ICMA

International Capital Market Association

QUARTERLY REPORT

ASSESSMENT OF MARKET PRACTICE AND REGULATORY POLICY

INSIDE:

EUROPEAN CAPITAL MARKET INTEGRATION POST-BREXIT

SECONDARY CORPORATE BOND MARKET LIQUIDITY

MANAGING RISK IN ASSET MANAGEMENT ACTIVITIES

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ICMA

International Capital Market Association

ICMA promotes resilient and well-functioning international capital markets, which are necessary for economic growth. ICMA's market conventions and standards have been the pillars of the international debt market for nearly fifty years.

Membership continues to grow and we now have more than 500 member firms in some 60 countries. Around 80% of our members are based in Europe.

Among the members are global investment banks, commercial and regional banks, brokers, private banks, institutional asset managers, pension funds, central banks, sovereign wealth funds and other institutions with a significant interest in the international capital market, such as supranational institutions, infrastructure providers, rating agencies and leading law firms.

ICMA members work with ICMA through its market practice and regulatory policy committees and councils to provide expert views on the issues affecting the international capital markets. The committees act as a forum for discussion and for reaching consensus on topics of common interest, developing recommendations for best market practice and the efficient operation of the markets and considering policy responses to regulators.

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Regulatory change: adjusting to the new normal *By Mandy DeFilippo*

Regulatory change and the industry's ability to adjust to it has become a theme for both sell side and buy side in the primary markets in Europe. We are in the middle of a series of regulatory developments which are having, and will continue to have, a meaningful impact on how primary new issue business is done in the capital markets.

The roll-out of the EU Market Abuse Regulation (MAR) at the beginning of July has had a tangible effect on how banks and other market participants engage with, and do business in, the capital markets in a number of areas. One aspect of MAR which has had a significant impact – perhaps greater than initially anticipated – has been the new rules it imposes in relation to market soundings in the context of securities offerings.

Under the new rules, for transactions involving issuers with EU listed securities, discussions that banks or issuers have with investors prior to announcement of a transaction which are designed to "gauge the interest" of the investor in the potential transaction will need to be recorded in detail – either literally, through voice recording, or through detailed written notes taken during the interaction.

The rules impose obligations not only on investment banks, but also on buy-side investors and on issuers. Buy-side investors have an obligation to record any in-scope meetings that they attend; and issuers have the same obligations where they seek to engage with investors directly. The rules also apply globally; issuers who are not incorporated in Europe can come within the scope of the rules simply by having securities listed on a European exchange, or traded on a European MTF platform.

As is often the case with new regulation, there have been some interpretative challenges around the new rules which have raised questions about how certain practices which are currently market standard in offerings of debt securities should be treated going forward. As a consequence, law firms and banks are revisiting constructs that are fundamental to any deal process and that have been settled practice for years. One example is in relation to deal announcements: how much information should be included in a transaction announcement in order for it to be viewed as such under the new regulation? These discussions are taking place on a transaction by transaction basis, and ultimately introduce complexity into deal execution processes where it did not exist previously. This naturally has a knock-on effect on the ability to execute syndicated offerings quickly and efficiently. If markets were to become volatile, with windows of opportunity presenting themselves only for short periods of time, this added complexity could mean the difference between issuers being able to launch and price new offerings of securities and having to wait, or simply deciding not to proceed at all.

ICMA's Primary Markets Practices Committee and its Legal and Documentation Committee have focused on this extensively in their recent meetings and deliberations. Through these groups, ICMA has been coordinating discussions among market participants and law firms, which are very important to facilitating the information exchange that is needed, to provide feedback to regulators, and, ultimately, for a consensus to emerge. This is what we will ultimately need to alleviate the uncertainty we are experiencing today.

MAR is not the only new regulation that is coming into effect in the short term. New Bank of Italy reporting requirements came into force on 1 October, which mandate the preparation and filing with the Bank of Italy of detailed reports in relation to any offerings of debt securities by an Italian issuer or to Italian investors. These new requirements will have a tangible, real impact on the day-to-day operations of banks and other market participants, and the industry is still waiting for clarification from the Bank of Italy in some significant areas. In anticipation of these rules coming into force, ICMA has been extensively involved in coordinating the various concerns raised by its members and relaying these to the Bank of Italy in a joint effort to clarify some of the uncertainties regarding the practical implications of these new requirements.

Regulatory change will continue for the primary markets and the industry in the medium term. Looking into 2017, the PRIIPs regime is currently expected to come into effect in January, and, one year later, 2018 will see the roll-out of MiFID II. These regulations will also require banks and other market participants to make significant changes to the way they have done things in the past in order to comply.

Now more than ever, organizations like ICMA have a central and important role to play in bringing market participants together to discuss the issues we are seeing and experiencing, and also in providing real market feedback – the voice of the markets – to regulators. Without this feedback, there is a real risk that new regulation may inadvertently create friction in the capital markets, which, when markets are constructive, may be nothing more than a nuisance for deal teams to work through – but when markets are more volatile, could keep transactions from coming to market, thus inadvertently creating an unwelcome chilling effect on the primary markets in Europe.

Mandy DeFilippo
Managing Director, Chief Operating Officer of Global Capital Markets EMEA, and Chief Risk Officer for GCM International (EMEA, Asia Pacific and Japan), Morgan Stanley International PLC, and a member of the ICMA Board.

Brexit and beyond

Despite the continuing uncertainty as to the precise form "Brexit" will take, and its timing, we continue to work with our members focusing on the implications of the vote on the capital markets. *By Martin Scheck*

We have held a number of calls with members, and placed the topic on the agenda of all of our market practice and regulatory committees and the regional ones. We have also created a "resource hub" on our website where members can conveniently source relevant Brexit-related papers from ICMA, the authorities and other bodies such as UK and Continental law firms.

We have completed a thorough review of our guidelines and standard market documentation to identify any immediate changes which might be required as a result of the referendum (none at this time) and will keep them under review. Interaction with the UK and European authorities has been intensive, both to update them with input from our membership and to discern their approach, to the extent that they know it. We are also liaising with other trade bodies and sharing information both at a European and UK level. It is important to mention that given we are an international association we are not involving ourselves in any of the many lobbying efforts to promote one financial centre over another.

There are two abiding themes coming from members with business both in the UK and the rest of the EU:

- they wish to continue their business with as little disruption as possible; and
- they would like to minimise the uncertainty so that they are able to plan for the future.

Against this backdrop many are reviewing their business models. They are assessing where they already hold licences in the EU27, what activities these cover, what additional licences or authorisations they might need, and what operational changes would be required to undertake the range of business across the EU27 that they currently undertake. They are also considering how the EU27 authorisations might impact access to the UK.

Much of our work at ICMA over the last 18 months has fallen within the framework of the EU's Capital Markets Union (CMU) initiative – although of course much of this had already been in progress prior to its launch in 2014. CMU encompasses ICMA workstreams such as covered bonds, securitisation, the new Prospectus Regulation, green bonds, secondary market liquidity, European corporate private placements and post-trade, amongst others. Although the UK vote to leave has raised discussion in the markets as to the future shape of CMU, the European Commission has reaffirmed its commitment to making this a reality. Our approach at ICMA has been to continue with this work which will contribute to a more effective capital market, playing a full role in financing the economy.

A particular focus during the summer has been to provide clarity on the Market Abuse Regulation, implemented on 3 July 2016. It is regrettable that the implementation of this well intentioned piece of EU legislation has left so many unanswered questions and that there has been so little guidance so far for market practitioners both in the primary and secondary debt markets. (See the Foreword by Mandy DeFilippo for more on this important subject).

Beyond Europe, the G20 Green Finance Synthesis Report published by the G20 Green Finance Study Group, in which we have been involved, at the G20 meetings in Hangzhou was encouraging: in particular the focus of the G20 on providing strategic policy signals and frameworks, which will help the green bond market scale up to be meaningful and mainstream. We co-hosted, together with China's Green Finance Committee, the United Nations Environment Programme and others, the International Green Finance Forum in Shanghai after the G20, and there was considerable optimism that the G20 message would be a turning point for the market.

Infrastructure finance through capital markets remains an important topic – we co-published in September a *Guide to Infrastructure Financing in Asia* and, working with one of our Chinese members, hosted in Hong Kong a seminar on infrastructure finance in the context of the "One Belt, One Road" initiative.

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European capital market integration post-Brexit

By Paul Richards

Summary: Maintaining European capital market integration post-Brexit would be of mutual benefit to the UK and to the remaining 27 EU Member States. There are limited ways of achieving this. Before and during the negotiations on Brexit, it will be important for the authorities to minimise uncertainty in capital markets, maximise continuity and, in the case of any changes, give sufficient time for capital market firms to prepare, so as to minimise disruption to capital markets and damage to the real economy, not just in the UK but across Europe as a whole.

Introduction

1 ICMA has encouraged capital market integration across national borders for almost 50 years.[1] The UK vote to leave the EU risks fragmenting capital markets in Europe between London as an international financial centre, on the one side, and financial centres in the remaining 27 EU Member States (EU27), on the other, particularly if the UK no longer has free unrestricted rights of access to the EU Single Market through the "single passport"[2] after withdrawal from the EU (ie Brexit).[3] This Quarterly Assessment considers possible ways of maintaining capital market integration post-Brexit, not just from the perspective of the UK, but from the perspective of Europe as a whole. Any settlement between the UK and the remaining EU27 will need to be acceptable, not only to the UK, but also to the European Council and the European Parliament, which will have a vote on it.

