. The scope of the Regulation is broad, although benchmarks deemed to be critical will be subject to stricter rules, including the power for the relevant competent authority to mandate contributions of input data. Administrators of benchmarks will have to apply for authorisation and will be subject to supervision by their national competent authority (NCA), with ESMA coordinating the supervision of benchmark administrators by NCAs; and for critical benchmarks a college of national supervisors including ESMA will be set up and take key decisions.

In the European Parliament, the *rapporteur* in relation to the European Commission's 18 September 2013 proposal, for an EU Regulation on indices used as benchmarks in financial instruments and financial contracts, is Cora van Nieuwenhuizen (ALDE, Netherlands). She has continued to seek agreement, working through a series of potential compromise amendments to the draft ECON report (which was published on 11 December 2014). Following from these efforts an ECON vote on adoption of the final report was successfully held on 31 March 2015, as reported in an ECON press release. This ECON report will be subjected to an EP plenary vote on 19 May, with the aim of obtaining broad political support before then commencing trilogue discussions. It is expected that these discussions may take some time, but an agreed Level 1 text should be in place sometime later this year.

Contact: David Hiscock
david.hiscock@icmagroup.org

"There has been a significant market reaction to the publication of the Principles, with widespread efforts being made to implement them.

Short-Term Markets

by David Hiscock and Andy Hill

European repo market

Alongside the ECB's announcement of an extended asset purchase programme (commonly referred to as a programme for quantitative easing, or QE), the ECB's 22 January 2015 QE press release included a bullet point as follows: "Holdings of securities issued by central governments, certain agencies established in the euro area and certain international or supranational institutions located in the euro area purchased under the expanded asset purchase programme will be eligible for securities lending." Having already spoken to the ECB in the past regarding the desirability of securities lending to help ensure that ECB holdings of securities do not unduly impair euro market liquidity, the ICMA ERC Committee promptly shared further thoughts with the ECB regarding the importance of establishing a QE related securities lending facility and subsequently offered further input to assist ECB work to design the agreed facility.

On 5 March, the ECB announced *Implementation Aspects of the Public Sector Purchase Programme* (PSPP), stating that securities lending "will be implemented in a decentralised manner", mirroring the organisation of the QE purchases. Then on 2 April 2015, it was further announced that, as of 2 April, the securities purchased under the PSPP are made available for securities lending in a decentralised manner by a number of Eurosystem central banks, with further NCBs to follow soon. The aim of this securities lending is to support bond and repo market liquidity without unduly curtailing normal repo market activity, with the Eurosystem primarily targeting those market participants with market making obligations. The Eurosystem central banks will use various channels taking into account not only the diversity of the existing securities lending arrangements and market characteristics across jurisdictions, but also the goal of starting securities lending without undue delay; and will endeavour to attain a further convergence of lending arrangements over time.

Published by the CGFS, on 31 March 2015, *Central Bank Operating Frameworks and Collateral Markets* explores whether and how the design of central banks' operational frameworks influences private collateral markets, including collateral availability, pricing, related market practices, and market performance under stress. It studies these issues by reviewing available information from a range of sources, including central bank case studies as well as surveys and interviews with private sector participants in collateral markets. Central banks influence markets for collateral through either the supply of assets available for use as collateral (a scarcity channel), the pledgeability of assets in private transactions (a structural channel), or both. They therefore have a variety of design choices at their disposal to influence collateral markets as well as to fine-tune the effects of their operations on these markets. While central bank operating frameworks are not usually the most important factor influencing collateral markets, the evidence presented in this report indicates that the influence of central banks may at times be significant, in particular during crisis times. This highlights the importance of carefully monitoring the effects of central bank operations on collateral markets, as well as the need for central banks to examine their operational frameworks to ensure preparedness for any future crisis response.

On 21 January 2014 the Commission's original proposal for an EU SFT Regulation (SFTR) was published; and, dated 14 November 2014, the EU Presidency published a revised version of this reflecting the European Council's SFTR General Approach. The European Parliament (EP) has also been working on its review of this proposal and on 7 January 2015 the *rapporteur's* first draft EP SFTR report (dated 22 December 2014) was published. The last three pages of this comprised a short "explanatory statement", which explains something of the rationale for the approach being proposed in the report. Following the tabling of amendments and applicable debates, during which ICMA worked closely with ISLA to try and best inform the evolution of the EP's report, ECON reached agreement on a text, on 24 March 2015; and issued an associated press release. A first trilogue meeting is expected on 28 April and these discussions are expected to progress quite rapidly, allowing for an agreed Level 1 text to be found by mid-year. An indicative date of 8 September 2015 has been set for EP plenary debate and approval.

On 13 November 2014, the FSB published for public consultation (for comment by 12 February 2015) its report, *Standards and Processes for Global Securities Financing Data Collection and Aggregation*. The proposed standards and processes are based on the policy recommendations in the FSB report, *Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, which was published in August 2013. The FSB recommended national/regional authorities to collect appropriate data on securities financing markets to detect financial stability risks and develop policy responses, and to provide the total national/regional data for these markets to the FSB for aggregation in order to assess global trends in financial stability. The ICMA ERC is supportive of the objective of ensuring that there is appropriate transparency of SFTs; and has itself actively contributed to this through its bi-annual European repo market surveys. To continue to assist in the necessary debate regarding how best to achieve this objective, in a globally consistent manner, the ICMA ERC responded, putting forward eight general observations – reflective of both its own practical experience in collecting repo data from its member firms and views of its member firms – as well as providing specific comments on the repo data questions.

Dated 16 December 2014, the *Regulation of the ECB of 26.11.14 Concerning Statistics on the Money Markets* (the MMSR) has been published in the *Official Journal of the EU*. Annex 1 gives details of the "Reporting scheme for money market statistics relating to secured transactions". This states that "Reporting agents report to the European Central Bank (ECB) or the relevant national central bank (NCB) all repurchase agreements and transactions entered into thereunder, including tri-party repo transactions, which are denominated in euro with a maturity of up to and including one year (defined as transactions with a maturity date of not more than 397 days after the trade date) between the reporting agent and other monetary financial institutions (MFIs), other financial intermediaries (OFIs), insurance corporations, pension funds, general government or central banks for investment purposes as well as with non-financial corporations classified as 'wholesale' according to the Basel III LCR framework." It then lays out the "Type of transaction-based data to be reported for each transaction". The ICMA ERC has discussed the MMSR with the ECB and will continue to work on it alongside its work on other repo reporting requirements.

On 12 June 2014, the Regulation on Markets in Financial Instruments (MiFIR) and the associated Directive (MiFID II) were published in the *EU Official Journal*. ESMA's work to develop necessary technical standards related to these new EU trading requirements is ongoing. Alongside of this, the ICMA ERC sought clarity from ESMA regarding the application of MiFID II pre- and post-trade transparency requirements in respect of repo transactions. In brief, ESMA indicated that both MiFID II pre- and post-trade transparency requirements will apply to SFTs traded on a trading venue (RM, MTF, OTF); but to avoid confusion in post-trade reporting from trading venues, it is proposed that reported SFT trades will be flagged as "non-price forming trades". Where, however, the SFT is traded OTC there is no pre-trade requirement and post-trade transparency will not be applied, on the grounds that SFTs are "non-price forming trades". It appears that this is all equally true regardless of whether the collateral is equity or non-equity. The ICMA ERC also took advantage of an ESMA consultation to seek full clarity (at page 20 of ICMA's response) that SFTs will not be subject to MiFIR transaction reporting, since they are subject to the more extensive reporting requirements coming in under SFTR.

Contact: David Hiscock
david.hiscock@icmagroup.org

Repo: legal issues

by Lisa Cleary

The BRRD and proposals for a resolution stay protocol for repo and securities lending transactions

The transposition of the Bank Recovery and Resolution Directive (BRRD) is under way across Europe, providing a harmonised legislative framework for the resolution of banks in Member States. One of the powers provided for in the BRRD enables resolution authorities to temporarily suspend termination rights and impose stays which would override specific provisions of certain agreements to which a resolved entity is party, including the Global Master Repurchase Agreement (GMRA). With the legislative overlay of the BRRD in place, recognition of Member States' resolution regimes will, at least within the EEA, be provided for as a matter of law. However, this does not necessarily deal with scenarios where there is a relevant extraterritorial element. In such scenarios, a contractual solution has been requested by the regulators to plug the legislative gap.

For the ISDA swaps market, the ISDA 2014 Resolution Stay Protocol was published in November 2014 in response to this request. The ISDA Resolution Stay Protocol is designed to contractually bind adhering parties to resolution stay regimes in named or qualifying jurisdictions. There is regulatory appetite to extend this contractual solution to securities financing transactions, including those documented under the GMRA, GMSLA, MRA and MSLA. Further, it is understood that regulations will be developed in the "Home Authority" jurisdictions (UK, France, Germany, Japan, Switzerland and USA) to support contractual solutions, requiring regulated entities to provide for contractual recognition of the Home Authorities' resolution regimes in given circumstances.

ICMA, ISLA and SIFMA were recently invited by the regulators to join discussions about the contractual recognition of resolution stays with respect to repo and securities lending transactions. Whilst the policy aims of the regulators are well understood in this regard, it is important that any contractual solution is sensibly calibrated, taking into account the specificities of the aforementioned master agreements and the structure of the repo and securities lending market. ICMA and ISLA have set up a joint working group to consider the regulatory requirements and consolidate market feedback on this matter.

GMRA legal opinion publication

ICMA obtains and annually updates legal opinions on the GMRA from numerous jurisdictions worldwide. ICMA has published legal opinions on the GMRA 1995, 2000 and 2011 versions, as well as the 1995 version as amended by the Amendment Agreement to the 1995 version and the 1995 & 2000 versions as amended by the 2011 ICMA GMRA Protocol for 63 jurisdictions.

GMRA legal opinion coverage changing

The ICMA European Repo Committee recently took a decision that, from spring 2016, the ICMA GMRA legal opinions will no longer cover the GMRA 1995. The opinions will continue to cover the GMRA 1995 as amended by the Amendment Agreement to the GMRA 1995 and the GMRA 1995 as amended by the 2011 GMRA Protocol (Revised). Opinion users must ensure that the specific opinions on which they seek to rely extend to their particular circumstances and satisfy themselves as to the strength of the opinions and the effect of the assumptions and qualifications contained therein.

Contact: Lisa Cleary
lisa.cleary@icmagroup.org

CSDR mandatory buy-ins and the repo market

In February 2015, ICMA responded to the Consultation Papers for *Technical Standards and Technical Advice for the Central Securities Depositories Regulation (CSDR*). A more detailed account of the response and a link to the response itself can be found in the Secondary Markets Section of this Quarterly Report.

Of particular concern to the European bond and financing markets is the provision in the Level 1 text of CSDR (already in law) for "mandatory buy-ins", which would mandate that any failing settlement in cash securities would automatically trigger a buy-in after four days in most instances, and after seven days for the least liquid securities. In the case of securities financing transactions, this will apply to the end-leg of any SFT and to the start-leg of all SFTs apart from very short-dated or open transactions. This effective exemption threshold for certain SFTs is based on the impracticalities of executing and settling a buy-in against the start-leg of an SFT that would have already matured. It seems that ESMA's thinking was that, in most cases, this exemption threshold would effectively be eight business days, based on four days after intended settlement date of the start-leg before the buy-in triggered, and another four days allowable to execute and settle the buy-in.

The primary concern to repo market-makers and users is that the possibility of being bought in on a failing start-leg of an SFT will be a deterrent to lending, as well as problematic from a risk management perspective. The most likely outcome will be a bifurcation of repo market liquidity, with lenders of securities only wishing to transact for very short term or open repos (so exempt), while borrowers of securities, in particular market-makers, will drive greater demand for term repos (non-exempt).

Currently the provision for mandatory buy-ins is scheduled to come into force in early 2016, although there is an ESMA recommendation for a delay in implementation until mid-2017.

With regard to mandatory buy-ins, the Level 2 consultation focuses on the detail of how this could be implemented in practice. In its response, ICMA has recommended that the maximum possible extension period (the period of time for which a transaction can fail before triggering the buy-in) of seven days be applied to all fixed income instruments, as well as a further seven days in which the buy-in can be executed and settled. Allowing for the possibility of deferring a buy-in, in the case that the buy-in cannot be executed (and which is provided for in the Level 1 text), this would effectively make the exemption threshold for SFTs 21 business days, or approximately one calendar month.

Based on the ICMA repo market survey data for December 2014, applying ESMA's suggested eight-day exemption threshold, approximately 45% of outstanding repo transactions would be in scope of mandatory buy-ins. By applying ICMA's recommendations, and taking the threshold to 21 days, this would reduce the outstanding market size in scope of mandatory buy-ins to just 20%, and so have a far less distortive impact on repo market liquidity.

Contact: Andy Hill
andy.hill@icmagroup.org

ICMA impact study for mandatory buy-ins: the repo market

To support its response to the consultation, and to illustrate the liquidity and pricing impacts of imposing a mandatory buy-in regime on both bond and repo markets, ICMA conducted an impact study. The *ICMA Impact Study for CSDR Mandatory Buy-ins* was published in February 2015, and has received widespread interest.

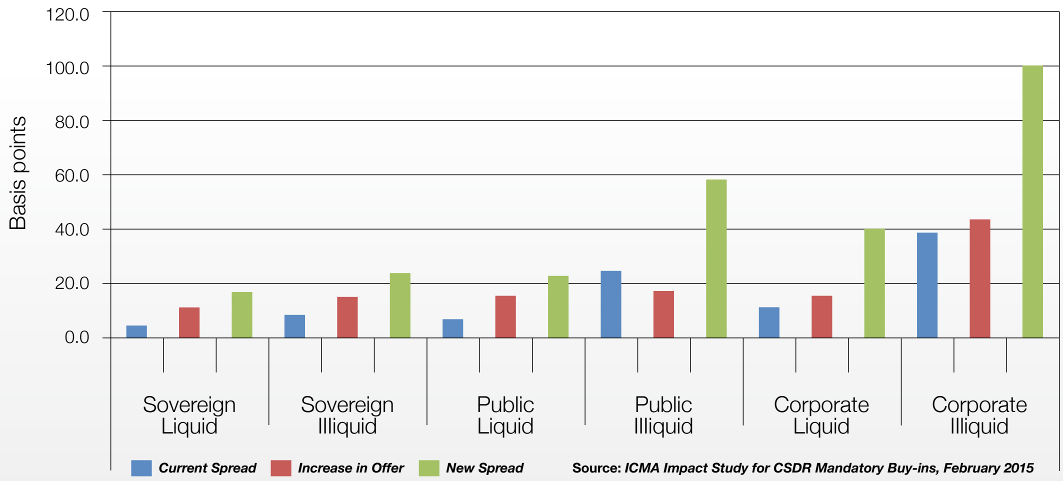
In conducting the study, market-makers for both European bonds and repos were asked to report how they would adjust their offer-side pricing for different asset classes, and different liquidity profiles (as defined by the Regulation), in a mandatory buy-in regime. The results were then aggregated and reflected in terms of the new, wider, bid-offer spreads post-CSDR. The impacts for outright bond markets are discussed in the Secondary Markets Section of this Quarterly Report.