Capital market integration as a common European interest

2 In considering the implications of Brexit for capital market integration in Europe, a distinction needs to be drawn between policy issues which relate only to the euro area and those which relate to the EU as a whole. The euro area needs to be integrated in areas of policy that do not apply to the rest of the EU, as a result of:

- Economic and Monetary Union (EMU), under which the European Central Bank is responsible for the euro as the single currency of the 19 EU Member States in the euro area, but not of the nine Member States in the rest of the EU, which continue to use their national currencies; and
- Banking Union, which applies to the euro area – through the Single Supervisory Mechanism and the Single Resolution Mechanism – rather than the EU as a whole, though non-euro area Member States in the EU can opt in.

While all European countries have an interest in EMU and Banking Union working well, decisions about the operation of both EMU and Banking Union relate only to the euro area.

3 By contrast, Capital Markets Union is an EU project which relates, not just to the euro area, but to the European Economic Area (EEA) as a whole (ie 31 countries) and, indirectly, to Switzerland. (See Box 1.) What all these countries in Europe have in common is involvement in the

1. Capital market integration across borders helps to encourage trade in financial services in both directions, increasing market efficiency and economic growth, whereas fragmentation increases costs and reduces efficiency.

2. The "single passport" allows financial services operators legally established in one EU Member State to establish or provide their services in the other Member States without further authorisation requirements.

3. 8,008 firms passport into the UK from another EU (or EEA) Member State. 5,476 UK firms passport into other Member States: FCA evidence to the House of Commons Treasury Select Committee, 17 August 2016.

EU project for Capital Markets Union, which is designed to promote capital market integration across borders in Europe as a whole, so as to encourage economic recovery in Europe and to help Europe compete globally with the US and Asia. Under the programme for Capital Markets Union proposed by the European Commission, there are many further steps which need to be taken.[4] But the immediate question is how best to maintain the degree of capital market integration that has been achieved already, when the UK leaves the EU.

Box 1: Countries outside the euro area involved in Capital Markets Union

Apart from the UK, the countries outside the euro area involved in EU Capital Markets Union fall into a number of categories:

First of all, six EU Member States – Bulgaria, the Czech Republic, Croatia, Hungary, Poland and Romania – are obliged to join the euro area when they meet the Maastricht convergence criteria, though none of them meets these criteria at the moment. (For example, none is currently a member of the Exchange Rate Mechanism (ERM): being a member of the ERM for at least two years is one of the requirements for joining the euro area.)

Second, Denmark and Sweden are EU Member States which are either legally exempt from joining the euro area (in the case of Denmark) or exempt in practice (in the case of Sweden).

Third, Iceland, Liechtenstein and Norway are members of both the European Free Trade Area (EFTA) and the European Economic Area (EEA). As members of the EEA, they accept EU rules without a vote on them in exchange for unrestricted free access to the EU Single Market.

In addition, fourth, Switzerland – which is a member of EFTA, but not the EEA – has a series of bilateral agreements with the EU. Following a referendum in 2014 in which Switzerland voted in favour of imposing a quota on EU immigration, the deadline for resolving the quota issue is February 2017. If it is not resolved, there is a risk that bilateral agreements between Switzerland and the EU will not be renewed by the EU when they fall due.

Maintaining capital market integration post-Brexit

4 Following the vote in the UK referendum on 23 June 2016 to leave the EU, the UK Government announced on 2 October that it will invoke Article 50 of the EU Treaty by the end of March 2017. This interval will give the UK Government time to finalise its approach to the negotiation of UK withdrawal from the EU and new trading arrangements with the EU27 in future. It will then be for the EU27 to respond. (See Box 2.)

The EEA option

5 When the UK leaves the EU, it would be possible to maintain European capital market integration if the UK were to join the EEA: ie in exchange for accepting EU capital market regulation without a vote, the UK would continue to be a member of the EU Single Market and have unrestricted free rights of access through the single passport. But there would be a number of potential difficulties with this approach:

- In order to join the EEA, the UK would need to join EFTA. The UK would also need to sign an EEA accession treaty, which would have to be agreed and ratified by all 30 EEA Member States (ie the EU27 as well as the three EFTA members of the EEA.) It is not clear whether they would all support UK membership of the EEA.
- Following the vote in the UK referendum, the UK Government has stated that it will give priority to controlling immigration from the EU27, which may in turn be unwilling to grant unrestricted free access to the EU Single Market in response.
- The UK Government has also stated that it will give priority to the primacy of UK law[5] over EU law in the UK, whereas membership of the EEA effectively provides for the opposite.
- Members of the EEA contribute to the EU budget. The UK Government will want to avoid new commitments to the EU budget, if possible, when the UK leaves the EU.

For all these reasons, the UK Government is not expected to join the EEA when the UK leaves the EU.[6]

The alternative option of a bilateral agreement between the UK and the EU27

6 Assuming that the UK does not join the EEA, the main alternative is for the UK Government to negotiate a bilateral agreement with the EU27 which would be "unique" to the UK and take effect as soon as possible after the UK leaves the EU. Under such a bilateral agreement, the UK

4. Arguably, the need for progress on Capital Markets Union is even more relevant for the EU27, once the UK leaves the EU, as the share of capital market financing is lower, and the share of bank financing is higher, in the EU27 than in the UK.

5. ie English and Scottish law.

6. though an interim arrangement (see below) may have some similarities.

would no longer be a *member* of the EU Single Market, but the UK Government would seek to negotiate *access* to the EU Single Market on favourable terms.

7 For capital markets, a key element in any bilateral agreement between the UK and the EU27 is expected to be the negotiation of "equivalence" (under which the regulatory regime in the UK would be deemed to be equivalent to the regulatory regime in the EU27) in exchange for "reciprocity" (under which the EU27 would have access to the UK domestic market on the same terms that the UK had access to the Single Market of the EU27).[7] Demonstrating equivalence would be important for the UK in order to obtain access to the EU Single Market on favourable terms. Equivalence may have to be established for each relevant capital market sector (eg banking, asset management, market infrastructure) or regulation (eg MiFID II), case by case, though it is possible that a bilateral agreement between the UK and the EU27 would give scope for differentiation in the UK in particular areas. In the same way that UK equivalence with the EU27 would be important for capital market participants in the UK, EU27 equivalence with the UK would be important for capital market participants in the EU27.

Box 2: Withdrawal negotiations between the UK and EU27

The first formal step towards withdrawal from the EU is for the UK Government to notify the European Council of the UK's intention to withdraw by invoking Article 50 of the EU Treaty. Invoking Article 50 is considered to be the only legal way to leave the EU. It is for the UK Government to decide when to invoke Article 50.

The UK Government announced on 2 October 2016 that it will invoke Article 50 by the end of March 2017. The other 27 EU Member States have made it clear that "there can be no negotiations of any kind before notification has taken place", though there have been informal contacts in the meantime.

In preparation for notifying the European Council under Article 50, the UK Government also announced on 2 October 2016 that, following the Queen's Speech in spring 2017, it will introduce a Great Repeal Bill into the House of Commons to repeal the European Communities Act 1972. The Great Repeal Act would come into effect on the date on which the UK leaves the EU.

Once notification under Article 50 has taken place, there is a period of two years for the UK Government to negotiate withdrawal from the EU with the European Council, acting by enhanced qualified majority voting with the consent of the European Parliament. If no agreement is reached, the UK will leave the EU two years after Article 50 has been invoked, unless the 27 remaining EU Member States unanimously agree with the UK to extend that period.

During the negotiations on the terms of withdrawal (for example, on UK budgetary commitments to the EU), the UK Government is expected to seek a new agreement on UK/EU27 relations in future. While the two sets of negotiations are interconnected, it is not yet clear whether they will be conducted consecutively or in parallel. Article 50 states that the withdrawal agreement should take account of "the framework for [the UK's] future relationship with the Union". But future UK/EU27 relations may need to be approved unanimously post-Brexit and ratified in all 27 remaining EU Member States.[8]

In the period after Article 50 has been invoked and before UK withdrawal, existing EU legislation will continue to apply in the UK, as will any new EU legislation due to be implemented before withdrawal (eg MiFID II on 3 January 2018).

When it invokes Article 50, the UK Government formally states its intention to withdraw. If the UK Government's intention subsequently changes[9] and it wishes to remain in the EU, it appears that the Article 50 process can be stopped before Article 50 expires and the UK leaves the EU.[10]

7. The UK's legal and regulatory system, and in some cases also its supervision regime, would have to be deemed "equivalent" to the EU regime, on the basis of the technical advice of the relevant ESA to the European Commission, subject to a vote of EU Member States. Where there are differences, the equivalence assessment would normally be "outcome-based".

8. Jean-Claude Piris, *The Financial Times,* 20 September 2016.

9. eg if there were to be a second referendum in the UK on the outcome of the negotiations, or if EU immigration controls were to be introduced, not just in the UK, but in the EU27.

10. Jean-Claude Piris, *The Financial Times,* 1 September 2016.

8 It should technically be feasible for the UK to demonstrate equivalence, if existing EU capital market legislation in the UK is "grandfathered" when the UK leaves the EU: ie EU Directives, which have been transposed into UK law, would not be changed, whereas EU Regulations and Regulatory Technical Standards, which currently apply directly in the UK and will no longer apply once the UK leaves the EU,[11] would be reintroduced as UK law. While equivalence is "outcome-based" for other third countries (like Switzerland), as they have their own capital market legislation, the position in the UK would be different from other third countries, when the UK leaves the EU, as UK and EU27 legislation would initially be the same, subject to "grandfathering".

9 There are three potential problems with the existing provisions for third country "equivalence" which a bilateral agreement between the UK and the EU27 would need to address:

- EU capital market legislation provides for equivalence in some cases (eg MiFID II), but not fully in all cases (eg CRD IV);
- equivalence depends on a judgment by the EU authorities which may take time to establish and may become subject to the political negotiations between the UK and the EU27 more generally; and
- it can be withdrawn by the EU unless the UK Government keeps UK legislation up to date with EU legislation in future. This approach may be problematic for the UK Government, if it wants to demonstrate that UK law is not subject to EU law in future.

Bridging the gap between UK withdrawal and the start of the bilateral agreement

10 Given that the UK Government is due to invoke Article 50 by the end of March 2017, its objective must be to complete the negotiations with the EU27 before Article 50 expires two years later (ie before the next UK General Election, which is scheduled for 2020). But it is not clear whether it will be feasible to conclude a bilateral agreement by then. Bilateral agreements with the EU take time to negotiate and to ratify in all Member States and the European Parliament. (The proposed bilateral agreement between Canada and the EU has so far taken seven years.) And there are few precedents for the bilateral negotiation of financial services.

11 If agreement proves not to be possible in the two-year period after Article 50 is invoked, and there is not unanimity among the EU27 on extending negotiations at the end of that period, then the UK would need to fall back on trading with the EU27 under the rules of the World Trade Organisation (WTO) and General Agreement on Trade in Services (GATS)[12], unless an interim arrangement between the UK and the EU27 can be agreed to cover the period between UK withdrawal from the EU and the introduction of a bilateral agreement. This interim arrangement would be designed to minimise market disruption and reduce the risk of "cliff effects" (ie a sudden change in the regulatory regime when the UK withdraws from the EU and another sudden change when the bilateral agreement between the UK and the EU27 takes effect later).

12 Such an interim arrangement could be based on a "presumption of equivalence" between the UK and the EU27, not just in the case of selected EU regulations but across the board, to bridge the gap between the expiry of Article 50 and the point at which the bilateral agreement comes into effect. It is not clear whether the UK would be required to make a payment to the EU27 for access. The terms of the interim arrangement would need to be as close as possible to the existing UK arrangements within the EU, and be announced as early in the process as possible, to minimise market uncertainty and disruption, and to give capital market firms sufficient time to prepare for legislative changes as a result of Brexit. Preparations in the UK could also be complicated by the UK regulators' requirement that some banks should ring-fence their retail from their investment banking activities by the end of 2018.

EU27 and UK authorisations

13 If it proves not to be possible to bridge the gap, there is an increased risk that capital market firms – on the sell side and the buy side – will question whether a bilateral agreement between the UK and the EU27 on equivalence will be achieved, how long it will take and how far they will be able to rely on it. A number of the largest international capital market firms operating in London have a banking licence and authorisation to operate within the EU27 already. So they would have unrestricted free access across the EU27 from their European headquarters or an existing subsidiary in the EU27. It seems likely that different market firms would use different financial centres – eg Frankfurt, Paris, Luxembourg or Dublin – depending on their existing arrangements and client needs. But where market firms do not yet have sufficient authorisations to provide all relevant capital market products from the EU27, the length of time needed to obtain these authorisations could well become a constraint, particularly if a significant number of financial institutions all apply to the same authorities in

11. ie Under the Great Repeal Act, the European Communities Act 1972 would be repealed.

12. The implications of providing services from the UK to the EU27 under GATS are unclear, and could create market uncertainty.

the EU27 at the same time. While there may be competition between different EU27 financial centres to attract capital market firms by speeding up their authorisation processes, it is quite possible that, to be ready in time for Brexit, capital market firms will have to make decisions before they know the outcome of the Brexit negotiations, particularly if they are responding to pressure from their clients.

14 In the same way as capital market firms located in the UK would need authorisation to operate in the EU27 after Brexit, firms based in the EU27 would need authorisation to operate in the UK, where they do not have authorisation already. If restrictions were to be imposed in the EU27, there would also be a risk that similar restrictions would be imposed in the UK, though that would not necessarily be the case if the UK authorities took the view that it was preferable for London's role as an international financial centre not to impose them.

Implications for capital market integration in Europe

15 It is not clear to what extent a bilateral agreement between the UK and the EU27 would preserve capital market integration between London and financial centres in the EU27: for example, whether banks would have to maintain two separate balance sheets, one for the UK and one for the EU27, which would be more expensive – in terms of capital and liquidity – than the single balance sheet they need within the EU at present. Nor is it clear what proportion of market firms' operations would need to be located in the EU27 by their supervisors in order to obtain authorisation and to maintain it; nor – beyond the supervisors' requirements – to what extent market firms would choose to base their capital market activities in the EU27 or in New York, as opposed to basing them in London. That would depend, not just on the cost of moving from London to a location in the EU27, but also on their assessment of the future viability of their capital market business in Europe and on their perceptions of London's future as a stable and predictable centre for international business that is competitive in global terms: ie in terms of a critical mass of skills, legal and market infrastructure, use of the English language, labour market flexibility, corporate and personal taxation, exchange rate competitiveness etc. Pending a clearer idea of the UK's negotiating proposals and the EU27 response, many market firms are currently in "wait and see" mode, while undertaking contingency planning.

16 Both the UK and the EU27 have a mutual interest in reaching an agreement covering capital markets, given the importance of London's role as an international financial centre both in European and global terms, and given the mutual benefit from trade in financial services across borders for both sides and for the European economy as a whole. However, financial services form only part of the overall arrangements that need to be agreed between the UK and the EU27, and the outcome in financial services may be affected by the outcome elsewhere in the negotiations. If, in the event, agreement could not be reached, then it would be open to the UK authorities to make regulatory changes in the UK to the EU *acquis* with the objective of increasing London's competitiveness, both in European and global terms. But this would be expected to be a fall-back option, as both the UK and the EU27 would have a mutual interest in reaching an agreement.

17 If it was possible for the UK to negotiate with the EU27 a separate sectoral agreement covering capital markets, the result could be that the City of London – as a European financial asset – would in practice remain "in" while the UK as a whole would come "out" of the EU. But an outcome of this kind would depend on three preconditions. One is that a separate sectoral agreement covering capital markets could be negotiated within the overall agreement between the UK and the EU27. Second, provision would need to be made for free movement of highly skilled working people to and from the City. Third, "the City" would not be defined by its physical location but by the EU capital market regulation to which it would continue to be subject after Brexit under UK law. However, the City would not necessarily be subject to less regulation under UK law otherwise. The UK authorities have been in the forefront of proposing strict regulation of financial services since the global financial crisis in 2007-09, and the UK would still need to meet its international obligations, many of which originate from agreements at global level among the G20, of which the UK will continue to be a member when it leaves the EU.

UK trade agreements with the rest of the world

18 Trade agreements between the EU and the rest of the world are an EU rather than a national competence. So, if the UK leaves the EU Customs Union[13], new agreements will also need to be negotiated between the UK and 53 other markets in the rest of the world, unless the UK is going to trade solely under WTO and GATS rules. The UK is currently a member of the WTO through membership of the EU. To become a full member of the WTO when it leaves the EU, the UK would need approval of the WTO's 163 members. Potential trade agreements with the US, Canada and Australia have all been mooted by the UK Government, but some trading partners are likely to wait to negotiate with the UK until after negotiations between the UK and the EU are complete, and nothing can be signed until after the UK leaves the EU.

13. The EU Customs Union applies a common external tariff on imports from the rest of the world.

Governance of capital market integration in Europe

The increasing role of the euro area

19 The prospective withdrawal of the UK from the EU highlights potential concerns about the governance of capital market integration across Europe. This is because the UK's withdrawal increases substantially the relative importance of the euro area in the EU. The euro area will represent 84% of combined EU GDP, excluding the UK. That puts the euro area in a powerful position to make decisions relating to the EU as a whole when these decisions are taken by qualified majority voting (as opposed to unanimity, as in the case of tax matters), and when members of the euro area decide to vote together.

20 In addition, one of the consequences of the UK vote to leave the EU is that the safeguards negotiated by the UK Government as part of the New Settlement agreed by the European Council on 19 February 2016, which were designed to prevent discrimination between the euro area and the rest of the EU, will not now come into effect, as they would have done if the UK had voted to remain. (See Box 3.)

21 As a result, the euro area could become the effective "rule maker" in European capital markets, while its European neighbours – both inside and outside the EU – would become "rule takers". So, for example, the UK Government would no longer have a vote on new EU regulations affecting capital markets in future, when it leaves the EU, even though capital markets in London are currently larger than any other financial centre in Europe. After Brexit, the UK authorities would be solely responsible for regulating as well as supervising London as an international financial centre; and once UK law has supremacy in the UK over EU law, the UK Government would have the freedom to introduce different capital market legislation in the UK. But if it did so, this might put at risk the UK's terms of access to the EU Single Market, unless a bilateral agreement between the UK and the EU27 provided flexibility.