With regards repo pricing, survey respondents were asked to report their price adjustments for offering one-month repos across three broad asset classes (sovereign, public, and corporate bonds), again based on the liquidity definitions used by the Regulation, on the basis that currently one-month repos would be in scope of mandatory buy-ins.

The study shows that term repo market pricing and liquidity will be severely impacted by the introduction of mandatory buy-ins. The current one-month average bid-offer spread for sovereign bonds is 6.7 basis points. Under a mandatory buy-in regime, this would widen to 19 basis points, almost trebling.

Meanwhile, the average spread for one-month illiquid sovereign bonds would widen from 12.5 basis points to 31.2 basis points. In terms of absolute spread widening, the impacts for public and corporate bond repo pricing are even more dramatic. The results across the six distinct asset classes are illustrated below.

The impact of mandatory buy-ins on one-month repo bid-offer spreads



Source: *ICMA Impact Study for CSDR Mandatory Buy-ins, February 2015*

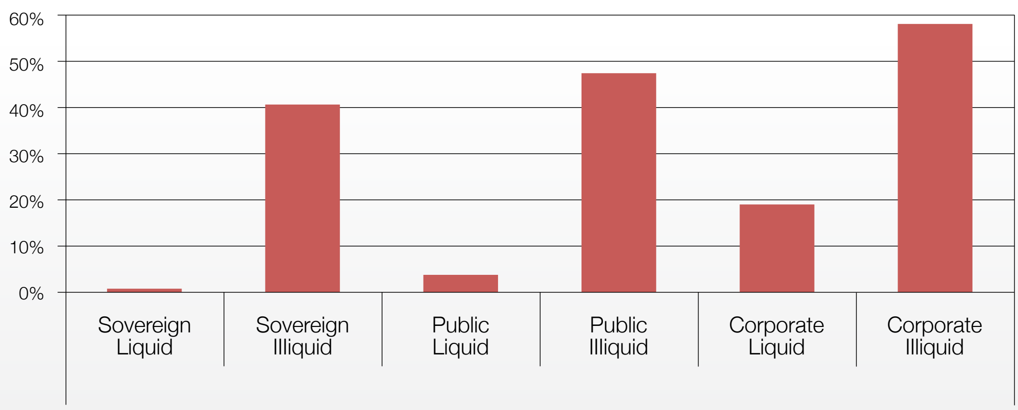
The study further illustrates that for less liquid securities, some repo market-makers will withdraw from showing term offers altogether. This is illustrated below.

ICMA hopes that the study will not only help support the case for applying the maximum possible extension period for fixed income securities, but also the maximum possible exemption threshold for SFTs.

Furthermore, the study highlights the need for a full and thorough impact assessment of the Regulation before implementation, and which would best be done after the successful roll-out of TARGET2-Securities and other initiatives intended to improve settlement efficiency.

Contact: Andy Hill
andy.hill@icmagroup.org

Percentage of repo dealers who will no longer offer term repo under mandatory buy-ins



Source: *ICMA Impact Study for CSDR Mandatory Buy-ins, February 2015*

SFT trade matching and affirmation seminar

Given the changing dynamics of the market, not least the result of ongoing regulatory initiatives, it is becoming clearer that there is a need to establish market-wide, standardized messaging protocols for securities financing transactions (SFTs). Currently, identification of repos or other forms of SFTs is rarely a feature of automated trade matching and affirmation. With regulation such as the CSDR, where certain SFTs carry an exemption from the provision for mandatory buy-ins, not only will it be necessary for those responsible for initiating the buy-in to be able to identify SFTs as distinct from outright cash securities transactions, but they will also need to be able to identify the separate legs of the SFT, as well as its term. Capturing the correct trading risk on trade date to ensure effective balance sheet management alongside reporting initiatives for SFTs, such as SFTR, will also most likely drive an increase in focus on timely matching and affirmation. It will require an even greater level of granularity related to the entire lifecycle of SFTs, including substitutions and re-rates. All of this points to far more sophisticated messaging protocols than are currently being utilised, as well as industry-wide standards to be developed and adopted. This need is exacerbated by the fact that, within its initial specification, TARGET2-Securities does not support SFTs as a distinct product.

The ICMA ERC Operations Group has been instrumental not only in identifying the pressing need to establish SFT messaging protocols, but also in trying to bring the industry together, including sell side and buy side as well as post-trade infrastructure providers, to discuss the challenges and achieve harmonized solutions.

The ICMA Seminar, *The Future Challenges in Post-Trade Processing for Repo – "Can We Join the Dots",* hosted by JP Morgan on 8 April, was a key milestone in the process of facilitating broader cross-industry engagement to develop and adopt SFT messaging protocols.

SFT market participants, sell side and buy side, as well as post-trade infrastructure providers, who are interested in joining the ICMA Operations Group workstream related to SFT messaging protocols, or who simply wish to learn more about the ongoing cross-industry initiatives, should contact Andy Hill, Secretary of the ICMA Operations Group.

Contact: Andy Hill
andy.hill@icmagroup.org

"

The study shows that term repo market pricing and liquidity will be severely impacted by the introduction of mandatory buy-ins.

> Consideration should be given to the appropriate treatment of ABCP within such a framework.

ECP market

MMFs: In the European Parliament, the *rapporteur* in relation to the European Commission's proposal, for EU Regulation of MMFs, is Neena Gill (S&D, UK); and, having debated the 26 November 2014 draft ECON report, an agreed ECON report, dated 4 March 2015, is scheduled for plenary debate on 28 April. This text provides that: "Asset Backed Commercial Papers shall be considered to be eligible securitisations provided that they are liquid as referred to in Regulation (EU) No 575/2013 and that the underlying exposures are of high credit quality." It also states that the Commission shall adopt Delegated Acts "concerning the specification of the criteria for identifying simple, transparent and standardised securitisation" with regard to each of the following aspects: (a) underlying exposures being exclusively comprised of eligible debt and sufficiently diversified; (b) conditions and numerical thresholds determining when the underlying debt is of high credit quality and liquid; and (c) the transparency requirements of the securitisation and its underlying assets. Meanwhile the European Council's deliberations continue.

ABCP: ICMA, together with AFME, the BBA and ISDA, responded, on 14 January 2015, to the EBA's *Discussion Paper on Simple, Standard and Transparent [SST] Securitisations* (which was discussed in this section of Issue 36 of the ICMA Quarterly Report). There is one specific aspect of this joint industry response which is important from the perspective of ABCP, which appears on pages 3-4, under the sub-heading: "We are disappointed that asset-backed commercial paper is out of scope". It is hoped that this will lead to further work to explore which criteria could be acceptable for ABCP SST securitisations.

Subsequently, ICMA, together with the GFMA, the IIF and ISDA, responded, on 13 February 2015, to the BCBS/IOSCO's Consultative Document on *Criteria for Identifying Simple, Transparent and Comparable [STC] Securitisations* (which was discussed in this section of Issue 36 of the ICMA Quarterly Report). There is one section of this joint industry response which is important from the perspective of ABCP, which is the answer to specific question 3 (which starts on page 9 of the response). It is hoped that this will lead to further work to explore which criteria could be acceptable for ABCP STC securitisations.

On 18 February 2015, alongside the launch of its CMU project, the European Commission published a Consultation Document (for comment by 13 May 2015) on securitisation. This consultation represents a first step towards a possible initiative on creating an EU framework for simple, transparent and standardised securitisation. Its aim is to gather information and views from stakeholders on the current functioning of European securitisation markets and how the EU legal framework can be improved to create a sustainable market for high-quality securitisation. On the basis of the feedback received, the Commission will reflect further on how to reach that objective.

Of particular note from an ABCP perspective is section "2.2 Identification criteria for short term instruments" (on page 7); and the related question 2 (on page 8):

A. To what extent should criteria identifying simple, transparent, and standardised short-term securitisation instruments be developed? What criteria would be relevant?

B. Are there any additional considerations that should be taken into account for short-term securitisations?

ICMA will be responding along similar lines to those adopted in its two above mentioned response papers.

Notwithstanding that this consultation is open until 13 May 2015, the joint response from the Bank of England and the ECB has already been made public. Encouragingly, this states that consideration should be given to the appropriate treatment of ABCP within such a framework. This is elaborated on in the answers given to Questions 2.A (at the bottom of page 3) and 2.B (at the top of page 4).

ICMA Standard Form ECP Documentation: ICMA has recently completed work on updating the ICMA Standard Form ECP documents contained in the ICMA Primary Market Handbook. The updated documents have been circulated to various ICMA Committees and working groups and will be officially published in the forthcoming revised ICMA Primary Market Handbook.

Contact: David Hiscock
david.hiscock@icmagroup.org

Primary Markets

by Ruari Ewing and Charlotte Bellamy

Prospectus Directive

On 18 February 2015, the European Commission launched a consultation on the next review of the Prospectus Directive (PD), with a deadline for comments of 13 May 2015. The PD review has been identified as a priority for early action under Capital Markets Union (CMU). As such, the general context of the review is a desire to reduce barriers to accessing the capital markets and to encourage growth.

The review is broad in scope and identifies a number of issues with the current PD regime. The general objective is "to reform and reshape the current prospectus regime in order to make it easier for companies to raise capital throughout the EU and to lower the associated costs, while maintaining effective levels of consumer and investor protection". In line with the CMU project, there is also a particular focus on how the prospectus regime applies to SMEs.

The Commission's Consultation Paper raises some fundamental questions about the current PD regime. An introductory section queries whether the principle of requiring a prospectus whenever securities are offered to the public or admitted to trading is still valid and the costs of preparing a prospectus. The "issues for discussion" are then divided into four other categories.

(i) *When a prospectus is needed:* This section discusses the current exemption thresholds and considers whether an additional exemption could be created for tap issues. There is a particular focus on the exemption in Article 3(2) for prospectuses relating to securities with a denomination of €100,000, with respondents being asked for views on whether such threshold is detrimental to liquidity in corporate bond markets. The general focus seems to be allowing a larger number of offers to be made without a PD-compliant prospectus. However, this section also considers whether the PD regime should be widened to include admission to trading on an MTF.

(ii) *The information a prospectus should contain:* This section also seems to focus on reducing burdens on issuers generally, with questions on (among other things) making the incorporation by reference mechanism more flexible and whether prospectuses need to include information that has already been made available under the Transparency Directive or be supplemented to include information that has been disclosed pursuant to the Market Abuse Directive. However, this section also discusses whether a length limit should be imposed on prospectuses or certain sections of the prospectus, which is likely to be impractical.

(iii) *How prospectuses are approved:* This section discusses whether approval processes across Member States can be streamlined further, extending the base prospectus facility, the tripartite prospectus regime, home Member State determination for debt issues, moving to an all-electronic system for filing and publishing prospectuses and equivalence of third-country prospectus regimes.

(iv) *Final questions:* This section is a "sweep-up" of other areas that the Commission is required to address

> **The PD review has been identified as a priority for early action under Capital Markets Union.**

in this review of the PD and asks respondents for views on whether there are any other areas that could add flexibility to the prospectus framework and facilitate the raising of capital or areas that could cause the prospectus framework to insufficiently protect investors.

As reported in previous editions of this Quarterly Report, the implementation of the last PD review caused significant uncertainty for issuers and lead managers (and is ongoing even now with ESMA still considering Level 2 measures under the Omnibus II Directive). It was therefore felt that the Commission should take a restrictive approach to its next review of the PD in order to allow a period of regulatory stability for the primary markets. However, the Consultation Paper appears to suggest an ambitious and open approach to this PD review. As such, there appears to be a welcome opportunity to address some fundamental aspects of the PD with a view to reducing burdens for issuers while appropriately protecting investors.

Nevertheless, a key point to bear in mind in any consideration of changes to the PD is the importance of protecting the existing, efficient, large and liquid wholesale debt market in Europe. Applying changes to the PD in a way which would have an adverse effect on the functioning of the wholesale market should be avoided.

Mindful of the above, ICMA's response is likely to have three aspects, namely: (i) to encourage the Commission's proposals that relate to the reduction of burdens; (ii) to argue against some of the less helpful suggestions made in the Consultation Paper; and (iii) to suggest additional areas for consideration that could help to reduce burdens and align with the CMU initiative.

The first aspect (encouraging the reduction of burdens) includes supporting a more flexible approach to incorporation by reference and a review of the need for a prospectus in the context of secondary market offers. It also includes agreeing with the suggestion that the somewhat arbitrary €100,000 threshold between "wholesale" and "retail" disclosure should be removed with the current "wholesale" disclosure regime applying to all prospectuses for debt securities. This suggestion would be based on a reconfiguration of retail investor protection to place more focus on regulatory tools other than disclosure (for example, MiFID intermediation) on the basis of evidence that suggests that retail investors do not read prospectuses and misunderstand shorter disclosure.

The second aspect (arguing against certain suggestions) includes disagreeing with the extension of scope of the PD to MTFs (on the basis that MTFs give valuable flexibility for wholesale issuers and it is not necessarily a problem that they each apply different rules) and arguing against the imposition of a length limit on prospectuses (on the basis that this will not necessarily make prospectuses easier to understand for investors and there may be serious concerns for issuers from a liability perspective if such a limit were to be introduced).

The third aspect (raising additional considerations that could reduce burdens) may include suggesting that the provision relating to what a prospectus needs to contain should be amended or reinterpreted to mean that a prospectus for vanilla debt securities only needs to contain the information that an investor needs to assess risks to payment and repayment on the bond. This could result in a significant reduction in the length and cost of prospectuses.

Generally, it will be interesting to see how the proposals for the next PD review develop. A significant reduction in burdens for issuers under the PD is likely to be achieved more successfully if it is complemented by plans to modify other legislation (such as MiFID) to achieve appropriate levels of protection for retail investors. It is hoped that regulators will take the opportunity that CMU presents in order to achieve this goal.

Contact: Charlotte Bellamy
charlotte.bellamy@icmagroup.org

Credit ratings and mandatory rotation

by Katie Kelly

ESMA issued a Call for Evidence on 3 February 2015 in order to collect information from market participants about the functioning of the credit rating industry and the evolution of the markets for structured finance instruments as required by Regulation 1060/2009 on credit rating agencies, as amended (the CRA Regulation). ICMA, on behalf of the corporate issuer members of the Corporate Issuer Forum, submitted a response to the Call for Evidence, limited to general observations on whether mandatory rotation should be extended to other asset classes (other than re-securitisations).

In its response, ICMA stated that, fundamentally, ICMA members do not support the proposed extension of mandatory rotation to other asset classes, *inter alia*, amid concerns that mandatory rotation interferes with the free choice of issuers and investors.

The response also highlighted that competition in the area of rating agencies – although difficult for those trying to break into the market – is welcomed, but should be driven by demands and requirements of issuers and investors, rather than off the back of a legal obligation. In addition, the very fact that rotation would be *mandatory* among what is a quite limited pool of rating agencies would somewhat undermine the competitive process.

Fundamentally, mandatory rotation risks damaging the quality of ratings. Continuity of monitoring and analysis is a very necessary element of the ratings process, and much time and effort is invested at both the level of issuers and rating agencies to ensure that there is a clear understanding of the issuer, the sector, the issuer's position in that sector and internal policies, including financial, legal, underwriting and risk management policies. Investing in the relationship – and therefore having the means to access the right channels of communication – also helps to ensure efficient dialogue.