22 As the UK would not participate in EU27 decisions and would not have a vote on them, it would not have any direct influence over decision-making in the EU27. Instead, the UK's influence would be in the indirect form of competitive pressure on the EU27 to ensure that EU capital market regulation was "fit for purpose". Capital market participants in Europe would themselves also wish to ensure that new EU27 capital market regulation was fit for purpose. If it was not fit for purpose, there would be a risk that some international capital market activity in the EU27 would move elsewhere, not necessarily to the UK, but to financial centres in the US or Asia. The risk of a shift to the US or Asia would be

Box 3: The EU safeguards if the UK had voted to remain

If the UK had voted to remain in the EU, the New Settlement agreed by the UK Government in the European Council on 19 February 2016 would have come into effect, but will not do so given the UK vote to leave. The main provisions in the New Settlement affecting capital markets would have been as follows:

EU Member States not participating in the euro area will not create obstacles to further deepening of Economic and Monetary Union in the euro area. Conversely, any further integration by euro-area Member States will respect the rights and competences of non-participating Member States.

Discrimination between the euro area and the rest of the EU is prohibited. Any difference in treatment must be based on objective reasons.

EU law on Banking Union applies only to credit institutions in the euro area and in other EU Member States which have opted in to Banking Union. In these Member States, measures may be needed that are more uniform than in the rest of the EU, while preserving the level playing field within the EU Single Market and contributing to financial stability.

Crisis measures safeguarding the financial stability of the euro area will not entail budgetary responsibility for Member States not in the euro area nor opting in to Banking Union.

The supervision or resolution of financial institutions and markets, and macroprudential responsibilities, to preserve the financial stability of Member States not in the euro area are a matter for them, unless they join common mechanisms to which they can opt in.

Any Member State can ask the President of the European Council for an issue relating to the application of the European Council's Decision to be discussed in the European Council, and due account will be taken of the urgency of the matter.

greater, if capital market firms in Europe had to comply with two different regulatory regimes – in the UK and the EU27 – instead of one at present.

Other governance issues

23 There are a number of other issues relating to the governance of European capital markets arising from the UK's vote to leave the EU:

- Once the UK leaves the EU, the ECB may want to draw the euro market infrastructure (eg euro clearing) from London into the euro area, so that the ECB can exercise closer supervision for financial stability purposes.
- The European Banking Authority is expected to move its headquarters from London to a venue in the EU27.
- A new regime for regulatory cooperation will be needed between the UK and the EU in place of the current regulatory regime in which the UK participates in the three European Supervisory Authorities (ESAs), though it is likely to be in the interests of both the UK regulators (ie the FCA and the PRA) and the ESAs for a cooperative relationship to continue in practice.
- The EU27 may take the opportunity to establish a European Capital Market Authority in due course, bringing together the three ESAs: a step hitherto opposed by the UK, though also by some other Member States. A key question is whether the remit of any such Authority would relate to the EU as a whole, or only to the euro area, and whether a change in the EU Treaty would be needed to establish it.
- Once it leaves the EU, the UK will no longer be able to be a shareholder in the European Investment Bank (EIB), as the shareholders are the EU Member States, unless there is a change in the EIB's Statutes. An explicit and unanimous decision by the remaining EU27 Member State shareholders would be required for the UK to remain an EIB member and for any further lending to the UK, though it is not expected that existing finance contracts would be affected. Setting up a national development bank in the UK (like KfW in Germany) would take time.
- The withdrawal of the UK is likely to lead to budget cuts at EU institutions, in part linked to a reduction in activities associated with the UK's decision to leave the EU.
- UK nationals may not any longer be eligible after Brexit to work on open-ended contracts in EU institutions. It is not yet clear whether existing contracts will be "grandfathered".
- There may also be implications for the future use of English law in new cross-border European agreements.

24 Finally, there is uncertainty in capital markets about whether Scotland will in due course hold a second referendum on leaving the UK, with a view either to remaining in the EU when the UK leaves or, if that is not possible, applying as an independent country to join the EU.

Conclusion

25 If capital market integration between the UK, the euro area and its other neighbours both within and outside the EU can continue to be maintained after the UK leaves the EU, the result will be a single capital market in Europe much larger in size than if it were to be fragmented. A single European capital market would benefit economic growth across Europe as a whole and help Europe to compete globally with the US and Asia. Both the UK and the EU27 have a mutual interest in maintaining capital market integration. Avoiding fragmentation is one of the key issues arising from Brexit for the international capital markets.

26 Both before and during the negotiations on Brexit, capital market firms – whether based in the UK or based elsewhere with UK counterparties – are likely to have a number of concerns which the authorities need to address: (i) the need to minimise uncertainty; (ii) the need to maximise continuity; and (iii) in the case of any changes, the need to give capital market firms sufficient time to prepare, so as to minimise the disruption to capital markets and to minimise damage to the real economy, not just in the UK but across Europe as a whole. It would also be helpful if the capital market provisions in the European Council decision of 19 February, which were designed to prevent discrimination between the euro area and the rest of the EU, could be reformulated to support capital market integration across Europe as a whole.

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IOSCO's examination of secondary corporate bond market liquidity

By Andy Hill, Senior Director, ICMA

Summary: Bond market liquidity is currently very widely discussed and studied. However, sourcing reliable data for analysis and producing verifiable conclusions does present a number of challenges.

Remaking the corporate bond markets

In July 2016, ICMA published *Remaking the Corporate Bond Markets*, its second study into the state and evolution of the European investment grade corporate bond secondary market. Based on analysis of interviews with market participants, data provided by various market data providers, and a survey of buy-side members, the study concludes that, in general, liquidity conditions continue to become constrained, as market participants find it more challenging both to provide and source liquidity. Isolating and quantifying contributing factors is difficult at best. However, market participants primarily attribute this deterioration to the confluence of various regulatory initiatives (most notably the increased cost of capital for market makers) and the impact of monetary policy. The study also notes that, while overall liquidity continues to decline, most visibly manifested as a lack of immediacy when executing orders, the story is more nuanced. For instance, the level of market liquidity available differs from client to client (with large, Tier 1 clients enjoying better liquidity than their smaller cohort), across markets (eg euro-denominated versus sterling-denominated bonds), and across the credit curve (eg "single-A" names versus "cross-over" credits). Furthermore, the ICMA study highlights the growing concern among corporate issuers themselves, who worry that the liquidity currently enjoyed in the primary markets will be unsustainable if secondary market liquidity continues to erode, particularly once the ECB ends its Corporate Sector Purchase Programme.

Examination of liquidity of the secondary corporate bond markets

In August 2016, IOSCO published the report, *Examination of Liquidity of the Secondary Corporate Bond Markets.* Similar to what prompted ICMA's earlier study in 2014, the IOSCO study was initiated in response to growing concerns from market stakeholders of deteriorating corporate bond market liquidity. IOSCO notes that this perceived deterioration is mostly attributed to changes in market structure, such as the diminished capacity of traditional intermediaries to make markets, and that many stakeholders argue that to some extent these changes are being driven by new regulation. IOSCO's intended approach was to undertake objective, evidence-based, data-driven analysis, reviewing the markets over the past ten years, across multiple jurisdictions, and using a combination of stakeholder roundtables (including sell side, buy side, trading venues, and academics), surveys of market participants and regulators, and a review of relevant academic and industry literature and studies.

The report concludes that: "[by] examining many different metrics in aggregate, IOSCO was able to see a more complete picture of market liquidity emerge. Based on the totality of information collected and analyzed, IOSCO did not find substantial evidence showing that liquidity in the secondary corporate bond markets has deteriorated markedly from historic norms for non-crisis periods." Furthermore, the study finds no substantive evidence of regulatory reforms contributing to a substantial decline in liquidity, although regulators continue to monitor the impacts of regulation. However, it does acknowledge that a number of factors are affecting the nature and dynamics of the market, including changing market structure, participant behaviour, regulations, and cyclical factors such as very low interest rates (although ICMA's research suggests that the first two factors are largely a consequence of, and response to, the last two factors). IOSCO also notes that, while the various data and information it sourced helped to provide an informed picture of current secondary bond market liquidity, the analysis of the data collected by member jurisdictions was challenging because of differences in data collection methods, scope, quality, and consistency.

The report, however, is not final, and IOSCO published its findings in the form of a Consultation Report, inviting public feedback on its study, particularly in as much as this could be substantiated by new evidence and analysis.

ICMA welcomes IOSCO's interest in the functioning and liquidity of the corporate bond markets and the resulting Consultation Report, as well as the opportunity to provide suggestions and data to assist IOSCO in further refining its analysis. While the general conclusions of ICMA's analysis of the European corporate bond market and IOSCO's more global perspective may differ in a number of respects, based on its own work, ICMA fully appreciates the challenges of sourcing comprehensive and meaningful data, as well as identifying and assessing the relevant indicators and metrics.

ICMA was therefore pleased to provide, in consultation with the members of its Secondary Market Practices Committee, a number of constructive and targeted recommendations designed to expand and enrich IOSCO's analysis. The full response can be found on ICMA's website.

The ICMA response

There are a number of reasons why IOSCO's conclusions are likely to differ from those of the ICMA studies, as well as general market participant feedback. Not only is sourcing reliable and consistent data across various jurisdictions challenging, but where analysis is subsequently based on merging these different data sets, particularly across different currencies, markets, or jurisdictions, deriving any meaningful conclusions is open to question. Corporate bond markets across different jurisdictions have very different characteristics in terms of market structure, participant composition, and liquidity dynamics. Therefore, as much as possible, analysis should be based on specific markets and within the same jurisdictions, to ensure consistency of analysis and relevance of any conclusions.

The integrity of market data being used is also of critical importance. For instance, IOSCO, along with a number of other recent studies published by market authorities, cite narrowing bid-ask spreads in the US and European markets as an indicator of improved liquidity. While bid-ask spreads represent a useful proxy for liquidity in terms of the cost of transacting in a particular bond, ICMA members have flagged two main concerns related to the use of bid-ask spreads in any analysis. The first (acknowledged in IOSCO's report) is the fact that, in the European markets at least, prices quoted on screens are rarely executable. The feedback from ICMA buy-side members would suggest that the bid-ask spreads posted on European trading platforms are at best indications for where small sizes might be traded, and at worst completely meaningless. Often dealer runs that feed onto platforms are not updated on a regular basis (thus best prices are often likely to be "stale"), while quotes also have a "last look" option, which allows the dealers to adjust or pull their prices when a counterparty tries to execute on them. In conducting its own analysis of European corporate bond market liquidity and efficiency, the consistent message from ICMA's members was that nothing can or should be inferred from either the number of dealer quotes available nor the width of the posted bid-ask spread.

The second issue with bid-ask spreads identified by ICMA's members is that, even if one assumes that they are a relatively reliable indication of where markets will clear, if one views the trend in nominal bid-ask spreads (which, as the report points out, appear to have narrowed in both the US and Europe) relative to the underlying yields of the bonds, one finds that in real terms bid-ask spreads have actually widened. In other words, a 1bp bid-ask spread as a measure of the "round-trip cost" for transacting in a bond yielding 1% is significantly wider than a 1.5bp bid-ask spread for a bond yielding 3%. Therefore, a time-series analysis of relative bid-ask spreads across jurisdictions might be a far more informative liquidity metric.

The use of academic liquidity modeling also presents a number of challenges and dangers. ICMA and its members are concerned that, in its assessment of liquidity metrics with respect to the European corporate bond markets, the IOSCO report relies quite significantly on the conclusions of a study undertaken on the French bond markets by the AMF[14] and another on the UK corporate bond market published by the FCA.[15] ICMA's members were keen to stress that both of these studies warrant closer scrutiny and more objective assessment, with respect both to their methodology and the data they utilize. What both these studies illustrate are the limitations, and danger, of trying to model for real world market behaviour, both in terms of the relevance of the methodology and the integrity of the data. While that should not discourage regulators, market participants, academic researchers, and others from continuing to investigate the efficiency and risks related to corporate bond markets through rigorous statistical analysis, it should at least highlight the importance of a

14. AMF, 2015, *Study of Liquidity in French Bond Markets*

15. FCA, 2016, *Liquidity in the UK Bond Market: Evidence from the Trade Data*

balanced assessment of the research methodology and assumptions, including a discussion of potential limitations, as well as emphasizing the need to corroborate empirical analysis with anecdotal data. If fund managers struggle to fill their orders, or corporate treasurers find it harder to price their next offering, they are unlikely to be consoled by a "Bao, Pan, Wang" analysis that suggests they have nothing to worry about. What ICMA has learned from its members is that in these instances it is the analysis that loses credibility, not the market end-user.

Finally, something that has been highlighted by a number of ICMA's buy-side member firms is that perhaps the most important indicator of liquidity is not so much what has traded, but rather what could not be traded. They point to the fact that any post-trade data will always give the impression of liquidity, since it represents something that actually traded. But this does not take account of orders that could not be filled, because there was no other side to the trade, the price was too far from the perceived fair value, or the price that they tried to execute on was not honoured.

As one fund manager explained to ICMA, if he sells 10 million of a 50 million order, say on the same day, in two clips, moving the market price less than one standard deviation, then the 10 million trade will be recorded, and any subsequent analysis will suggest that the market was indeed liquid for 10 million bonds, at that time. What the analysis will not reveal is that two weeks later he might still be looking for a bid for the remaining 40 million. Thus, "dropped trades" and unfilled orders are far more revealing variables for determining and measuring liquidity, as opposed to what actually did trade.

Conclusion

Corporate bond markets serve a vital economic function of bringing together corporations requiring capital to fund or expand their businesses and investors and savers looking to earn a stable income from their investments and savings. They thus play a key role in facilitating economic growth, productivity, and employment. Furthermore, in supporting economic growth and activity, corporate bond markets help to catalyze the development of other financial markets. IOSCO's research is therefore of critical relevance and importance, and ICMA would encourage IOSCO not only to refine and build on the work it has undertaken in compiling this report, but to use this as a launch pad for the ongoing monitoring of the various global corporate bond markets.

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Perhaps the most important indicator of liquidity is not so much what has traded, but rather what could not be traded.

Summary of ICMA's recommendations to IOSCO

General comments and recommendations

- *Regional analysis:* Corporate bond markets across different jurisdictions have very different characteristics in terms of market structure, participant composition, and liquidity dynamics. The analysis would be far more relevant and valuable if it attempted, as much as possible, to focus on individual corporate bond markets (or at least by region).
- *CDS and repo markets:* As noted in the report, the efficiency and liquidity of the related financing and hedging markets are a critical consideration in evaluating corporate bond market liquidity. Further research into the various credit repo and single name CDS markets would add to the completeness of the analysis.
- *Investor perspectives:* Further discussion and qualitative analysis of the perception and importance of market liquidity for the buy side would help frame the analysis as well as inform the observations and conclusions drawn from the empirical analysis.
- *Issuer perspectives:* ICMA hears from its corporate issuer constituents that they are increasingly frustrated by being left out of the discourse around secondary market liquidity and efficiency; something which is of vital importance to them.

Measures of illiquidity

- *Immediacy:* A number of ICMA's members have pointed out that focusing on data and metrics related to what has traded is misleading when analyzing liquidity; what is more important is what did not trade. While challenging to source, any analysis of data relating to unfilled orders or "dropped trades" across the various markets would inform the overall analysis significantly.
- *Trading volumes and turnover:* Analysis of the potential bifurcation of liquidity across credit ratings within different jurisdictions could help highlight some of the more localized nuances and liquidity dynamics of the various markets.
- *Trade sizes*: Deeper analysis (potentially of a qualitative nature) in the dynamics driving observed smaller trade sizes would be highly informative, rather than outlining potential interpretations.
- *Bid-ask spreads:* The quality, and therefore meaningfulness, of bid-ask spreads as a metric has been highly questioned in the context of the European markets, on the basis that these are largely un-executable, and in many cases the advertised prices are stale. Care should therefore be taken to ensure that any analysis based on bid-ask spreads relates to executable and reliable quotes. Furthermore, while the general observation is that notional bid-ask spreads have narrowed both in the US and European markets, it would be more meaningful to analyze these in terms of the relative bid-ask spread (ie as the cost of transacting relative to the return of the underlying asset).
- *Liquidity modeling:* Great care needs to be taken when presenting the results of research that is based on academically derived liquidity models, whether in isolation or as a component of a constructed liquidity metric. The outcomes should be qualified with a balanced discussion of the potential limitations of both the methodology and the underlying data, and, as much as possible, empirical analysis should be cross-referenced with anecdotal data.

Managing risk in asset management activities

By Stéphane Janin, Head of Global Regulatory Development, AXA Investment Managers, and Chair of the AMIC Fund Liquidity Working Group, and Patrik Karlsson, Director, ICMA, and AMIC Secretariat

Summary: AMIC welcomes the focus by the FSB in its most recent consultation on systemic risk in asset management on the activities that can cause risk, rather than on the type of market participant.

The Financial Stability Board (FSB) recently consulted on proposed policy recommendations to address structural vulnerabilities from asset management activities. This is the third consultation on systemic risk in asset management, stemming from previous work in 2014 and 2015 to design assessment methodologies for non-bank non-insurer global systemically important financial institutions (NBNI G-SIFIs). In July 2015, the FSB announced that it had decided to wait to finalise the assessment methodologies until its new work on structural vulnerabilities from asset management activities was completed. This resulted in the third consultation, which ran from 22 June to 21 September 2016.

ICMA's Asset Management and Investors Council (AMIC) wrote a response to the consultation, led by the AMIC Fund Liquidity Working Group. The working group was set up in 2015 to draft, in cooperation with the European Fund and Asset Management Association (EFAMA), a research report on liquidity risk management in investment funds. It was a natural progression to take the experience gained in that report to respond to the FSB.

The FSB's consultation on asset management activities makes 14 recommendations addressing perceived risk arising from (i) lack of information and transparency, (ii) liquidity risk management, (iii) leverage in funds, (iv) operational risk, and (v) securities lending activities.

In our response, AMIC strongly welcomed the approach by the FSB to focus on the activities of asset managers rather than designating individual companies as systemically important. In our response to the second consultation on designating NBNI G-SIFIs in 2015, we had already called for consideration of the broader market ecosystem, and in particular for a greater focus on the activities that cause risk rather than the entities that cause risk.