Equality of expertise and ability of every rating agency – and indeed every analyst – cannot be assumed, meaning that knowledge, know-how and experience may be lost and need to be built up on every rotation. This would lead to inefficiencies in the rating process not only in terms of process, but also in terms of cost. Knowledge-sharing between rating agencies may help with the handover process on rotation, but this may also give rise to confidentiality issues. Further, knowing that information may be shared at the end of a term may affect the free-flow of information between the issuer and the rating agency.

With rating agencies using different methodologies, notching adjustments and terminology, forced rotation to an agency using disparate metrics could lead to a different rating being applied, at times with no apparent direct correlation to the issuer. Similarly, different agencies may have different requirements in terms of, for instance, financial covenants, risk allocation in contractual arrangements and other protections, including areas of subjective judgment. All of these elements could create uncertainty and inconsistency for investors, who may already be faced with restrictions on investible securities rated by certain rating agencies.

The deadline for response to the Call for Evidence was 31 March 2015, after which the evidence obtained will be analysed by ESMA as part of the development of the technical advice to be provided to the European Commission pursuant to Articles 39(4) and 39(5) of the CRA Regulation.

Contact: Katie Kelly
katie.kelly@icmagroup.org

Issue 37 | Second Quarter 2015
www.icmagroup.org

ICMA Primary Market Handbook review

by Lalitha Colaco-Henry

Summary

This article reports on the review of the ICMA Primary Market Handbook which is now nearing completion. It highlights the aims of the review and outlines some of the more significant changes that have been made to the Handbook. It also looks briefly at next steps.

Introduction

It is hard to believe that the review of the ICMA Primary Market Handbook (Handbook) started four years ago in 2011 and we are only now nearing the completion of this monumental task, which has seen the Handbook go through a thorough top-to-bottom review. When the review was initially established, the aims were to (i) simplify and possibly shorten the Handbook; (ii) ensure that the proper emphasis was given to the most important recommendations; and (iii) update the Handbook.

We are looking to start the sign-off process with the relevant ICMA Committees shortly. After that, the whole Handbook will be submitted for Competition Law review following which it will be typeset and printed. At the moment we hope that it will be published in the second quarter of this year, but given the time it has taken to get the project this far, it is conceivable that this timeline may slip.

Revised structure of the Handbook

One of the significant problems with the current structure is its navigability. When it was launched in 1985, the Handbook consisted of a few short pages that covered the issuance of straight Eurobonds. The Handbook has since evolved into a comprehensive document covering a broad range of issues dealing with the syndicated issuance of international primary bond offers. However, because the Handbook developed gradually over 30 years, there is very little structure to the book, the provisions do not follow a logical order and there is no index, all of which make locating provisions in the Handbook difficult and time-consuming. So, one element of the work has been to develop a logical structure for the Handbook that is adaptable to the insertion of new provisions over time. Accordingly, the revised Handbook will comprise:

- 12 Chapters – containing all the Recommendations and guidance on those Recommendations;
- 17 Appendices – containing ICMA standard language and guidance on specific topics;
- 2 further Appendices – containing a Reader's guide and a Glossary; and
- a table of contents and an index.

Chapter 1 deals with the scope of the Handbook. Chapter 2 deals with provisions relating to programme establishments and updates. Chapters 3 to 11 are structured so that they generally follow the chronology of a typical new bond issue:

- Chapter 3 – Prior to transaction announcement
- Chapter 4 – Transaction announcement
- Chapter 5 – Bookbuilding and launch
- Chapter 6 – Allocation and allotment
- Chapter 7 – Pricing
- Chapter 8 – Confirmation to Managers
- Chapter 9 – Stabilisation
- Chapter 10 – Issue documentation and signing
- Chapter 11 – Closing and settlement

The new Reader's guide makes clear that while provisions have been included in a particular chapter they may nevertheless need to be considered at an earlier or later stage of the transaction and so it is important to view these chapters as a whole rather than considering each chapter in isolation. The final chapter (Chapter 12) contains provisions applicable to Euro Commercial Paper. Going forward, the new simplified structure should make it much easier for readers to navigate the revised Handbook.

The revised Handbook now clearly sets out that it applies to ICMA members when lead-managing syndicated international primary bond offers other than: (i) high-yield bonds; (ii) equity-linked bonds (though the ICMA Agreement Among Managers v2 can still be used); and (iii) US dollar-denominated global bonds (though in respect of such deals, members are recommended to provide (on request) the details of the relevant US affiliate contacts to other managers). It should be stressed

“The revised Handbook requires an Initial Syndicate Communication.

“Retention” and “pot” deals

A “retention” deal is one where a manager receives an allotment of securities at the discretion of the Lead Manager, which the manager then sells directly to its clients. On the other hand, a “pot” (or “book-built”) deal is one where, in its simplest form (100% pot with no retention), the whole of the issue is set aside to be allocated to investors out of a central order book run by one or more of the Bookrunners for the issue. Other syndicate members contribute orders to the pot but do not control the final allocation or distribution of securities.

that the Handbook is intended to govern the relationships between members of a syndicate. It does not touch upon interactions between different functions within the same firm. Nor does it seek to re-state applicable law and regulations, and, as you would expect, everything in the Handbook remains subject to applicable law and regulation.

There are two main types of deal structure in the syndicated international primary bond offer market – pot deals and retention deals. While the majority of deals today are structured as pot deals, some deals are nevertheless structured as retention deals. As a result, the revised Handbook makes clear which provisions apply to which type of deal. Accordingly, all the provisions apply to both types of deal structure unless specified otherwise.

Additionally, a considerable amount of time was spent thinking about the information that should be provided at different junctures of a deal – ie who needs what information and when they need it by. For example, the revised Handbook requires an Initial Syndicate Communication, setting out the basic terms of an issue, to be notified to prospective managers at the earliest possible time prior to their names being publicly associated with the transaction and prior to pricing. The new provisions set out what the basic terms should include, though the list is brief and not exhaustive. The revised Handbook also makes clear that there must be a positive response to an Initial Syndicate Communication before a prospective manager is publically named in relation to the transaction. The revised Handbook also sets out Recommendations relating to the Confirmation to Managers, which used to be referred to as the Invitation Telex. The revised Handbook sets out what one would expect to see in the Confirmation to Managers and also sets out that the Confirmation to Managers should be sent to managers as soon as practicable after pricing.

Updating the Handbook

With respect to the third aim of the review, we have worked to ensure that all the provisions in the Handbook are up-to-date and consistent with current market practice and relevant EU Directives and that any obsolete provisions are deleted. We are currently in the process of drawing up a table of destinations which will set out whether current Handbook provisions have been taken forward into the revised Handbook and if so where they are located. The table will be for illustrative purposes only and should be used as a general guide. However, in drawing up the table, we have been conscious that:

(i) there are some provisions that have been carried forward into the revised Handbook without any amendment;

(ii) there are some provisions that have been carried forward into the revised Handbook with consequential amendments (and/or slight improvement/simplification);

(iii) there are some provisions that have been carried forward into the revised Handbook with substantial revisions;

(iv) there are some provisions that have been deleted but elements of the underlying concept have been retained in the revised Handbook; and

(v) there are some provisions that have been deleted in their entirety.

In relation to points (iii) and (iv) the cross-references to the revised Handbook, if any, will be qualified.

The revised Handbook will still be available in both printed form and electronically on-line. It will also be available to both ICMA members and those non-members who are subscribers.

Contact: Lalitha Colaco-Henry
lalitha.colaco-henry@icmagroup.org

Public Sector Issuer Forum

by Nicholas Pfaff

The Public Sector Issuer Forum (PSIF) brings together the major Sovereigns, Supranationals and Agencies (SSAs) actively issuing in the European capital markets. The PSIF currently has 35 institutional members including the majority of European DMOs, the European Commission (as an issuer), key agencies such as Kreditanstalt für Wiederaufbau (KfW) and the leading multilateral development banks of which the European Investment Bank, the European Bank for Reconstruction and Development and the World Bank.

Supported by ICMA through a Secretariat based in Paris, the PSIF's objective is to act as an information exchange among its members. The participants share, through confidential discussions, experience and concerns from their capital markets activity, focusing both on market practice and on the impact of increasing regulation on their operations. Participants individually decide whether to follow up on any particular points arising from PSIF meetings in their own organisations or through their respective national channels. Exceptionally, the PSIF may choose to act collectively on a matter of sufficient common concern.

The PSIF is coordinated by a Steering Committee with three members representing each a key SSA (Sovereigns, Supras and Agencies) constituency. The Steering Committee currently includes Madelyn Antoncic (VP & Treasurer, World Bank), Frank Czichowski (Senior VP & Treasurer, KfW) and Anne Leclercq (Director Treasury, Belgian Debt Agency).

The PSIF convened three times in 2014. In March 2014, the PSIF was held in Frankfurt, hosted by Rentenbank. This was an opportunity for a presentation and dialogue with the European Central Bank (ECB) on the topic of the European Banking Union with a focus on the Asset Quality Review. In June 2014, the PSIF was hosted by the UK DMO in London. Amongst others, the PSIF conducted a dialogue with ISDA on European Regulatory Reform, mainly focused on EMIR and MiFID II. During this meeting, the PSIF Charter was approved enshrining in particular its existing focus while formalizing its membership criteria.

In October 2014, the PSIF was held at the World Bank in Washington. The IMF provided insights at the meeting on the challenges of elaborating and implementing macro-prudential policy. There was also a discussion on the release of reinforced collective action clauses in sovereign bonds which emphasized the successful collaboration between ICMA and the US Treasury, the IMF, the IIF, as well as market participants and practitioners.

The PSIF held its first 2015 meeting in February, hosted by Eurofima in Basel. Discussions were held on regulatory topics and policy with the Financial Stability Board, among others. The next meeting is scheduled for June 2015 in London.

Contacts: Nicholas Pfaff and Valérie Guillaumin
nicholas.pfaff@icmagroup.org
valerie.guillaumin@icmagroup.org

Other primary market developments

There have been a variety of other primary market developments over the past quarter.

- *UK FCA restrictions on the retail distribution of CoCos:* On 27 January 2015, ICMA responded to the UK FCA's consultation on restrictions on the retail distribution of regulatory capital instruments, raising the points noted in the previous edition of this Quarterly Report.
- *Securitisation:* On 14 January 2015, ICMA, jointly with AFME, the BBA and ISDA responded to the EBA's Discussion Paper on *Simple, Standard and Transparent Securitisations* and on 13 February 2015, ICMA, jointly with GFMA, the IIF and ISDA, responded to BCBS/IOSCO's Consultative Document on *Criteria for Identifying Simple, Transparent and Comparable Securitisations.*
- *PRIIPs:* On 17 February 2015, the Joint Associations Committee on retail structured products submitted with ICMA's support a response to the ESMA Discussion Paper published on 17 December (and reported on at some length in the First Quarter 2015 edition of this Quarterly Report). The response addressed technical aspects arising in the context of retail structured products. ICMA did not respond from the vanilla markets perspective as vanilla bonds appear to be out of scope of the new regime.
- *UK FCA Wholesale Competition Review:* On 19 February 2015 the UK Financial Conduct Authority (FCA) published a Feedback Statement to its July 2014 *Wholesale Sector Competition Review – Call for Inputs* (to which ICMA briefly responded on 6 October 2014 simply flagging press coverage indicating robust competition amongst bond underwriters). The Call for Inputs had discussed various aspects of equity underwriting (as this had been the focus of previous competition work by the UK Office of Fair Trading), noted hypothetically that "similar mechanisms might be at play in the issuance of debt securities" and welcomed evidence on whether these or other issues exist in the supply of debt. In this respect, the Feedback Statement notes the following feedback from respondents in the context of debt issuance transactions specifically: competition for debt underwriting is effective; large corporate clients have relationships with several banks and rotate the lead firm in separate DCM transactions, which incentivises banks to provide a good service and promotes competition; and in this context, fees cannot fall much further before debt underwriting becomes unprofitable. The FCA has announced plans to launch a wholesale market study into investment and corporate banking (with related terms of reference to be published in the spring), including debt underwriting (presumably for consistency and completeness). In this respect, there is likely to be much interest in the final recommendations of the UK's *Fair and Effective Markets Review* (FEMR) scheduled for June 2015 (see a summary of ICMA's response to FEMR towards the beginning of this Quarterly Report). This is because (i) the FCA's Competition Review extends beyond a classic competition focus to touch on conduct of business elements also covered by the FEMR, and (ii) the FEMR also specifically includes competition aspects.
- *ICMA Standard Form ECP Documentation:* ICMA has recently completed work on updating the ICMA Standard Form ECP documents contained in the ICMA Primary Market Handbook. The updated documents have been circulated to various ICMA Committees and Working Groups and will be officially published in the forthcoming revised ICMA Primary Market Handbook.

Contacts: Ruari Ewing and Charlotte Bellamy
ruari.ewing@icmagroup.org
charlotte.bellamy@icmagroup.org

Secondary Markets


by Andy Hill and Elizabeth Callaghan

MiFID II Level 2

One of ICMA's aims is to set standards of good market practice for "the orderly functioning of the markets". With this in mind, ICMA put together a technical Working Group made up of heads of fixed income dealing desks on the buy side (asset managers) and heads of fixed income trading desks and market structure on the sell side (investment banks/brokers) to respond to the latest ESMA Consultation Paper, published on 18 December 2014, on MiFID II Level 2. ICMA's response was submitted by ESMA's deadline of 2 March 2015 (and is available on the ICMA website). Those involved in the Working Group included representatives of GAM, Goldman Sachs International, HSBC Bank plc, Nomura International plc, Nordea Investment Management, Société Générale S.A. and Tradition (UK) Ltd. The focus of the Working Group was on transparency, as it relates to liquidity, in the bond market.

MiFID II extends much of the equity transparency requirements in MiFID I to fixed income instruments. Often, this is referred to as the "equitisation" of the fixed income markets. This means potentially pre-trade transparency with firm executable prices advertised to the whole market and post-trade disclosure transparency of details such as price, volume and time of trade. However, fixed income markets are not the same as equity markets. In fixed income markets, transparency does not equal liquidity. The importance of this concept explains why ICMA concentrated on liquidity-related questions in responding to ESMA's Consultation Paper (CP).

As bonds are quite complex, made up of moving parts such as maturity dates, coupons, multiple currencies and cyclicality, ESMA's CP proposals need considerable refinement in order to become "fit for purpose" in serving the needs of all market participants in the international bond markets, including investors. ICMA therefore approached ESMA's question 57 on the methodology of liquidity determination with a two pronged solution:

First, ICMA's preferred solution was a hybrid response. This was based on the fact that the only way to truly calibrate liquidity is daily (trading) behaviour. In order to make the bond classification sensitive enough, ICMA had to include elements of ESMA's Instrument by Instrument Approach (IBIA) alongside its Class by Class Approach (COFIA) to create the hybrid mechanism. We deliberately designed the hybrid approach as far as possible to meet ESMA's "simplicity and predictability of calculation" criterion while protecting the interests of market participants and not creating the opportunity for "false positives" (bonds identified as liquid when in fact they are illiquid). We concluded that it was not possible to protect the interests of market users whilst using COFIA alone.