Furthermore, we believe that focusing on asset managers in isolation was flawed. This siloed thinking about systemic risk failed to take into account the wider risks across the whole market. The FSB's approach should focus on market-wide activities, irrespective of the type of market participant involved. This means that analysis and policy recommendations should take into account the broader financial ecosystem of market participants, beyond just asset managers, and their actions in capital markets.

We believe greater efforts should be made to survey the activities and investment decisions of all parts of the investment world instead of focusing exclusively on third party asset managers. We would prefer a holistic, market-wide approach, which takes into account the impact of the actions of a range of market participants at large.

Most importantly, we made the case that this activities-based approach by the FSB should explicitly replace the previous approach based on the designating NBNI G-SIFIs among asset managers. We are deeply concerned by FSB statements that the FSB may still return to the NBNI G-SIFI assessment methodologies.

In the Consultation Paper, the FSB makes a number of recommendations on addressing risk from asset management activities. While we welcomed many as a sensible codification of what is already common practice, we argued that the recommendations took insufficient account of the diversity of the fund world. For example, how a fund manager manages liquidity if he has a concentrated institutional investor base and a concentrated portfolio will be quite different from how he would manage it with a diverse retail base and a broad portfolio.

There are risks associated with recommending a one-size-fits-all approach, especially with regard to stress tests, where a single methodology could lead to adverse outcomes.

In our response, we welcomed the helpful section on liquidity as it contained significant details about available mitigants for fund managers, many of which were detailed in the fund liquidity risk report we co-wrote with EFAMA. We stressed in particular that in the European Union a comprehensive set of EU regulatory provisions allow for managing the fund liquidity risk (eg the AIFM and UCITS Directives) which are complemented by a large series of nationally recognised industry tools (although not recognised in all EU jurisdictions yet).

We noted that, in relation to determining the liquidity of market assets, there might be problems with using specific metrics like bid-ask spreads or quotes. Perhaps the most important indicator of liquidity for investors is not so much what has traded, but rather what could not be traded. Any post-trade data will always give the impression of liquidity, since it represents something that actually traded. But this does not take account of orders that could not be filled. Therefore, we recommended that FSB should avoid specific metrics and refrain from prescribing liquidity criteria for open-ended funds' investment in illiquid assets. Our response drew on the separate ICMA study on corporate bond liquidity which explored many of these areas.

When considering leverage limits for individual funds, we argued that it is important for the FSB to bear in mind that leverage does not by itself equal riskiness, particularly depending on how it is calculated. Accurately depicting risks in leverage requires care. In particular, we objected to the notion of developing a single "simple and consistent" leverage calculation method.

While we agreed in principle that regulators could collect data about the use of leverage by investment funds for market-wide risk monitoring purposes, we expressed concern about the use of "consistent" and what this could lead to. In Europe mutual and alternative funds have different methods of measuring leverage. Investment funds, whether open-ended or closed-ended, represent a very wide diversity of investors and employ a wide diversity of investment strategies. Different measurements of leverage are more meaningful depending on the particular type of funds – as recognised in a number of provisions of the AIFM and UCITS Directives.

We would not want this FSB work on a harmonisation of leverage measurement (for the purpose of reporting market-wide risk) to inhibit the ability of managers to appropriately measure, monitor and manage risks related to leverage in their funds.

In the FSB's section on operational risk, we were particularly concerned to note that the FSB recommended that "large" or "significant" managers be identified and be subject to stricter rules. We found this approach similar to the debate in the previous two consultations on designating NBNI G-SIFIs. We do not agree with this approach: we think that the same set of rules should apply to the whole world of asset managers, in an appropriate manner and depending on the activity being addressed.

Potential operational risks within a smaller asset manager might even have greater market-wide effects because smaller asset managers are less well equipped and have fewer means to cope with them. In particular, market-wide risk may be generated by a player which is not necessarily large – that is why, more generally, for market-based finance we strongly advocated that the FSB considers activities in the whole market.

Finally, we recognised the FSB's concern in the area of asset managers acting as agent lenders and providing indemnification. We agreed that authorities should monitor this area carefully. However, we argued that borrower default indemnification might be a relatively limited obligation. We were also concerned about the claim that different regulation of banks and asset managers could lead to regulatory arbitrage in securities lending. We outlined important differences between banks and asset managers reflected in their regulatory frameworks, such as asset managers not relying on government-insured deposits nor having access to central bank liquidity. Nonetheless, we agreed that relevant regulators should engage with those asset managers who undertake this activity about enhancing risk management.

After the FSB has digested the responses it has received, this work will be taken forward, mostly by the International Organization of Securities Commissions (IOSCO). AMIC and its members will continue to engage on this topic. Furthermore, the work to respond to this consultation has led AMIC to explore the possibility of conducting more in-depth research into the issue of leverage in 2017, in order to better document existing regulatory and market practice. It is one of the key topics in fund risk management and would complement the previous research report into liquidity risk management.

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GDP-linked bonds: a new design for sovereign debt markets

By Leland Goss, General Counsel, ICMA

Government debt linked to domestic economic growth is not a new idea. Indeed, the concept has been promoted since the 1980s by a number of economists as well as the official sector including the IMF and United Nations.

Today one legacy of the global financial crisis is that it has left a high ratio of public debt to GDP around the world. Sovereign borrowers that have excessive debt combined with weak economic performance face potential costly and disruptive restructurings or default, which in the recent experience with Argentina and Greece have had potential global financial systemic implications. At the same time, a challenge and goal for policy makers is for more stable capital flows for both developed and emerging countries which can also be disruptive and a contributing cause of a sovereign debt crisis.

A model set of terms and conditions, or "term sheet", for GDP-linked sovereign bonds has been drafted and is nearing final form, could help address these risks and concerns. This work is being completed by an *ad hoc* working group consisting of investment managers, lawyers and economists from the Bank of England, together with support from ICMA and other trade associations.

- The basic concept of GDP-linked government bonds is for their coupons and principal payments to be indexed to nominal GDP and in so doing allow both the burden of servicing interest payments and repayment of principal to adjust with the sovereign's ability to pay.
- The major market and social welfare benefit of this is to reduce the risk of sovereign debt crises and disruptive defaults during a recession or downturn. In this regard, often GDP-linked bonds are seen as a form of holding equity in a sovereign, whose entire return will vary with economic performance instead of on a fixed basis.
- In theory, GDP-linked bonds can be designed to reduce the default risk premium by allowing the debt servicing burden to be reduced in times of fiscal duress. On the other hand, for investors, particularly those who believe a particular sovereign may be on its return to prosperity, GDP-linked bonds offer returns that can later outperform corresponding conventional bonds.
- Over a longer period of time of continued issuance, GDP-linked debt as well as other forms of state-contingent debt could work to de-risk sovereign balance sheets.

A number of issues to be overcome, however, have thus far made borrowers hesitant to offer these instruments. Among others, the revision and quality of GDP data as well the market's desire for there to be near-term diversification, liquidity and representation in recognised indices need to be addressed for there to be adequate market acceptance. The new *London Term Sheet* provides responses to address these and other issues raised in the past with the concept of bonds linked to growth. Members of ICMA's Asset Management and Investors Council (AMIC) are right now reviewing and providing comments on this new design and ICMA intends to very soon more widely consult with its members in this regard.

See Financial Stability Paper 39: Sovereign GDP-linked bonds: James Benford, Thomas Best and Mark Joy, with contributions from other central banks

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Securing the future of interbank markets in the frontier economies

By Maria-Pia Kelly, Frontclear, September 2016

Interbank markets in emerging markets and developing countries (EMDC) are often shallow, raising concerns about the broader economic impact of these markets.

There is a strong relationship between a bank actively trading in interbank markets and its capacity to extend more financing to its clients. Yet most commercial banks in EMDC are not able to participate due to a variety of factors. These largely include counterparty credit concerns, and an all-round lack of knowledge.

In 2015, Frontclear, an innovative financial markets development company, set out to tackle this. Frontclear is driven by an ambition to catalyze stable and inclusive interbank markets in EMDCs. Its contribution is to enable local financial institutions to access interbank markets through the provision of credit guarantees and often combines its guarantees with deep-reaching technical assistance. The guarantees cover a transacting institutions' counterparty credit risk and are provided on the condition that local currency assets can be utilized for collateral management purposes. Frontclear's guarantees are Basel III compliant and cover the due payment of early termination amount (ETA) under ISDA contracts and Net Exposure under GMRA. All guarantees are, in turn, counter-guaranteed by the German Government-owned bank KfW, which is an AAA-rated development finance institution. Frontclear investors include EBRD, FSD Africa (funded by DFID), Proparco, TCX and Cardano Development.

Transactions

Frontclear's first transaction was executed in March 2016. Commercial Bank of Africa (CBA) and Standard Bank of South Africa (SBSA) executed a US$25 million cross-currency repo transaction, which was made possible by Frontclear's guarantee. CBA received US$25 million in one-year funding from SBSA and offered Government of Kenya Infrastructure Bonds as collateral. This is the first example of Frontclear's involvement in the deepening of markets in emerging and frontier countries, being a repo based on full title transfer and traded under international standard documentation.