Second, we then proposed to ESMA that if, despite the arguments highlighted, ESMA continues to be of the view that COFIA alone is the only way forward in the interests of regulatory simplicity, it would be vital to at least reduce the "Large in Scale" (LIS) and "Size Specific to The Instrument" (SSTI) ESMA thresholds for determining market transparency obligations. A "tiered" LIS and SSTI pure COFIA approach formed our second or "reserve" proposal to ESMA. We considered that a tiered LIS and SSTI would at least prevent the potential numbers of false positives that were observed in ESMA's analysis tables in the Consultation Paper. Using ESMA's analysis of its pure COFIA methodology, the false positives ranged anywhere from 42% to 74%. ICMA's (technical) Working Group was greatly concerned that ESMA routinely understated the importance of the inaccurate classification of instruments which its proposed COFIA methodology throws up. Covered bonds and corporate bonds had a particularly high percentage of "false positives".

ICMA's preferred liquidity determination mechanism combined an IBIA calculation or "Liquidity Gate", which uses an average spread (allowed in MiFID II Level 1), alongside a granular COFIA, which took into account: issuance size; credit rating; currency; time since issuance; time to maturity; and bond coupon characteristics.

The "reserve" solution was a pure COFIA methodology but with a tiered Size Specific to the Instrument (SSTI) and Large in Scale (LIS), significantly reduced from ESMA's proposed thresholds. The granular COFIA fields mentioned above were still used.

Both of these liquidity determination mechanisms were backed up by solid MiFID II Level 1 language (which is now law), providing evidence that the necessary changes could be permitted.

ICMA also highlighted the impact of unintended consequences (also in our response to question 57) on the investor community with specific examples.

In addition to liquidity determination, ICMA proposed (in our response to question 77) that transparency deferrals be two business days instead of 48 hours and that the supplementary deferral regime be longer than the proposed four weeks: we suggested 12 weeks. This is due to the fact that a firm often takes much longer than four weeks to hedge a large trade.

Lastly, ICMA proposed adding "Package Transactions" (transactions that are combinations of asset classes or combinations within asset classes) in our response to question 70. These were left out of the Consultation Paper, and ESMA acknowledged this in its Open Hearing. ICMA proposed changing the proposed Regulatory Technical Standard (RTS) to state: Package Transactions should be illiquid if the package contains liquid and illiquid components. Also, all components of a package have to be tradable on a single venue, in order that the package be considered "traded on a venue".

The next steps for MiFID II are as follows:

April 2015: Questionnaire on transparency on non-equity instruments

June 2015: Final RTS submitted to the European Commission

December 2015: Final ITS and Guidelines submitted to the European Commission

January 2017: MiFID II applies in practice.

Contact: Elizabeth Callaghan
elizabeth.callaghan@icmagroup.org

CSDR Level 2

On 18 February 2015, ICMA submitted its response to the ESMA Consultation Papers for *Technical Standards and Technical Advice under CSD Regulation* (CSDR). ICMA's primary concern is with regard to ESMA's proposals on settlement discipline, in particular "mandatory buy-ins". While ICMA is broadly supportive of many of the regulatory measures designed to improve the safety and efficiency of European securities settlements systems, including the introduction of cash penalties for failing settlements, many of ICMA's members, both on the sell side and the buy side, are deeply concerned about the provision to introduce automatic buy-ins in the case of settlement fails.

The key recommendations argued in ICMA's response (and in keeping with the Level 1 text) are as follows:

- For fixed income, buy-ins should be initiated and executed at the trading level (and not the CSD or trading venue level).
- For non-cleared trades where there are interdependent fails, the chain should be resolved through the use of a "pass-on" mechanism between trading counterparties, as currently utilised under ICMA Rules.
- The buy-in process will require significant automation given the potentially vast number of buy-ins being initiated every day (a study by the European Central Securities Depositories Association suggests that, based on current settlement efficiency rates, the Regulation would trigger over 7,500 new buy-ins per day, or 1.8 million per annum).

- MiFID II pre- and post-trade transparency requirement liquidity calibrations are unfit for the purpose of calibrating buy-in extension periods. In the interest of orderly and efficient markets, all fixed income securities should have an extension period of the maximum allowable seven days. Similarly, the buy-in "timeframe" (the period of time from the start of the buy-in process up to eventual settlement of the buy-in) should also be seven days.
- It should still be possible to settle securities during the buy-in timeframe, up until the buy-in is executed.
- In determining the exemption thresholds for SFTs, the possibility for deferral should be considered. Applying a seven-day extension period and timeframe, this would make the exemption threshold 21 business days (roughly one calendar month).
- A delay before implementation of settlement discipline of at least 18 months is required (ideally not before the full roll-out and testing of TARGET2-Securities). Furthermore, implementation should be phased, with buy-ins following cash penalties by at least 18 months. Currently, implementation is expected in early 2016, but ESMA is recommending an 18-month delay to allow market participants and stakeholders to make the necessary preparations and systems enhancements to support successful implementation and compliance.

In January, ICMA joined a small industry delegation with AFME to meet ESMA in Paris in order to discuss some of the above recommendations. In February, the AFME-ICMA delegation also met CONSOB in Rome, which is chairing the ESMA CSDR Settlement Discipline Task Force. One of the key points that ICMA made, and which is very much supported across all industry constituents, is that for fixed income markets, buy-ins should be initiated, executed, and managed at the trading level – that is, between trading counterparties for non-cleared trades, and CCPs for cleared trades – and not by the CSD or trading venue, as has been suggested by ESMA in the Level 2 RTS in the case of non-cleared trades. It has been explained to ESMA that CSDs are not in a position to identify which transactions warrant a buy-in; nor are they able to identify interdependent transactions producing multiple fails ("fails chains"), where a trading level "pass-on" mechanism would require only one buy-in executed at the end of the chain. Similarly, trading venues, such as electronic bond and repo trading platforms, have even less visibility of the settlement status of the transactions they facilitate.

ICMA was hopeful that the significance of this critical point would be incorporated into the re-drafting of the Level 2 text. But, following comments by Steven Maijoor, Chair of ESMA, at an ECON hearing on 23 March, it would appear that ESMA is reluctant to accommodate trading level buy-ins. It would seem that, while ESMA understands the rationale for keeping buy-ins at the trading level, it is of more importance to ESMA to ensure enforceability of the Regulation against non-EU counterparties, which it considers could

“

In the interest of orderly and efficient markets, all fixed income securities should have an extension period of the maximum allowable seven days.

best be achieved by making CSDs or trading venues responsible for driving the buy-in process.

ICMA still firmly believes that the best possible outcome of the ongoing discussions and consultations will be for the European Commission to revisit the Level 1 text and to reconsider its position on implementing a mandatory buy-in regime.

Contact: Andy Hill
andy.hill@icmagroup.org

ICMA impact study for mandatory buy-ins: the bond markets

In January and February 2015, ICMA conducted a study to ascertain and quantify the impacts of the introduction of mandatory buy-ins under the CSD Regulation on the European fixed income markets. The study was designed to support ICMA's response to the Consultation Papers *on Technical Standards and Technical Advice for CSD Regulation*, as well as to raise general awareness of the likely detrimental impacts for European bond market pricing and liquidity as a result of implementing a mandatory buy-in regime.

The ICMA impact study

The automatic and inflexible nature of mandatory buy-in regulation presents an additional level of risk to market-makers who provide offer-side liquidity in securities that they may not necessarily hold in inventory. Given the impact of Basel III on the cost of banks' balance sheets, market-makers generally run very low levels of inventory, and so in most cases they will be offering securities that they do not hold. In the event that they are unable to cover these short-sales, either in the cash or financing markets, in a timely manner, they will be subject to a mandatory buy-in and so incur an unpredictable, and so largely unquantifiable, cost. This will prompt dealers either to add a premium to their current offer levels for securities, or to refrain from showing offers completely.

The basis of the study was a survey of ICMA's sell-side members, in particular the larger global fixed income market-makers. The survey targeted traders and trading desks responsible for market-making in government, public, and corporate bonds, both for outright cash bond markets and securities financing transactions (repos). The survey had both quantitative and qualitative components. The quantitative component asked how market-makers for various fixed income asset classes would change their offer price for securities that they did not hold in inventory (in the Box) when moving from a discretionary buy-in regime to a mandatory buy-in regime. To quantify the impact of this, respondents were also asked to quote the average bid-ask spread that they currently show for the relevant securities. The qualitative component allowed the respective market-makers to comment on the impacts they anticipate to their market and business as a result of the imposition of mandatory buy-ins.

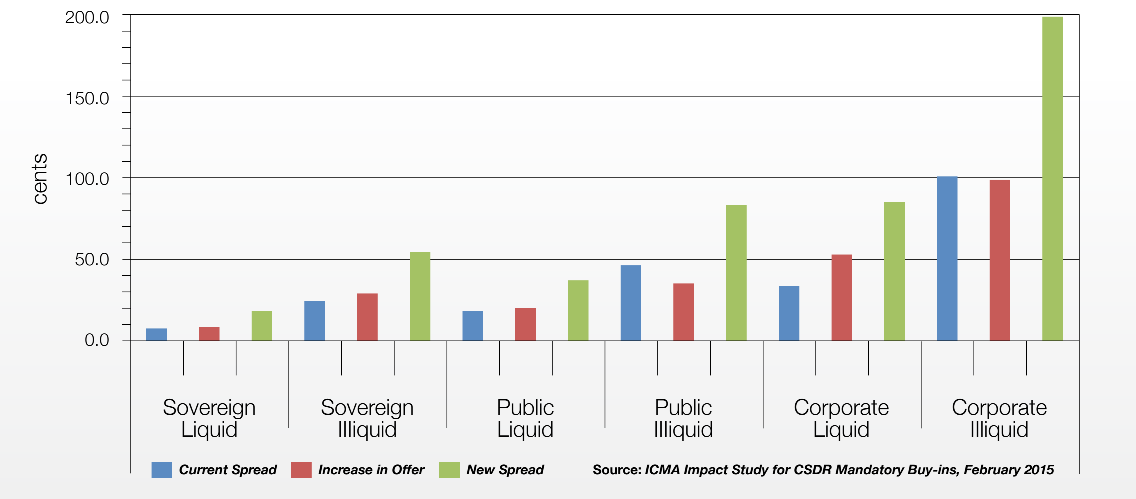
This study illustrates that if, or when, mandatory buy-in regulation is implemented (scheduled for early 2016), liquidity across secondary European bond and financing markets will reduce significantly, while bid-offer spreads will widen dramatically. The results suggest that even the most liquid sovereign bonds will see bid-offer spreads double, while secondary markets in less liquid corporate bonds may effectively close. The survey further suggests that for many less liquid bonds, including sovereign and public issues, market-makers will retrench from providing liquidity altogether.

The study, as well as measuring the impact on bond and repo market spreads, also attempts to monetize this impact based on available market data and current market structure. The costs are significant, running into several billions of euro per annum, even allowing for the inevitable market contraction that mandatory buy-ins will cause. This does not include the significant investment that will be required by CSDs and market participants in order to support the proposed settlement discipline mechanisms.

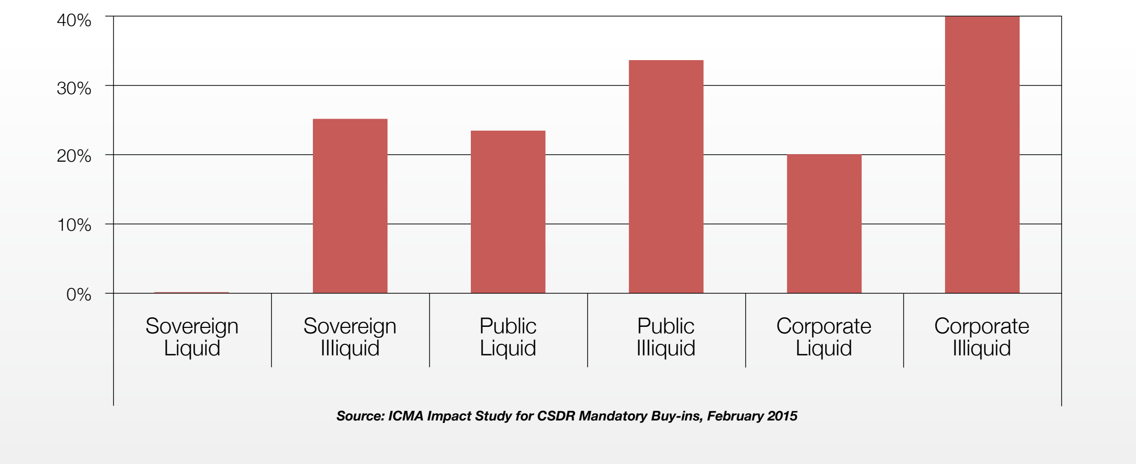
The study provides a very real sense of how bond and repo market prices will need to adjust for a mandatory buy-in regime, as well as the possible scale of liquidity retrenchment. This is a cost to the users of the bond markets: investors, both institutional and retail, and, ultimately, the issuers themselves, both public and private, who will inevitably have to pay an increased "illiquidity premium" through their primary issuance. In other words, this is a cost to the real economy.

The charts overleaf illustrate the impact of mandatory buy-ins on offer prices across the six asset classes. In moving to a mandatory buy-in regime, a number of market-makers will no longer show offers in securities that they do not hold in inventory; this impact is also illustrated.

The impact of mandatory buy-ins on bond market bid-offer spreads



Percentage of market makers who will cease to offer bonds unless pre-positioned



Costing the regulation

Based on the available market data, and related assumptions around both the bond and repo market structure, the estimated annual cost to the market of implementing a mandatory buy-in regime, even applying the most conservative estimates, is likely to run into tens of billions of euro per annum. This cost will directly impact investors, and in turn issuers who will be forced to pay an "illiquidity premium" for their primary debt issuance. These costs, of course, do not account for the market contraction that is likely to follow the introduction of a mandatory buy-in regime, although this could be viewed as a cost in itself.

Conclusion

This study clearly illustrates the likely impact of mandatory buy-ins for European bond and repo market liquidity and pricing. The inevitable increase in cost and decrease in liquidity that mandatory buy-ins will forge will be borne not by the banks and broker-dealers, but by investors. In turn, this is likely to have cost and risk implications for borrowers, both public and private, and will result in an additional "illiquidity premium" to their cost of capital. Thus, the negative externalities of mandatory buy-ins impact not banks, but the real economy. Meanwhile, its ability to improve settlement efficiency remains unproven, and if anything, given the liquidity impacts highlighted by this study, it may very well result in the opposite.

Contact: Andy Hill
andy.hill@icmagroup.org

Asset Management

by Patrik Karlsson and Katie Kelly

Bail-in

The ICMA Bail-in Working Group met most recently in March 2015 at the EBRD, under the governance of a newly-constituted Steering Committee. One of the consistent themes of the Bail-in Working Group has been that, as the buy side is being asked to take significantly more risks with bail-inable debt, one of its objectives is to ensure better disclosure at both an issuer level and also at the level of the regulators. There remains a lot of work to be done in terms of new disclosure (for example, on TLAC and MREL). Further meetings with regulators in order to present a buy-side consensus will be on the agenda of the Bail-in Working Group.