More recently in August 2016, Standard Chartered executed a US$/NGN 15 million one-year cross currency swap for

Access Bank in Nigeria, which was made possible by a custom guarantee issued by Frontclear. The transaction was entirely collateralized in naira and thus the first of its kind in the country. This transaction is a testament to the impact Frontclear can have in challenging EMDC interbank markets. Without Frontclear's guarantee, this transaction would not have been feasible.

Technical assistance and collaborating with ICMA

Frontclear's technical assistance programme (FTAP) plays a primary role in developing interbank market knowledge and to better interbank transacting. Following extensive due diligence involving desk research and in-country interviews, FTAP is able to determine the market's needs and formulate a support programme accordingly. FTAP programmes focus on enhancing the legal and regulatory environment, facilitating the development of local market infrastructure and enhancing the capabilities of market participants to effectively conduct interbank transactions. FTAP training reflects very practical subjects such as fixed income boot camps and GMRA operationalization, which contribute to the skills base of both commercial banks and regulators alike. Another example of FTAP support is to promote legal certainty by working with experts to analyze GMRA enforceability and, in turn, with regulators to adjust the legal environment as needed. Finally, FTAP is involved in comprehensive research studies with academics and highly specialized financial consultants to deliver essential understanding of market infrastructure such as OTC exchanges.

Since its inception, Frontclear has been developing a pivotal relationship with ICMA in achieving the above, with both sides equally motivated to develop interbank markets. ICMA has played a key role in many of the Frontclear sponsored activities. In April 2016, ICMA and Frontclear joined forces in Tbilisi to develop a legal opinion on GMRA enforceability followed-on by training on the international repo market, covering structural, operational and legal characteristics of repos and GMRA documentation. Since this event, the National Bank of Georgia has been actively rewording required legislation to better fit the commercial banking needs. ICMA and Frontclear have also combined to deliver "Understanding and implementing GMRA" workshops in Kenya (for both commercial banks and another with the Central Bank of Kenya) and will soon be doing so in Ghana, Zambia and other parts of East Africa. Activity evaluations continuously show that participants are impressed by the relevance of content, ease of delivery and the wealth of knowledge they gain in such a short time. These activities provide essential knowledge to the key interbank market players in emerging market and developing countries. Frontclear and ICMA will continue their partnership and in an expanding number of markets across the coming year.

Since its inception, Frontclear has been developing a pivotal relationship with ICMA.

Summary of practical initiatives by ICMA

There are a large number of practical initiatives on which ICMA has been engaged over the past quarter with, and on behalf of, members. These include:[16]

Primary markets

1 *PSIF:* The Public Sector Issuer Forum (PSIF), for which ICMA provides the Secretariat, has agreed a strategic plan drawn up in consultation with PSIF members.

2 *FMSB:* ICMA held a meeting in September 2016 with Mark Yallop, the new Chair of the FICC Market Standards Board (FMSB) to discuss how ICMA can best support the FMSB's work. Mark Yallop also addressed the ICMA European Repo and Collateral Council on 27 September in London.

3 *Market Abuse Regulation:* ICMA has continued to hold a series of meetings and conference calls for members in the ICMA Primary Market Practices Committee, the ICMA Legal and Documentation Committee and other working groups on pre-sounding and stabilisation under the Market Abuse Regulation, which came into effect on 3 July. ICMA also held a briefing call for issuers on 14 July. The ICMA Primary Market Handbook's stabilisation materials are being updated.

4 *ICMA Primary Market Handbook:* Various updates to the ICMA Primary Market Handbook were published in July, including an updated ICMA Agreement Among Managers (version 1) catering for issues underwritten on a "several" basis as well as issues underwritten on a "joint and several" basis; a new guidance note on negative interest rates; and various other updates to Recommendations and Appendices, all as detailed on the ICMA website.

5 *Prospectus Regulation:* ICMA has continued to meet various regulators to discuss the proposed Prospectus Regulation, focusing on the key points for ICMA members, such as the distinction between the retail and wholesale disclosure regimes for bonds.

6 *Bank of Italy Article 129 rules:* There has been a relatively positive response from the Bank of Italy to the joint letter which ICMA helped to coordinate on the forthcoming Article 129 rules on post-issuance reporting.

7 *PRIIPs:* ICMA is coordinating a common approach to selling restrictions and related procedures to address the impact of the PRIIPs' regime on institutional new issues.

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

Secondary markets

8 *Corporate Sector Purchase Programme:* Following the discussion with the ECB in ICMA's Secondary Market Practices Committee (SMPC) on 17 May on the market impact of the ECB's Corporate Sector Purchase Programme (CSPP), there was a further discussion on the ECB's CSPP, and a similar initiative by the Bank of England, at SMPC on 10 August.

9 *ICMA corporate bond market liquidity study:* In early July, ICMA published its *Second European Investment Grade Corporate Bond Secondary Market Study*, undertaken by Andy Hill, into the current state and evolution of the European investment grade corporate bond secondary market.

10 *European Commission Expert Group:* Andy Hill was invited by the European Commission (DG FISMA) to speak at the Commission's workshop on corporate bond market liquidity in Brussels on 26 July, and has been appointed to the Commission's Expert Group on corporate bond market liquidity.

11 *IOSCO consultation on corporate bond market liquidity:* ICMA responded by the deadline of 30 September to the IOSCO consultation on corporate bond market liquidity, following publication of IOSCO's own study in early August.

12 *MiFID II:* At the request of members, ICMA has a joint buy-side and sell-side MiFID II Working Group to discuss the implementation of the ESMA Level 2 RTS relating in particular to transparency.

13 *Review of ICMA Buy-in Rules:* With the support of the ICMA Secondary Market Practices Committee, ICMA is consulting members on possible revisions to ICMA's Buy-in Rules so as to improve the efficiency and transparency of the buy-in process, while also keeping open the possibility of a buy-in auction mechanism.

Repo and collateral markets

14 *Leverage Ratio:* The ICMA European Repo and Collateral Council (ERCC) responded on 6 July to the BCBS' consultation on the Leverage Ratio, offering suggested recalibrations to refine the regime.

15 *SFTR:* The ICMA ERCC responded to a list of questions from ESMA in preparation for its second consultation on the Securities Financing Transaction Regulation (SFTR) draft technical standards. This was published by ESMA on 30 September. The ICMA ERCC is planning to submit a

detailed response by the deadline of 30 November.

16 *Collateral management:* The ICMA ERCC is providing input to help advance work on collateral being conducted under the auspices of the Commission's European Post-Trade Forum and, distinctly, the ECB's COGESI.

17 *Asset segregation:* The ICMA ERCC submitted a response on 23 September to the ESMA Call for Evidence on *Asset Segregation and Custody Services.*

18 *European repo market survey:* The 31st semi-annual ICMA European repo market survey, providing a "snapshot" of repo business at close of business on Wednesday, 8 June 2016, was published to coincide with the ICMA ERCC General Meeting, on 27 September.

19 *CCPs:* ICMA published on 27 September a research paper prepared in consultation with the ERCC by John Burke on CCP trade acceptance practices.

20 *FinTech:* The ERCC Operations Group has established a FinTech Working Group to discuss FinTech solutions in the post-trade space, including Distributed Ledger Technology.

Asset management

21 *Fund liquidity:* ICMA's report on *Fund Liquidity,* prepared jointly with EFAMA, has been presented by René Karsenti and Peter de Proft to the ESMA Securities and Markets Stakeholders Group and the ESMA Board of Supervisors. The report sets out the legislative requirements and market-based tools available to manage liquidity risk in investment funds in Europe.

22 *Bail-in:* In consultation with the ICMA Bail-In Working Group, ICMA has written again to the ECB on the need for transparent, consistent and comparable treatment of bad loans and encumbered assets, and the need for a consistent approach in achieving subordination. Members of the Bail-in Working Group are due to meet representatives of the European Commission, the Single Resolution Board and the ECB in October and November to discuss the letter.

23 *Activities of asset managers:* ICMA responded by the deadline of 21 September to the consultation by the Financial Stability Board (FSB) on the whether any of the activities of asset managers could give rise to systemic risk. ICMA's response welcomed the FSB's focus on activities rather than entities, but cautioned against analysing asset managers in isolation from other market participants. ICMA also warned that overly prescriptive stress tests could have negative consequences and recommended that the current multiple methods of measuring leverage should not be replaced by a single measure.

Capital market products

24 *Global Capital Award:* ICMA has received an award for its work on Green Bond Principles. The Global Capital Award for Most Valuable Innovation for the Green/SRI Bond Market was presented at the Euromoney/Global Capital Sustainable & Responsible Capital Markets Forum in Amsterdam on 6 September.

25 *ECPP:* ICMA is planning a seminar on European Corporate Private Placements (ECPP) – formerly Pan-European Private Placements – at KBC in Brussels on 25 October, where the keynote speaker will be Olivier Guersent, Director General of DG FISMA in the European Commission. Meanwhile, ICMA has been updating the first edition of the ECPP Market Guide.

26 *Infrastructure finance:* On 31 August, ICMA and ASIFMA published the *Guide to Infrastructure Financing in Asia*. Based on the European version, this is the first comprehensive guide of its kind that outlines how infrastructure projects can be financed in Asia, including through the capital markets.

Other meetings with central banks and regulators

27 *Brexit:* ICMA has held a series of meetings on Brexit with the UK authorities at their request. In addition, at ICMA's invitation, Richard Knox of HM Treasury had a discussion with ICMA members at the ICMA Regulatory Policy Committee meeting on 15 September.