The Bail-in Working Group is fully supportive of worthy efforts to date that have been made in the area of resolution. However, it has also identified areas where uncertainty remains, not least regarding the unpredictability of the practical application of resolution powers, valuation methods and the fairness as to how losses are attributed. Mindful of the fact that no two bank resolutions are ever likely to be the same, the recent resolution of Hypo Alpe Adria Bank – although a complex, unique and exceptional case – demonstrates that there is uncertainty as to how the bail-in powers under the EU Bank Recovery and Resolution Directive will be applied in practice, and highlights the need for a clear roadmap that the resolution authorities are intending to use.

Fundamentally, maintaining the hierarchy of claims and ensuring that investors are no worse off than in a liquidation remain fair objectives, but there is a lack of certainty that this will always apply in practice across different corporate structures and in different parts of Europe. Clarity and consistency of views are needed on the position in the hierarchy waterfall of senior and subordinated HoldCo debt versus senior or subordinated OpCo debt.

Further, with the added uncertainty as to whether non-compliance with TLAC would constitute a trigger, there remain concerns on the proliferation of capital triggers and how well defined and transparent these triggers will be to the creditors most exposed to write-downs. Ideally, all triggers should be harmonised to help address the difficulty in evaluating which are the triggers that will actually cause intervention by the resolution authorities.

The Single Resolution Board – established in 2014 to prepare resolution plans, to carry out the resolution of failing banks and to be in charge of the Single Resolution Fund – will be fully operational with a complete set of resolution powers in 2016, and will work in close cooperation with national resolution authorities. In the meantime, and until then, the Bail-in Working Group is planning another meeting for June 2015, at which these issues, together with a number of other, more specific points, will be explored in more detail with the buy side and the regulators.

“ **The Bail-in Working Group has identified areas where uncertainty remains.**

Contact: Katie Kelly
katie.kelly@icmagroup.org

Systemic risk and asset management

The global debate on systemic risk in the non-bank, non-insurance world continues unabated. In January 2014 the FSB and IOSCO issued a consultation on the methodology to designate non-bank, non-insurance international systemically important financial institutions (NBNI G-SIFIs). The first consultation was heavily criticised by industry for linking size with risk without considering other factors. In recognition of this, FSB and IOSCO issued a second consultation on 4 March 2015, recognising that size alone is not a sufficient indicator of potential risk to the system. In addition to size, the new methodology to identify systemically important investment funds also takes into account leverage and use of derivatives and securities financing transactions.

In revising the proposed methodologies, the FSB and IOSCO intend to capture different types of systemic impact posed by a wide range of business models and risk profiles, while also maintaining broad consistency with the existing assessment methodologies for global systemically important banks (G-SIBs) and insurers (G-SIIs). At the same time, they have allowed a greater role for supervisory judgment in the assessment compared to the G-SIB and G-SII methodologies.

The AMIC Market Finance Working Group, set up last year, is considering how to respond to the second consultation and coordinate with other trade associations. The Working Group considers that the FSB's decision to add asset managers to potentially systemic institutions potentially problematic. Furthermore, in reacting to the criticism about too much focus on size, FSB and IOSCO seem to have over-complicated the designation process. It is likely that the Working Group will request a simpler focus on leverage, relative size of positions in a given market and substitutability.

The deadline for responses is 19 May 2015.

Contact: Patrik Karlsson
patrik.karlsson@icmagroup.org

Research unbundling in MiFID II

The ICMA Asset Management and Investors Council (AMIC) has become increasingly concerned with developments on investment research regulation in MiFID II. AMIC's particular concern is with the forthcoming Delegated Acts being drafted by the European Commission concerning the issue of investment research in MiFID II following ESMA's final Technical Advice on this subject, issued in December 2014.

AMIC members have been actively following the evolution of the research unbundling debate, primarily in the UK by responding to the Financial Conduct Authority's (FCA) consultations (CP13/17: see the response on ICMA's website) and discussion papers (DP14/3: see the response on ICMA's website). AMIC's position has been that clients should be able to rely on their asset managers to act in those clients' best interests when they purchase research services. AMIC supports rule changes that enhance investor protection and market integrity.

AMIC has also warned against the potential negative impact on choice and availability of quality research, which could particularly have a negative impact on the diversity of available opinions and companies followed, as coverage concentrates on large companies with the greatest weight in managed portfolios, at the expense of SME and mid-tier research.

AMIC argues that the use of a solution like a commission sharing arrangement (CSA), with appropriate budgeting and clear reporting to clients has been proven to work well and improves market functioning.

AMIC does not agree with the suggestion in the Technical Advice that asset managers must control, rather than just operate and direct, a research payment account (RPA) (or a CSA under current arrangements). Agreeing client research budgets up front, or only being able to increase the research budget with the client's written agreement, is operationally very onerous. It is likely to lead to a number of clients opting not to agree and therefore benefitting from a "free ride" on research paid by others. It is far preferable to continue the current CSA approach of budgeting appropriately for research and informing clients of the amount spent in reasonable detail.

AMIC does not believe that ESMA's approach underlying the RPA of two-way communication between the client and the manager will work in practice and considers that it will lead to significant problems in the near and medium term. AMIC has urged the European Commission to allow firms to retain the use of solutions like CSAs, which can achieve the policy goals of unbundling research fees from execution fees, help bring down commission spend in the market, provide greater clarity to clients on what their money is spent on and most importantly, getting asset managers to spend their clients' money as if it were their own.

Furthermore, AMIC is concerned that the FCA considers that research unbundling applies not only in the commission-based equities markets, but also in the spread-based fixed income market. AMIC has strongly urged the European Commission to allow more time to fully consider the impact the extension to fixed income would have.

Contact: Patrik Karlsson
patrik.karlsson@icmagroup.org

Capital Market Products


by Nicholas Pfaff and Katie Kelly

Pan-European private placement initiative

The Pan-European Private Placement Working Group (PEPP WG) set itself the task in 2014 to produce two key deliverables for early 2015. These objectives were met on schedule:

- Standardised documentation coordinated within the PEPP WG was made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The *Pan-European Corporate Private Placement Market Guide* was released on 11 February 2015. The Guide sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

The Guide builds on existing practices and documents used in the European bond and loan markets, especially the Charter for Euro Private Placements (developed by the Euro PP Working Group). The objective is that most European private placement transactions will over time use the Guide as the market standard. It is expected that the Guide will: (i) expand the market as a source of cost-effective funding for European mid-sized companies; (ii) grow the European investor base for private placement transactions; and (iii) lower operation costs by promoting the use of standardised PEPP transaction documentation. The Guide is designed to be regularly updated as the PEPP market develops and evolves.

A key goal is to ensure that that the standards and practices which the Guide promotes are well understood and implemented by market participants. To this end, various events throughout Europe have been planned to engage the issuer community, investors, as well as the heads of DCM and CIOs/portfolio managers of investment firms, in order to ensure maximum visibility. The first such events took place in Paris on 13 April and in London on 14 April.

The PEPP market is perceived as potentially a significant contribution to the goals of the European Commission's Capital Markets Union (CMU). Following earlier contacts of the PEPP WG with the Financial Services Committee (FSC) of the European Council, the Economic and Financial Affairs Council held in Brussels on 9 December 2014 welcomed in its press release such market-led efforts to develop a pan-European private placement market.

The PEPP WG is now preparing under ICMA's umbrella a draft response to the CMU Green Paper on whether "any action by the EU is needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?" A number of proposals are under consideration especially with respect to how regulatory incentives may possibly be created to facilitate institutional investment flows into the market.

Going forward the PEPP Working Group will evolve into a permanent Joint Committee under ICMA coordination. The priority is to remain as inclusive as possible bringing together investors, as well as intermediaries and issuers. It will also encourage continued official sector participation which has worked very well to date, and provides an invaluable sounding board and communication channel on concerns that may be arising at an early stage from a regulatory perspective. The objective of the Joint Committee will be: (i) to promote PEPP market development; (ii) to enable continued market self-regulation (eg by keeping the Guide and standardised documentation up-to-date and relevant); (iii) to facilitate additional European expansion; (iv) to monitor and, when possible, quantify market activity; and (v) more generally, to flush out any issues that would hamper issuance of, or investment in, PEPP at a regulatory or practical level.

Contacts: Nicholas Pfaff and Katie Kelly
nicholas.pfaff@icmagroup.org
katie.kelly@icmagroup.org


Green bond initiative

by Nicholas Pfaff and Valérie Guillaumin

The Green Bond Principles (GBP) held their first Annual General Meeting (AGM) in London on 27 March 2015 hosted by the European Bank for Reconstruction and Development (EBRD). The GBP are voluntary process guidelines that recommend transparency and disclosure to promote integrity in the development of this fast growing market by clarifying the approach for issuance of a green bond. By extension the GBP also refer to the community of supporting market participants and stakeholders. ICMA runs the Secretariat of the GBP.

Green bonds (GBs) raise funds for new and existing projects which deliver environmental benefits. The GB market grew substantially during 2014 with an estimated $36.6 billion of new GB issuance from borrowers including international and national development banks, as well as municipal and corporate issues. The market is expected to grow substantially in 2015.

The GBP AGM was followed by the first annual GBP conference also held at the EBRD and open to all GBP stakeholders and the press. The key focus of both events was the 2015 update of the GBP. The update was published by the Executive Committee of the Green Bond Principles (GBP), a representative group of issuers, investors and intermediaries in the GB market, with the support of ICMA. This publication follows a wide consultation of the members and observers of the GBP – a community of more than a 130 institutions transacting or otherwise active in the GB market.

Amongst other refinements of the GBP, a comprehensive high-level definition of GBs has been included and the refinancing of green projects has been addressed. The recognized broad categories of eligible projects have been updated, and have also been complemented by four overarching areas of concern which are climate change, natural resources depletion, biodiversity conservation and/or pollution. A particular effort has also been made to elaborate on assurance that issuers may be expected to obtain to confirm their alignment with the key features of their GBs. The GBP are also complemented by online resources covering, amongst others, third party work on impact reporting.

Both the GBP AGM and conference were very well attended and received positive feedback from participants. In addition to a review and discussion of the GBP 2015 update, the AGM included an information session and discussion of the GBP governance and proposed changes. The subsequent conference featured panels on market approaches to evaluating the environmental sustainability of "green" projects and the outlook for the GB market; as well as keynote speeches by András Simor, Vice President and Chief Financial Officer, EBRD; by Rachel Kyte, Group Vice President and Special Envoy for Climate Change, World Bank; and by Matthew Arndt, Head of Environment, Climate and Social Policy, European Investment Bank.

András Simor described the EBRD as the only multilateral development bank to have an explicit mandate in its founding agreement "to promote in the full range of its activities environmentally sound and sustainable development." He also expressed the view that the GB market should remain very inclusive and that it is "critical to ensure that a diverse group of issuers can access the market".

Rachel Kyte emphasised the forthcoming climate summit in Paris in December 2015, underlined the role that the GB market could play to finance the energy transition in the developing world as part of the wider need to increase north-south climate finance flows. She also called on the GB market to develop in new areas such as "greater use of asset-backed bonds, greater support for new and local markets, using local currencies, and investing in resilient infrastructure".

Matthew Arndt presented the EIB's new Climate Awareness Bond newsletter which includes impact reporting on the green projects financed by its bonds featuring detailed project-level figures on the expected environmental effects of the loans, for example on Greenhouse Gas emissions. This reporting is based on the work of the informal Working Group on Green Bond Impact Reporting of the AfDB, EIB, IBRD and IFC.

The follow-up from the GBP AGM and conference will be to, among others, formally consult members on the proposed update of the GBP governance, promote awareness of related developments in areas such as impact reporting, as well as consider calls to expand bridges to the wider universe of Environmental, Social and Governance finance.

Contact: Nicholas Pfaff and Valérie Guillaumin
nicholas.pfaff@icmagroup.org
valerie.guillaumin@icmagroup.org

"
A comprehensive high-level definition of GBs has been included.

Securitisation and the buy side

Securitisation continues to be viewed by authorities across the world as a key funding tool for the real economy. The new EU Financial Services Commissioner, Lord Hill, has listed securitisation as one of the areas for the new College of Commissioners to focus on in its work on creating a Capital Markets Union (CMU). A securitisation consultation (*An EU Framework for Simple, Transparent and Standardised Securitisation*) was issued in parallel to the Green Paper on CMU.

The European Commission's consultation asks for views on criteria to identify simple, transparent and standardised securitisations and on how to treat such securitisations prudentially. The Commission's consultation follows previous consultations on securitisation from various international regulatory bodies, including:

- a joint Bank of England and ECB Discussion Paper on *The Case for a Better Functioning Securitisation Market in the European Union* launched in May 2014;
- an EBA Discussion Paper in October 2014 on criteria to identify *Standard, Simple and Transparent* (SST) securitisation; and
- a BCBS and IOSCO Consultative Document on *Criteria for Identifying Simple, Transparent and Comparable Securitisations* (STC) issued in December 2014.

The AMIC Securitisation Working Group has previously worked closely with the Investment Association (IA) and AFME to coordinate the industry's positioning and will continue to do so with the current Commission consultation. Key issues in the current consultation include:

- the EU risk retention rule, including moving enforcement of risk retention from investors to originators;
- the rights of investors in synthetic structures; and
- the responsibility for enforcing compliance with any "qualifying" securitisation criteria.

The deadline for responses is 13 May 2015.

Contact: Patrik Karlsson
patrik.karlsson@icmagroup.org

Market Infrastructure

by David Hiscock

ECB: Contact Group on Euro Securities Infrastructures (COGESI)

The agenda, summary and supporting presentations (Review of latest developments related to FMIs; CSDR – mandatory buy-ins; Developments in collateral management services; and Collateral availability and usability) from the meeting of COGESI, held in Frankfurt, on 26 November 2014, were published. Also, in January 2015, at the request of COGESI, the ECSDA published an overview of the various links between CSDs – which came along with a comprehensive map of CSD cut-off times and characteristics. Furthermore, the 2013 COGESI report on collateral eligibility compiled a comprehensive set of tables comparing collateral policy frameworks. COGESI having committed to regularly update these tables, so as to provide an up-to-date reference point for the comparison of the various frameworks, published revised versions showing the status as at 1 January 2015. The next regular semi-annual meeting then took place on 23 March 2015, in Frankfurt, with further reviews of developments and discussions about how to enhance repo and collateral markets.

ECB: Money Market Contact Group (MMCG)

On 26 February 2015, the *MMCG's Work Programme for 2015* was published. A regular quarterly meeting of the MMCG was held in Frankfurt on 18 March 2015. The agenda included: (i) presentation of the main results of the quarterly MMCG euro money market survey and update on the MMSR; (ii) recent ECB decisions and announcements with regard to the monetary policy implementation; (iii) review of the latest market developments and other topics of relevance; (iv) update on the STEP market developments; and (v) update on regulatory developments for MMFs.

ECB: Bond Market Contact Group (BMCG)

The BMCG's ninth meeting took place in Frankfurt on 27 January 2015. Alongside the summary of discussions seven presentations from the meeting are available: "Item 1 – Bond market outlook"; "Item 2.1 – Analysis of October 2014 risk-off episode from a HF perspective"; Item 2.2 – Events of October 2014 from a dealer perspective"; "Item 3.1 – Impact of ABSPP and CBPP3 and potential LSAPs"; "Item 3.2 - Impact of ABSPP and CBPP3 January 2015 from an investor perspective"; and "Item 4 – Best practice framework for euro area government bond markets". Subsequently, on 4 February 2015, the BMCG's *work Programme for 2015* was published; and, on 16 March 2015, the BMCG held an *ad hoc* teleconference, to share views on the early days of the Eurosystem's public sector purchase programme (PSPP) and its market impact. The next regular quarterly BMCG meeting is scheduled for 21 April 2015. This will include discussions of global portfolio flows and their impact on European bond markets; and of liquidity in the bond (and credit) markets; and a presentation of the EFC Sub-Committee on EU Sovereign Debt Markets.

ECB: TARGET2-Securities (T2S)

The Governing Council of the ECB formally renewed the mandate of the T2S Board members for another two years, starting in February 2015. Marc Bayle, Director General Market Infrastructure and Payments at the ECB, was appointed Chairman, with Pierre Beck, Executive Director at Banque centrale du Luxembourg, as Deputy Chairman, and eight other members from Eurosystem central banks. The Governing Council also renewed the mandate of Kristian Kjeldsen, Head of the Payment Systems Department at Danmarks Nationalbank (the Danish central bank signed the T2S Currency Participation Agreement and will make the Danish krone available in T2S in 2018). Finally, two non-central bank members, Paul Bodart (former Executive Vice President and Head of EMEA Operations, Bank of New York Mellon) and Joël Mérère (former member of Euroclear SA/NV Management Committee), were appointed.

On 5 January 2015, it was announced that the T2S user testing had moved one step further. Synchronisation Point 9.1 was achieved and the CSDs and NCBs of wave 1 started multilateral interoperability testing activities. Since 1 October 2014, they have been involved in bilateral interoperability testing, where each CSD tests the T2S software in isolation from the other CSDs and NCBs. In the current phase of multilateral interoperability testing each CSD can test settlement processes in interaction with the other participating CSDs and NCBs of the first migration wave.

On 16 January, an important T2S software release was delivered, on time and as planned, to CSDs and NCBs for user testing. With this release, the full set of T2S functionalities foreseen for the go-live date is now available. Testing of this release by the Eurosystem saw a 93% success rate for the whole T2S platform and work continues on fixing the bugs detected before T2S goes live on 22 June 2015. Those CSDs in the first wave are Bank of Greece Securities Settlement System (BOGS); Depozitarul Central (Romania); Malta Stock Exchange; Monte Titoli (Italy); and SIX SIS (Switzerland).

Together with the CSDs and NCBs participating in T2S, the Eurosystem started community testing on 2 March 2015 – another important milestone of the T2S Programme. The activities began with the uploading of the initial cash balances and securities positions, whereupon the communities (ie the directly and indirectly connected parties) of the wave 1 CSDs and central banks were then able to start testing their interaction with T2S.

On 18 February, three new technical/functional documents were published. These are: (i) T2S User Requirements Document, Version 5.04; (ii) Business Functionality for T2S Graphical User Interface, Version 2.0; and (iii) Business Process Description (BPD). Dated January 2015, *Insights on the Usage of Minimum Settlement Unit, Settlement Unit Multiple and Deviating Settlement Units* and *Insights on Matching Fields from a Message Perspective* were added to the T2S knowledge based repository. Subsequently, dated February 2015, *List of T2S Privileges and Third Party Receipt Privilege* was added.

Euroclear France will host the next T2S Info Session in Paris on 16 April 2015, with the key theme being post-trade harmonisation and the findings of the Fifth Harmonisation Progress Report. In addition, the ECB and 4CB will update participants on the project status, while Euroclear France will present its T2S service offer.

In June 2013, the T2S Advisory Group (AG) mandated the T2S Harmonisation Steering Group (HSG) to create a Task Force, which reports to the HSG, to analyse the issue of settlement discipline regime in the T2S markets in the context of the expected CSDR level II legislation and the related work of ESMA/ESCB. The Task Force is composed of members from all segments of the T2S Community as nominated by T2S AG members and approved by the HSG. The objective of the Task Force is to provide the HSG with a T2S Community proposal for contributing to the ESMA/ESCB work on the CSDR level II RTS on settlement discipline. In April 2014 the HSG agreed to broaden the objective of the Task Force to work on providing a T2S Community proposal also on other CSDR level II RTS and ITS. Not having done so since April 2014, the Task Force met on 12-13 January 2015 and 26-27 January 2015.

The Cross-Border Market Practices Sub-Group (XMAP), which was set-up by the HSG in May 2013, is mandated to analyse known or potential issues with respect to the impact of existing and diverging market practices and rules on cross-border settlement efficiency in T2S and to propose T2S market best practices to the HSG regarding these topics. XMAP met on 4-5 February 2015, with the agenda and summary of the meeting being published; and again on 25-26 March.

The HSG itself met on 24-25 February 2015. Following the Chairman's introduction and updates from members, the ECB team presented a proposal for the HSG action plan in 2015; an updated impact analysis on non-compliance; a first draft of the fifth T2S harmonisation progress report; a note on the impact of the LEI on T2S; and updated the HSG on the CSG task force on insolvency procedures. The chairman of the Corporate Actions Sub-group (CASG) presented the results of the 2015 gap analysis, which will feed into the fifth harmonisation progress report; and the XMAP chairman presented three deliverables. In addition, there were discussions on Portuguese market non-compliance with omnibus account restriction; why the Tax Barriers Business Advisory Group (T-BAG) recommendations are particularly important for a level playing field in T2S; and the ongoing work of the European Working Group on Portfolio Transfers.

The Directly Connected Parties Group (DCPG) – composed of representatives of directly connected parties (DCPs), CSDs, central banks and the T2S Programme Office – met on 26 February 2015, with the agenda and summary of the meeting being published; and again on 23 March. The DCPG is also maintaining a register of its open issues.

The AG, which provides advice to the Eurosystem on T2S-related issues, met on 23-24 March 2015. The agenda for this meeting included review of the T2S Harmonisation work stream; T2S Programme Status; reporting and debriefing – regarding meetings of governance bodies, including the T2S Board, the CSD Steering Group (CSG), the Change Review Group (CRG) and the Operations Managers Group (OMG); and a summary of the meeting has been published. The AG will next meet, on 2 July 2015, in Milan.

Global Legal Entity Identifier System (GLEIS)

On 26 January 2015, the Global Legal Entity Identifier Foundation (GLEIF) announced the release of its website. The GLEIF website is an important milestone in the establishment of the LEI as a key component for a global entity identification management. The GLEIF was established by the FSB in Basel, Switzerland and is overseen by the LEI Regulatory Oversight Committee (ROC). The GLEIF website (i) contains a wealth of information about the

GLEIS including details about the GLEIF, its mission, vision and governance, and its people; (ii) provides details about the LEI and how entities can obtain an LEI from the many GLEIF partners around the globe; (iii) provides important information about the benefits provided by the GLEIS; and (iv) provides stakeholders with the means to communicate with the GLEIF and to update the public on their latest developments. Looking forward to 2015, the website will provide market participants with access in the languages of the G20 countries to the authoritative database of all LEIs issued globally and the associated reference data. The launch of the GLEIF website is welcomed by the ROC in its 2014 *Year End Progress Note*.

The website will provide access in the languages of the G20 countries to the authoritative database of all LEIs issued globally and the associated reference data.

On 29 January 2015, the LEI ROC Committee on Evaluation and Standards published an open document intended as guidance to pre-LOUs in complying with the ROC Principles for the Interim GLEIS, published on 24 August 2014. Adding to earlier cases, ROC notes of 28 January 2015, and 5 March 2015 announced the endorsement of further pre-LOUs in accordance with the process described in Annex 1 of the Principles. There is a list of the ROC endorsed GLEIS pre-LOUs (operational) and also a broader list of four digit prefixes allocated to sponsored pre-LOUs.

BIS: Committee on Payments and Market Infrastructures (CPMI)

On 26 February 2015, the CPMI and IOSCO published three reports on progress towards the implementation of the Principles for Financial Market Infrastructures (PFMI). The reports focus on the implementation of the Principles (as contained in the PFMI) for CCPs and TRs in the EU, Japan and the US. The three reports are based on peer reviews of whether, and to what degree, the content of the jurisdiction's legal and regulatory or oversight framework is complete and consistent with the PFMI (in each case reflecting the status as at 18 April 2014). Overall, the reports demonstrate that the three jurisdictions have made good progress in implementing the Principles – this is especially evident for CCPs, but progress for TRs has been more varied. Where appropriate, the reports highlight gaps and make recommendations for addressing them. Further assessments covering other jurisdictions and FMI types are scheduled for 2015-2016.

Also on 26 February 2015, the CPMI and IOSCO published *Public Quantitative Disclosure Standards for CCPs*. To help ensure that the risks of using CCPs are properly understood, CCPs need to make relevant information publicly available, as stated in the CPSS-IOSCO PFMI, published in April 2012. The CPSS and IOSCO published a Disclosure framework in December 2012 to improve the overall transparency of financial market infrastructures. That framework primarily covers qualitative data that need relatively infrequent updating (for example, when there is a change to a CCP's risk management framework). To complement that disclosure framework, this latest document sets out the quantitative data that a CCP should disclose more frequently. This final report has been revised in light of the comments received on the consultation version of the report, published in October 2013.

BIS: Irving Fisher Committee on Central Bank Statistics

To support better policy making, ensuring and improving data-sharing between statistical and supervisory authorities has become more important in recent years; and there is a need to create a new culture of data-sharing and cooperation, which may not be easy to initiate. The January 2015 report *Data-sharing: Issues and Good Practices* describes some data and cooperation business models that have been implemented in a number of countries – these could be used as benchmarks, although starting points in data-sharing and cooperation differ and tailor-made solutions will have to be found in each country. The report outlines a range of good practices and practical guidance, which are intended to serve all countries and organisations that wish to improve data-sharing and cooperation irrespective of the existing arrangements. Given the number of possible stakeholders in data-sharing, the report illustrates the clear synergies to be gained from centralising data collection in the central bank statistical function.

Contact: David Hiscock
david.hiscock@icmagroup.org

Macroprudential Risk

by David Hiscock

On 5 January 2015, the ESRB published its Risk Dashboard, Issue 10. The overview note for Issue 10 notes points in relation to interconnectedness and systemic risk indicators; the macroeconomic outlook; debt levels; credit supply; financial conditions; banks; and real estate. Concerning financial conditions, it is reported that:

- overall, financial market conditions remain buoyant – money market spreads and financial market liquidity indicators have been stable at low levels over 2014; and, as indicated by the global risk aversion indicator, risk sentiment has since 2012 remained in line with pre-crisis levels;
- however, volatility has increased significantly in some market segments – uncertainty regarding euro-area interest rates has recently increased again, with, in particular, implied volatility of euro-area short-term interest rates having reached historically high levels (surpassing levels observed in 2012-2013); and, in addition, the volatility of the euro exchange rate with other major currencies has risen significantly from its historical low in mid-2014.

Shedding Light on Shadow Banking is an IMF staff working paper, published on 5 January 2015. In this paper an alternative approach to estimate the size of the shadow banking system is developed, using official data reported to the IMF complemented by other data sources. This alternative approach is based on the expansion of the noncore liabilities concept developed in recent literature to encompass all noncore liabilities of both bank and nonbank financial institutions. As opposed to existing measures of shadow banking, these newly developed measures capture non-traditional funding raised by traditional banks. The new approach is applied to 26 jurisdictions and results are analysed over a twelve-year span. It is found that noncore liabilities are procyclical and display more volatility than core liabilities for most jurisdictions in the sample. This approach can be replicated over time using internationally-comparable data and thus may serve as an operational tool for IMF surveillance and policy analysis.

On 6 January 2015, the ESRB published a letter from the ESRB Chair to Jonathan Faull, Director General of FISMA at the European Commission, on the possible use of Article 459 of the CRR (which allows for action to address macroprudential risks at EU level, complementary to Member State level actions). This letter reports that the ESRB have not yet seen circumstances where the Commission would wish to invoke this power. It notes that the main risks discussed by the ESRB over the past year have included weak macroeconomic activity; an abrupt reversal in the search for yield, amplified by pockets of illiquidity; and sovereign debt sustainability. These risks are being addressed by actions being taken at member state and EU level.

The letter goes on to state that the need to use Article 459, CRR might in theory be prompted by: (i) systemic fragilities in financial markets; and (ii) indirect contagion in its various forms (eg through asset price correlations, fire-sales, or the information channel). Article 459, CRR could be used to enhance systemic stability by requiring credit institutions or investment firms to improve – albeit temporarily – public disclosures on exposures, indicators or practices of systemic relevance. This would ensure a coordinated effort to strengthen transparency across the EU; and acting at the EU-wide level would in this case reduce the risk of an inaction bias, avoiding the "first-mover" problem.

On 15 January, the EBA published its impact assessment report for liquidity coverage requirements. Overall, this analysis points to improvements of EU banks' compliance with LCR requirements and shows that the implementation of the LCR is not likely to have a negative impact on the stability of financial markets and of the supply of bank lending. The report is based on liquidity data provided by 322 European banks, covering about 2/3 of total banking assets in the EU, and it will inform EU policies aimed at strengthening the resilience of EU banks.

On 7 February, the BIS released an updated set of indicators of global liquidity, which are intended as measures of the ease of financing in global financial markets. Alongside the global liquidity indicators, the BIS also published a preliminary analysis of the oil-debt nexus, exploring recent developments in oil markets. The latest BIS global liquidity indicators, which cover data through September 2014, highlight developments which include:

- As banking systems recover, and with risk appetites remaining strong, bank lending has strengthened as a channel for global liquidity, alongside persistently high volumes of global bond market issuance.
- At end-September 2014, credit in US dollars to non-bank borrowers outside the US totalled $9.2 trillion ($4.2 trillion of debt securities and $4.9 trillion of bank loans), an increase of 9.2% over a year earlier, and of over 50% since end-2009.
- Long-term debt issuance continues to be supported by extraordinarily low long-term yields, which for some sovereigns are now negative for a significant portion of the yield curve.

Asset Bubbles: Re-thinking Policy for the Age of Asset Management is an IMF staff working paper, published on 11 February. This paper offers reflections on why asset bubbles continue to threaten economic stability despite financial markets becoming more informationally-efficient, more complete, and more heavily influenced by sophisticated (ie presumably rational) institutional investors. Candidate explanations for bubble persistence — such as limits to learning, frictional limits to arbitrage, and behavioral errors — seem unsatisfactory as they are inconsistent with the aforementioned trends impacting global capital markets. The author argues that the business risk of asset managers acts as strong motivation for institutional

"Long-term debt issuance continues to be supported by extraordinarily low long-term yields, which for some sovereigns are now negative

herding and "rational bubble-riding". Two key policy implications follow: (i) procyclicality could intensify as institutional assets under management continue to grow; and (ii) remedial policies should extend beyond the standard suite of macroprudential and monetary measures to include time-invariant policies targeted at the cause (not just symptom) of the problem. Prominent among these should be reforms addressing principal-agent contract design and the implementation of financial benchmarks.

In his 24 February speech, *Financial Reform and the Role of Regulators: Evolving Markets, Evolving Risks, Evolving Regulation*, Jaime Caruana, General Manager of the BIS, starts by noting the need to (i) recognise increasing complexity and to adopt a wide perspective in managing risks; and (ii) take on board the evolving nature of markets and risks. Keeping these two points in mind he then turns to his main topic, What is the role of regulators?, expressing the view that they have three main roles: (i) to complete the regulatory agenda; (ii) to implement regulations consistently and analyse the effects of implementation; and (iii) to monitor and adapt to the transformation of risks. Whilst elaborating on the latter of these, he highlights three risks that have taken on greater salience in the environment of financial intermediation through bond markets: market liquidity; leverage-like behaviour; and dependence on central banks.

On 10 March, the ESRB published a *Report on the Regulatory Treatment of Sovereign Exposures*, which the ESRB believes needs to be re-examined at a global level. These exposures have been seen by many as a source of fragility in the recent and prolonged episodes of financial stress, while others have seen them as a factor of crisis mitigation. The report describes the regulatory treatment of sovereign exposures in the EU, analyses the incentives that it may create, provides data measuring those exposures and offers analytical explanations of recent developments. It argues that, from a macroprudential point of view, the current regulatory framework may have led to excessive investment by financial institutions in government debt; whilst recognising the difficulty in reforming the existing framework without generating potential instability in sovereign debt markets. It examines a set of possible options which may be considered, both in banking and insurance, and offers a detailed discussion of the pros and cons.

On 11 March, ESMA published its Report No. 1, 2015 on *Trends, Risks and Vulnerabilities in EU Securities Markets*, covering market developments from July to December 2014. The report finds that market conditions in the EU have remained tense, with high asset valuations, stable asset prices over time but with rising short-term price volatility across key markets. There were strong price movements in FX and commodity markets; and overall capital-market issuance for corporate funding continued to increase. Sources of market uncertainty included the low-interest-rate environment, public debt policies in EU Member States, strong swings in FX rates and commodity markets, and political and geopolitical risks in the EU's vicinity – all of which resulted in increased levels of liquidity and market risk, whilst contagion and credit risk remained at high levels. ESMA also monitors market developments which may present future vulnerabilities; and its report for the last half of 2014 identified the following potential issues: Fund investments in loan participation and loan origination – nascent market, big risks?; Alternative indices – smart beta strategies and what they mean for investors; and Monitoring systemic risk in the hedge-fund industry.

Shifting Tides – Market Liquidity and Market-Making in Fixed Income Instruments, was published on 18 March as part of the latest BIS Quarterly Review. Drawing from a recent report by the CGFS, the authors identify signs of increased fragility and divergence of liquidity conditions across different fixed income markets. Market-making is concentrating in the most liquid securities and deteriorating in the less liquid ones. The shift reflects cyclical (eg changes in risk appetite) as well as structural (eg tighter risk management or regulation) forces affecting both the supply of and demand for market-making services. Although it is difficult to definitively assess the market implications, the authors outline several possible initiatives that could help buttress market liquidity.

The Use and Effectiveness of Macroprudential Policies: New Evidence is an IMF staff working paper, published on 17 March. Using a recent IMF survey and expanding on previous studies, the authors document the use of macroprudential policies for 119 countries over the 2000-13 period, covering many instruments. Emerging economies use macroprudential policies most frequently, especially foreign exchange related ones, while advanced countries use borrower-based policies more. Usage is generally associated with lower growth in credit, notably in household credit. Effects are less in financially more developed and open economies, however, and usage comes with greater cross-border borrowing, suggesting some avoidance. And while macroprudential policies can help manage financial cycles, they work less well in busts.

The General Board of the ESRB held its 17th regular meeting on 19 March, exchanging views on risks and vulnerabilities in the financial system. The EU economy remains fragile despite emerging signs of economic recovery; and the low interest rate environment, lower oil prices and the depreciation of the euro should support further improvement in economic conditions. Nevertheless, potential negative side effects on financial stability have to be closely monitored. The General Board then had a first yearly discussion on the macroprudential policy stance in the EU in 2014, this being the first year after the introduction of macroprudential instruments in the EU through the CRD/CRR. In 2014, several measures were taken by Member States, aiming mostly at the prevention and mitigation of excessive credit growth and leverage in specific areas – the ESRB is regularly publishing on its web site the measures notified by EU Member States (around 90 in 2014, of which around half reflect an active policy stance, while the rest is of more administrative nature). The ESRB will start further work on the conceptual framework to assess the macroprudential policy stance in the EU.

Next the General Board discussed the potential use of the leverage ratio for macroprudential purposes, agreeing to publish a new provisional Chapter on the topic in the ESRB Handbook on macroprudential instruments – this Chapter complements ongoing work at the EBA and BCBS on minimum leverage ratio requirements and will be reviewed in 2017, once the BCBS has published the final definition and calibration of the microprudential leverage ratio. The ESRB aims to publish this Chapter in April 2015 with the objective of providing guidance on the design of macroprudential leverage ratios to macroprudential authorities in the EU and enhancing coherence and coordination in approach. The General Board also appointed 12 new members of the Advisory Scientific Committee of the ESRB, for a term of 4 years. Following on from this meeting, on 26 March, the ESRB published the 11th issue of its Risk Dashboard.

On 23 March, Mario Draghi, in his capacity as Chair of the ESRB, spoke at a hearing before ECON. He opened by observing that the potential for widespread financial distress remains one of the main threats to economic recovery; and that the ESRB plays a key role in mitigating the risk of disruption to the EU financial system.

He then give an overview of the many substantial macroprudential policy measures that have been taken in the EU since the new capital rules for banks became applicable 15 months ago – noting that, since the beginning of 2014, there have been about 45 new macroprudential policy measures, including the activation of capital instruments available under the CRD and CRR, as well as other instruments available under national legislation; and that another 45 minor administrative measures have been issued. Roughly half of the 90 measures have been taken by just four Member States – Denmark, Slovakia, Sweden and the United Kingdom – whilst some Member States, including France, Germany, Italy, Poland and Spain, did not take any measures in 2014. The large majority of measures are of a tightening or "conservation" nature, with most of them (≈ 85%) aiming to address concerns related to credit growth and leverage; whilst the remaining measures tackle systemic risks arising from banking groups that are large and complex.

Next, Mario Draghi turned to a specific topic of substantial macroprudential policy interest: the regulatory treatment of sovereign exposures – in relation to which the ESRB recently published detailed findings from two years of assessment work. The report argues that current rules underestimate the possibility of sovereign default and therefore do not fully reflect the risks associated with sovereign exposures; and that such preferential treatment can lead to systemic risks arising from overinvestment in government debt, crowding-out of lending to the economy and the reinforcement of the bank-sovereign link. Possible policy options include increasing capital requirements for sovereign exposures and applying large-exposure limits, but any action needs great care and would only be implemented once the situation in sovereign bond markets has normalised, and in the framework of a review of the Basel Accord.

Mario Draghi closed by flagging that the ESRB's continued reflection on whether the macroprudential policy framework is adequate includes the extension of macroprudential policy to non-banks, which play an increasingly important role in Europe's financial system. The ESRB is progressing with work on developing macroprudential policies for financial market activities and non-bank financial entities, including shadow banks. For example, the ESRB is aware that a systemic risk of vicious liquidity spirals – whereby funding and market liquidity interact, generating contagion – still exists. To mitigate this systemic risk, macroprudential authorities could consider setting conservative minimum or time-varying margin requirements (for both OTC and CCP cleared transactions), in order to reduce the risk of a sudden increase in margin requirements.

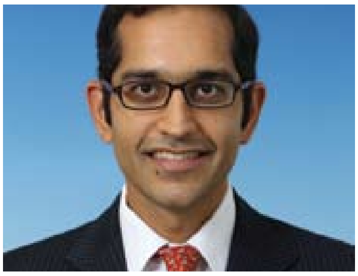
During the first quarter of 2015, three new papers were published under the auspices of the ECB's Macroprudential Research Network (MaRS):

- Published on 12 February 2015, *Leading Indicators of Systemic Banking Crises: Finland in a Panel of EU Countries* investigates leading indicators of systemic banking crises in a panel of 11 EU countries, with a particular focus on Finland; and using quarterly data from 1Q 1980 to 2Q 2003, in order to create a large number of macro-financial indicators, as well as their various transformations.

- Published on 23 March 2015, *Macroprudential Oversight, Risk Communication and Visualization* discusses the role of risk communication in macroprudential oversight and of visualization in risk communication. Beyond the soar in data availability and precision, the transition from firm-centric to system-wide supervision imposes vast data needs. The authors conclude that two essential, yet rare, features for supporting the analysis of big data and communication of risks are analytical visualizations and interactive interfaces.

- Published on 24 March 2015, *Ending Over-Lending: Assessing Systemic Risk with Debt to Cash Flow* introduces the ratio of debt to cash flow (D/CF) of nations and their economic sectors to macroprudential analysis, particularly as an indicator of systemic risk and vulnerabilities. For a panel of 33 nations, the authors explore historic D/CF trends, and apply the same procedure to economic sectors. In terms of an early-warning indicator, they show that the D/CF ratio provides a useful additional measure of vulnerability to systemic banking and sovereign crises, relative to more conventional indicators.

Contact: David Hiscock
david.hiscock@icmagroup.org



ICMA in Asia-Pacific

by Mushtaq Kapasi

Asian Primary Market Committees

ICMA has established two Committees focused on the Asian debt primary markets. The Asia Bond Syndicate Forum brings together leading global and regional underwriters in the cross-border markets. The subjects covered have included investor meetings, order book transparency, pricing iterations, allocations, stabilisation, retail distribution, and the dynamics and risks of a growing market. Complementing the syndicate forum, ICMA's more recent gathering of Asia legal and transaction managers puts a greater emphasis on regulation, compliance, contracts and disclosure. Discussions have echoed to some extent many of the topics arising in the ICMA Primary Market Practices Committee and the ICMA Legal and Documentation Committee, but have also shed a light on some areas where Asian perspectives and dynamics differ.

First ICMA Asia Primary Market Forum

In March 2015, ICMA held its inaugural Asia Primary Market Forum in Hong Kong, which brought together delegates from syndicate desks, legal and operations teams, infrastructure providers, law firms, and regulators across the region. Michael Duignan, Senior Director, Corporate Finance, Hong Kong Securities and Futures Commission, delivered an opening keynote address which drew upon his extensive experiences as a regulator in both Europe and Asia, and described the evolution of financial regulation and cross-border coordination in the context of market dynamics and global politics over the last two decades. James Fok, Head of Group Strategy, Hong Kong Exchanges and Clearing Limited, gave a closing presentation which highlighted the increased importance of international bond markets as a source of finance in Asia, and Hong Kong's continued focus on developing the city as a hub for exchange-traded fixed income.

The two keynotes were complemented by two panel discussions on the regional markets, one focused on bond syndicate practices, and the other focused on legal and documentation questions. Both panels offered perspectives not only from underwriting banks, but also from issuers, investors, and leading law firms. The bond syndicate panel covered topics including pricing guidance, the art and science of distribution to investors, secondary market liquidity, varying expectations of issuers from different jurisdictions, and the role and limitations of industry-led standards. The legal and documentation panel covered topics such as reducing reputational risk in an environment of increased global regulatory enforcement, enhancing due diligence and disclosure for new and infrequent issuers, managing information flows during the marketing process, and documenting relatively untested credit support structures common to Asia.

Also, the Asia Primary Market Forum included an introductory workshop on the ICMA Primary Market Handbook (PMH), which is used as a key reference for standard market practices in debt capital market transactions in the region. Overall, the ongoing revisions to the PMH are being closely watched by Asian market professionals. The PMH covers internationally syndicated primary debt capital markets offerings, generally excluding high-yield and equity-linked transactions. Although the PMH often does not apply to US dollar-denominated transactions, in Asia the distinctions among G3 issuances are more fluid, and many of the principles and standard provisions of the PMH are followed in cross-border transactions denominated not only in Euro, but also in Japanese yen and USD. In addition, many of the long-standing principles and standard clauses of the PMH have been borrowed and adapted to local Asian capital markets.

Dialogue with China

In addition to ICMA's more general initiatives in the regional markets, ICMA has had extensive dialogue with China's National Association of Financial Market Institutional Investors (NAFMII) to aid in the development of standards in the onshore interbank bond market as this market continues to grow in volume, attract new entrants, and diversify its products. In particular, as part of the UK-China Economic and Financial Dialogue, ICMA and NAFMII have established a private sector working group bringing together experts from financial institutions in London and China to share expertise on primary market practices, procedures, and related regulations.

Contact: Mushtaq Kapasi
mushtaq.kapasi@icmagroup.org

ICMA Events and Courses

Join ICMA and its members at the ICMA AGM and Conference 2015, Amsterdam, 3-5 June

Hotel Okura
Ferdinand Bolstraat 333
1072 LH Amsterdam
The Netherlands

Wednesday 3 June 2015

19:30-23:00: Welcome reception Rijksmuseum

Thursday 4 June 2015

09:30-11:30: Annual General Meeting (Open to ICMA members only)

13:05 - 13:20: Opening keynote address: Jeroen Dijsselbloem, Minister of Finance, The Netherlands

13:20 - 13:35: Keynote address: Klaas Knot, President, De Nederlandsche Bank (Central Bank of the Netherlands)

13:35 - 13:55: Keynote address: Lord Jonathan Hill, EU Commissioner, Financial Stability, Financial Services and Capital Markets Union

13:55 - 14:55: Panel: Capital Markets Union: The new Commissioner for Financial Stability, Financial Services and Capital Markets Union has been asked to focus on "bringing about a well regulated and integrated Capital Markets Union, encompassing all Member States, by 2019" . The panel will address the key questions: What is wrong with the EU that Capital Markets Union could help fix? What does Capital Markets Union mean and what form should it take? What would be a practical agenda for achieving Capital Markets Union?

Moderator: Cyrus Ardalan, Chairman of the Board, ICMA and Vice Chairman, Head of UK and EU Public Policy and Government Relations, Barclays Bank plc

Panellists: William Connelly, Chief Executive Officer, ING Commercial Banking, Bertrand de Mazières, Director General, Finance, European Investment Bank, Daniel Trinder, Managing Director, Global Head of Regulatory Policy, Deutsche Bank, Cora van Nieuwenhuizen, MEP, the Alliance of Liberals and Democrats for Europe

14:55 - 15:25: Coffee Break

15:25 - 15:40: Keynote address: Dick Sluimers, Chief Executive Officer, APG

15:40 - 16:30: Panel: Capital markets and growth - the buy-side perspective
The recent emphasis on rebalancing the funding of the European economy by moving to market based finances is presented as an opportunity for the non-bank sector. Are buy-side asset managers and investors, ready to replace traditional bank funding? What barriers do they face in taking this step? How can regulators and policy makers assist the transition?

Moderator: Robert Parker, Chairman, ICMA Asset Management and Investors Council and Senior Advisor – Investment, Strategy and Research, Credit Suisse

Panellists: Simona Paravani-Mellinghoff, Managing Director, Head of Client Solutions, Delegated CIO/Fiduciary, Blackrock, Hans Stoter, Chief Investment Officer, NN Investment Partners, Andreas Utermann, Global Chief Investment Officer, Allianz Global Investors GmbH

16:30 - 16:45: Keynote address: Michael Spencer, Group Chief Executive Officer, ICAP plc

16:45 - 16:50: Closing remarks: Martin Scheck, Chief Executive, ICMA

16:50: Close of Conference

20:00 - 01:00: Gala reception: OceanDiva Original

Friday 5 June 2015

08:00: Exhibition opens

09:00 - 09:05: Opening remarks: Martin Scheck, Chief Executive, ICMA

09:05 - 09:45: Developments in China's onshore RMB market: Introductory remarks: Spencer Lake, Group General Manager and Global Head of Capital Financing, HSBC Bank plc

Keynote address: Zhen Xu, Chairman, Shanghai Clearing House

09:45 - 10:05: Panel: Green bonds in the context of Socially Responsible Investment: Growth of the green bond market, the evolution of the Green Bond Principles and what does the future hold for SRI finance?

Speakers: Christopher Flensborg, Head of Sustainable Products and Product Development, Skandinaviska Enskilda Banken (SEB), Suzanne Buchta, Managing Director – Debt Capital Markets, Bank of America Merrill Lynch

10:05 – 10:35: Coffee break

10:35 – 10:50: Keynote address: Steven Maijoor, Chairman, European Securities and Markets Authority

10:50 – 11:40: Panel: Developments in primary and secondary bond markets: How have bond markets fared in a year that has seen extended QE in the euro zone, declining liquidity in secondary markets, more change to the regulatory landscape and continuing geopolitical instability? Will we see more of the same in the next 12 months? What are the key factors shaping the bond markets of the future?

Moderator: Martin Egan, Chairman, ICMA Primary Market Practices Committee and Global Head of Primary Markets, BNP Paribas

Panellists: Michael Gower, Treasurer, Rabobank Group

Anne Leclercq, Director Treasury & Capital Markets, Belgian Debt Agency, Rutger Schellens, Global Head Capital Market Solutions, ABN AMRO, Roman Schmidt, Divisional Board Member & Global Head of Corporate Finance, Commerzbank AG, Kitty Yoh, Deputy Treasurer, Long Term Funding, GE Capital

11:40 - 12:30: Panel: Secured financing – why it is important?: The expert panel will consider the role that secured financing plays in the global financial system, with particular emphasis on the increasing use of collateral to underpin regulatory change, for example in clearing for OTC derivatives and implementation of central bank policy (QE). Will the cumulative effects of regulatory initiatives (MiFID II, CSDR Mandatory buy-ins, FSB proposals for haircuts) intended to reform the collateral market actually cause the supply of collateral to dry up? Are we already in danger of throwing out the baby with the bathwater? Or is there still time to nurture the market with well-thought out regulatory measures?

Moderator: Godfried De Vidts, Chairman, ICMA European Repo Council and Director of European Affairs, ICAP Securities Limited

Panellists: Richard Hochreutiner, Head Global Collateral and Director, Group Treasury, Swiss Re, Michael Manna, Head of Fixed Income Financing Trading, EMEA, Barclays, Michel Semaan, Managing Director, Nomura and Member of the ICMA European Repo Committee, Lewis Webber, Deputy Head, Capital Markets Division, Financial Stability Strategy & Risk, Bank of England

12:30 – 12:45: Keynote address: Wim Boonstra, Chief Economist, Rabobank

12:45 – 12:55: Closing remarks: Martin Scheck, Chief Executive, ICMA

12:55: Lunch

14:00: Close of event

The ICMA Conference is open to all interested financial market participants.

ICMA members are entitled to a number of free delegate passes

Check icmagroup.org for more details and to register.

ICMA Future Leaders

Following the successful launch of the ICMA Women's Network ICMA has set up a Future Leaders Committee, comprised of individuals aged under 35 from member firms, to help ICMA to reach out to the younger generation among its membership. The emphasis is on encouraging individuals building their careers in the industry to access the global network of capital market contacts that ICMA can offer. Events and initiatives will be planned to encourage the same sense of ICMA community enjoyed by ICMA members at a more senior level.

Contact: FutureLeaders@icmagroup.org

ICMA Womens' Network

IWN Workshop: Practical tips for networking with Miranda Brawn, London, 21 April

Join the ICMA Women's Network for a unique opportunity to tap into one of the City's leading achievers and learn how to optimise networking skills for your career advancement. Miranda Brawn, barrister and investment banker, will share her experiences and to give guidance and encouragement on how networking can work for you in a capital market context.

This event is open to ICMA members only.

Register

@ICMAWomensNet **Join us on Linked In**

Contact: icmawomensnetwork.org

diary

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

29 APR

ICMA Asset Management and Investors Council (AMIC) Meeting & Seminar, Amsterdam, 29 April

The AMIC represents a broad range of international investors drawn from all sectors of the industry, including institutional asset managers, private banks, hedge funds, pension funds, insurance companies and sovereign wealth funds. The AMIC Council meeting is a half day conference, open to all private banks and international asset managers. Topics for discussion at the April meeting in Amsterdam, include: the EU pensions landscape; Capital markets union and long term investing; and Threats to the asset management industry.

Register

29 APR

ICMA & Clifford Chance seminar: an in-depth review of the Global Master Repurchase Agreement (GMRA), Singapore, 29 April

This seminar will provide attendees with an in-depth review of the fundamental provisions of the GMRA 2000, the key differences with the GMRA 2011 version with a paragraph by paragraph analysis, the GMRA 2011 Protocol and recent case law relating to GMRA and repo documentation. It is targeted at those with up to five years experience at financial institutions, investment banks, asset managers, hedge funds, corporations and regulators from the legal or documentation teams, treasury, risk management, middle and back office or collateral management.

Register

6-7 MAY

The ICMA CBIC & The Covered Bond Report Conference, Frankfurt, 6-7 May

The agenda for the one day conference will be drawn up by key members of the ICMA Covered Bond Investor Council (CBIC) and The Covered Bond Report, and it will explore those issues that are at the top of the investor base's agenda. Panel discussions will include improved transparency in the market as well as looking at new structures, and recent regulatory developments. The winners of *The Covered Bond Report Awards for Excellence* will be announced on the eve of the event, at the pre-conference reception.

Register

18 MAY

ICMA European Repo Council Annual General Meeting, Brussels, 18 May

The ERC Annual General Meeting is a good opportunity to hear about the various issues, including recent regulatory and legal developments, that are facing the market and the steps being taken to develop and grow the market, alongside the formal business of the AGM (including annual elections for the ERC Committee). This event will be hosted by Euroclear and is open to all in the European Repo Market.

Register

17 JUN

European Regulation: An Introduction for Capital Market Practitioners, London, 17 June

Against a background of far-reaching regulatory change ICMA's one-day, fast-track workshop on European regulation for capital market practitioners gives a overview of the new regulatory landscape for financial institutions in Europe. It puts the major European regulatory initiatives into the context of the global reforms agreed by the G20 and explains the European legislative process, while taking a look at specific regulations affecting the capital framework of banks, investor protection and disclosure.

Register

01 JUL

Global Master Agreements for Repo & Securities Lending, Madrid, 29 June-1 July

The Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA) are the essential legal underpinnings for repo and securities lending markets respectively. The workshop offers a detailed review and comparison of both legal agreements and their application, including coverage of the GMRA 2011, together with case studies, building on a rigorous introduction into the operational and basic legal characteristics of the repo and securities lending markets, and insights into key features of the market such as triparty repo and the use of CCP, as well as accounting and tax treatment. Hosted by Ashurst.

Register

ICMA Executive Education

Global standard qualification for the fixed income market revised and re-launched

ICMA Executive Education has completely revised its long established premium qualification for the fixed income market and re-launched it as the ICMA EE Fixed Income Certificate. The certificate, which has been the gold standard for finance professionals for almost 40 years, retains its emphasis on developing practical skills for trading, investment and risk management, while introducing a new syllabus that reflects the realities of today's fixed income markets.

The course is organised around three essential topic areas:

- Trading the Yield Curve with Cash Market Securities
- Interest Rate Derivatives
- Credit Trading

Each section has been expanded to include new material reflecting the evolution of products and market regulation, including:

- Changes in market practice for LIBOR fixings (following the Wheatley review) and the calculation and application of option-adjusted spreads (OAS).
- Expanded section on inflation indexed bonds
- A new sub-section on sovereign credit risk
- The impact of roll yield on the performance of futures hedges and strategies.
- The construction and analysis of conditional steepening and flattening trades using swaptions, use of interest rate caps and floors and swaptions to trade views on correlation between forward rates and how credit default swaptions can be used to express views on the level and volatility of credit spreads.
- Expanded treatment of the impact of Dodd-Frank and EU reforms (EMIR, MiFID II/MIFIR, etc.) on OTC derivatives market practice (central clearing and swap execution facilities).
- More on capital requirements (Basel III, EU CRD, counterparty risk capital charge, etc.) and other "firm-level" aspects of regulation.

In line with the requirements of the international banks and fund management companies who are the main clients for the programme and its global reach, the course material is delivered in both classroom and online versions.

The new online course version benefits from innovative interactive software and a much more supportive student experience. Students who choose the distance learning option will have six months to study the course material, but new monthly, web based review sessions allow them to interact with their fellow FIC students, address any questions they have and recap on the material they are expected to have covered over the previous month with the course tutor. Clear targets, regular monitoring and structured progress allow students to complete this demanding course and achieve the high standard that the final certification exam demands.

The classroom programme is delivered as a one week residential course. Students on this are also given access to the online FIC campus in advance of the course to help them to prepare for the week's teaching, which is intended as an intensive review of the course material.

Contact: education@icmagroup.org

ICMA Executive Education Courses in 2015

Level I: Introductory Programmes

Financial Markets Foundation Course (FMFC)
London: 6-8 May 2015
Luxembourg: 10-12 June 2015
Luxembourg: 21-23 September 2015
London: 4-6 November 2015

Securities Operations Foundation Course (SOFC)
London: 28-30 September 2015
Brussels: 11-13 November 2015

Securities Operations Foundation Course (SOFC) Online Programme
Next start date: 1 May 2015 (register by 30 April)

Level II: Intermediate Programmes

Fixed Income Certificate (FIC)
(Formerly known as the IFID)
Barcelona: 19-25 April 2015
Barcelona: 25-31 October 2015

Fixed Income Certificate (FIC) Online Programme
(Formerly known as the IFID Online Programme)
Next start date: July 2015 (to be confirmed)

Operations Certificate Programme (OCP)
Brussels: 15-21 November 2015

Primary Market Certificate (PMC)
London: 18-22 May 2015
Frankfurt: 5-8 October 2015
London: 23-27 November 2015

Primary Market Certificate (PMC) - Conventional and Sukuk Markets
Dubai: TBC

Level III: Specialist Programmes

Collateral Management
London: 28-29 April 2015

Corporate Actions - An Introduction
London: 12-13 May 2015

Corporate Actions - Operational Challenges
London: 14-15 May 2015

Fixed Income Portfolio Management
London: 17-18 June 2015

ICMA Executive Education Skills Courses

Successful Sales
London: 11-12 May 2015

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
ADB	Asian Development Bank
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
ASEAN	Association of Southeast Asian Nations
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BMCG	ECB Bond Market Contact Group
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
CFTC	US Commodity Futures Trading Commission
CGFS	Committee on the Global Financial System
CICF	Collateral Initiatives Coordination Forum
CIF	ICMA Corporate Issuer Forum
CMU	Capital Markets Union
CNAV	Constant net asset value
CoCo	Contingent convertible
COGESI	Contact Group on Euro Securities Infrastructures
COREPER	Committee of Permanent Representatives (in the EU)
CPMI	Committee on Payments and Market Infrastructures
CPSS	Committee on Payments and Settlement Systems
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
CSDR	Central Securities Depositories Regulation
DMO	Debt Management Office
D-SIBs	Domestic systemically important banks
DVP	Delivery-versus-payment
EACH	European Association of CCP Clearing Houses
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
ECPC	ICMA Euro Commercial Paper Committee
EDGAR	US Electronic Data Gathering, Analysis and Retrieval
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Financial Stability Facility
EFSI	European Fund for Strategic Investment
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ELTIFs	European Long-Term Investment Funds
EMIR	European Market Infrastructure Regulation
EMTN	Euro Medium-Term Note
EMU	Economic and Monetary Union
EP	European Parliament
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
FAQ	Frequently Asked Question
FASB	Financial Accounting Standards Board
FATCA	US Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FCA	UK Financial Conduct Authority
FEMR	*Fair and Effective Markets Review*
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FSB	Financial Stability Board
FSC	Financial Services Committee (of the EU)
FSOC	Financial Stability Oversight Council (of the US)
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
G-SIIs	Global systemically important insurers
HFT	High frequency trading
HMRC	HM Revenue and Customs
HMT	HM Treasury
IAIS	International Association of Insurance Supervisors
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
IIF	Institute of International Finance
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
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 fűr Wiederaufbau
KID	Key Information Document
KPI	Key Performance Indicator
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
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MEP	Member of the European Parliament
MiFID	Markets in Financial Instruments Directive
MiFID II	Revision of MiFID (including MiFIR)
MiFIR	Markets in Financial Instruments Regulation
MMCG	ECB Money Market Contact Group
MMF	Money market fund
MOU	Memorandum of Understanding
MREL	Minimum requirement for own funds and eligible liabilities
MTF	Multilateral Trading Facility
NAFMII	National Association of Financial Market Institutional Investors
NAV	Net asset value
NCA	National Competent Authority
NCB	National Central Bank
NSFR	Net Stable Funding Ratio (or Requirement)
OAM	Officially Appointed Mechanism
OJ	*Official Journal of the European Union*
OMTs	Outright Monetary Transactions
ORB	London Stock Exchange Order book for Retail Bonds
OTC	Over-the-counter
OTF	Organised Trading Facility
PD	Prospectus Directive
PD II	Amended Prospectus Directive
PFMI	Principles for Financial Market Infrastructures
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-Based Investment Products
PSI	Private Sector Involvement
PSIF	Public Sector Issuer Forum
QE	Quantitative easing
QIS	Quantitative impact study
QMV	Qualified majority voting
RFQ	Request for quote
RM	Regulated Market
RMB	Chinese renminbi
ROC	Regulatory Oversight Committee of the Global Legal Entity Identifier System
RPC	ICMA Regulatory Policy Committee
RSP	Retail structured products
RTS	Regulatory Technical Standards
SEC	US Securities and Exchange Commission
SFT	Securities financing transaction
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SLL	Securities Law Legislation
SMEs	Small and medium-sized enterprises
SMPC	ICMA Secondary Market Practices Committee
SMSG	Securities and Markets Stakeholder Group (of ESMA)
SPV	Special purpose vehicle
SRM	Single Resolution Mechanism
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
T+2	Trade date plus two business days
T2S	TARGET2-Securities
TD	EU Transparency Directive
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss-Absorbing Capacity
TRs	Trade repositories
UKLA	UK Listing Authority
VNAV	Variable net asset value

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.

Published by: Corporate Communications, International Capital Market Association Limited, 23 College Hill, London EC4R 2RP
Phone: + 44 207 213 0310 info@icmagroup.org

ICMA
International Capital Market Association

International Capital Market Association (ICMA)
Talacker 29, 8001 Zurich, Switzerland
Telephone +41 44 363 4222 Fax +41 44 363 7772
www.icmagroup.org