28 *Central banks:* ICMA had a meeting with Chris Salmon, Executive Director, Markets, at the Bank of England on 26 September.

29 *Official groups in Europe:* ICMA continues to be represented, through Martin Scheck, on the ECB Bond Market Contact Group; through René Karsenti, on the ESMA Securities and Markets Stakeholder Group; and through Godfried De Vidts on the ESMA Secondary Markets Standing Committee, the ECB Contact Group on Euro Securities Infrastructures (COGESI), the ECB Macroprudential Policies and Financial Stability Contact Group, the European Post-Trade Forum and the Bank of England 's Securities Lending and Repo Committee (SLRC).

30 *Official groups in Asia:* ICMA is also an official member of China's Green Finance Committee under the auspices of the People's Bank of China, as well as the Green Finance Study Group under the G20.

Primary Markets

by Ruari Ewing and Charlotte Bellamy

EU prospectus regime

The Prospectus Directive review is entering a new, important period. The three co-legislators have now agreed their positions and are expected to enter into negotiations known as trilogues at the end of October 2016, with a view to reaching political agreement on a final text for the Prospectus Regulation by the end of 2016.

ICMA remains heavily focused on the proposals and continues to be in touch with relevant legislators to highlight the concerns of the vanilla bond market. Previous editions of the ICMA Quarterly Report have commented upon the European Commission's proposal published in November 2015 (see First Quarter 2016 edition of this Quarterly Report) and the general approach of the Council of the European Union, published in June 2016 (see Third Quarter 2016 edition of this Quarterly Report). The final of the three co-legislators' texts is the text adopted by the European Parliament in September 2016.

ICMA has reviewed and compared the three texts, focusing in particular on seven key points for the vanilla bond market, and communicated a preferred approach and drafting suggestions to key MEPs, national regulators and the European Commission. Both the European Parliament and Council texts include a number of helpful improvements for the bond market. It is crucial that those improvements are retained in the final text if Europe's wholesale bond market is to continue to function effectively with bonds listed on European regulated markets.

The seven points that ICMA has highlighted as being particularly important for the bond market are:

1. the need to maintain differentiated disclosure for wholesale and retail bonds, including an exemption from the prescribed format summary requirement for wholesale bonds;
2. the need to calibrate the new risk factor requirements in a manner that is workable for issuers;
3. the need to ensure that the prospectus summary liability regime and the purpose of the summary are clear and consistent throughout the Prospectus Regulation;
4. the scope of the general disclosure test, which could be narrowed for bonds to ensure prospectuses only contain the information that investors really need;
5. clarity in relation to investor withdrawal rights triggered by the publication of a supplement and the circumstances in which they apply;
6. a suitable implementation period that allows Level 2 measures to be properly considered, consulted upon and delivered in sufficient time for market participants to adjust to the new regime; and
7. the need to ensure that a new threshold that would require a prospectus to be prepared for the admission to trading on a regulated market of shares resulting from the conversion or exchange of other securities where the resulting shares represent 20% or more of the number of shares already admitted to trading does not have unintended consequences for regulatory capital and loss absorbing capacity (eg CoCos) and other securities that may be converted mandatorily under BRRD.

Of the above concerns, the most important point is the need to maintain distinct disclosure regimes for wholesale and retail bonds, including an exemption from the summary requirement for wholesale bonds. This distinction exists under the current regime on the basis that bonds with a minimum denomination of €100,000 or more benefit from a lighter, wholesale regime and an exemption from the prescribed format summary requirement. Removing the distinction between wholesale and retail bonds for disclosure purposes (as suggested by the European Commission in its November 2015 proposal) would introduce significant additional costs for Europe's wholesale bond issuers, with no corresponding benefit for the institutional investors to whom they offer and sell their bonds. This was confirmed by statements made by Pamela Gachara of the

Investment Association at the recent IFLR Prospectus Rules Conference, who noted that institutional investors are in favour of a distinct disclosure regime for wholesale bonds. However, Pamela Gachara also noted that institutional investors face significant practical difficulties in allocating bonds across various portfolios (and a consequential challenge in relation to treating their customers fairly) as a result of the current €100,000 minimum denomination regime.

Institutional investors' concerns in this area are one of the reasons that ICMA has been advocating for a differentiated disclosure regime, including an exemption from the prescribed format summary requirement, for bonds that are *offered to qualified investors only*. This "qualified investor only" approach was adopted by the European Parliament in its text. While this regime would not be as simple or easy to apply in practice for sell-side market participants as the current €100,000 minimum denomination regime, it should address institutional investors' concerns with the current regime and may also allow retail investors to invest in bonds *indirectly*, for example through MiFID authorised discretionary managers who would take investment decisions on behalf of their retail investor clients. Allowing such indirect retail investment in capital markets products would represent a step towards one of the central aims of the Capital Markets Union initiative by giving retail investors a means of saving for their retirement (something that will be increasingly important as Europe's population ages).

We understand, however, that there are concerns in some quarters that a "qualified investor only" approach may mean that retail investors could buy securities on a regulated market without the benefit of a retail prospectus. One option that could be considered to address this concern would be to require securities with wholesale prospectuses that are offered to qualified investors only to be admitted to a segregated section of a regulated market that is only available to qualified investors.

In addition, market participants noted at the recent IFLR Prospectus Rules Conference that the €100,000 minimum denomination regime and a "qualified investor only" regime are not mutually exclusive. Legislators may therefore wish to consider the possibility of including both options in the Prospectus Regulation, in order to give issuers the flexibility to choose the most appropriate option for the circumstances. For example, where securities are not considered to be suitable for retail investors (eg CoCos), issuers may wish to continue to use high minimum denominations, as well as offering those securities to qualified investors only.

Whichever option or combination of options is chosen, the key point remains that a distinction between the disclosure requirements for wholesale and retail bonds (including an exemption from the prescribed format summary) must be retained in the Prospectus Regulation if Europe's vanilla bond markets are to continue to function effectively within the scope of the Prospectus Regulation.

A separate issue that also has the potential to encourage bond issuers to consider structuring their bond issuance to fall outside the Prospectus Regulation regime (for example by listing their securities on markets outside of Europe and only conducting exempt offers in Europe) are the new requirements in relation to risk factor disclosure. It is essential that these requirements are calibrated properly, bearing in mind the need to ensure risk factor disclosure is useful for investors, but also that increasing issuers' liability will increase their costs and potentially affect their appetite to issue securities within the scope of the Prospectus Regulation regime. While market participants seem to agree that increased awareness in relation to risk factor disclosure is needed to ensure that such disclosure is approached on a more considered basis, the prescriptive requirements proposed by the European Commission and the Council are unlikely to achieve their intended results. Indeed, such prescriptive requirements may, at best, result in increased costs for issuers and disclosure that is arguably less useful for investors (in particular if issuers are required to categorise their risk factors in to categories of low risk, medium risk and high risk) and, at worst, represent another reason for issuers to structure their bond issuance to fall outside the Prospectus Regulation regime. Pamela Gachara of the Investment Association acknowledged this in her speech at the IFLR Prospectus Rules Conference, noting that issuers do need to consider the materiality of their risk factor disclosure carefully, but that the rules should not be overly prescriptive.

It is hoped that legislators appreciate the significance of the concerns noted above as they move towards reaching a political agreement in the coming months. As always, further information on these points and the other five key concerns noted above is available from ICMA staff.

The most important point is the need to maintain distinct disclosure regimes for wholesale and retail bonds.

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Packaged Retail and Insurance-based Investment Products (PRIIPs)

Various legislative and market developments have occurred ahead of the PRIIPs regime's scheduled coming into application on 31 December 2016.

Legislative process: On 14 July, the European Commission adopted a Level 2 Delegated Regulation on product intervention powers (an aspect of PRIIPs ICMA has not been focusing on). However, on 14 September, the European Parliament objected to the earlier Level 2 Delegated Regulation on KID presentation, content, review/revision and provision (and related annexes) adopted by the Commission on 30 June (see First Quarter edition of this Quarterly Report). The Parliament also called for a delay to the PRIIPs regime's scheduled application date. It was subsequently suggested in Council to not object to this earlier Delegated Regulation (noting the Parliament's objection) but 23 (subsequently corrected to 24) Member States expressed the view that the PRIIPs regime's coming into application be postponed by 12 months. ICMA and market practitioners are continuing to work, for the time being, on the assumption that the PRIIPs regime's application date remains 31 December.

> **ICMA and market practitioners are continuing to work, for the time being, on the assumption that the PRIIPs regime's application date remains 31 December.**

Retail scope: At a Commission PRIIPs Implementation Workshop on 11 July, staff from the European Supervisory Authorities (EBA, EIOPA and ESMA) helpfully confirmed that discretionary managers are not retail clients (see "portfolio manager, [...] in the name and for the account of a retail investor" under Question 3 in some of the workshop's published slides), which addresses some prior uncertainty and seems at least consistent with both a plain reading of the professional client concept under MiFID II and PRIIPs' policy focus on retail investor decision-making.

Product scope: In terms of the scope of products that fall within the definition PRIIPs as being "packaged", and further to prior coverage (in the 2016 and 2014 Third Quarter editions of this Quarterly Report), there currently seems to be a market consensus that basic fixed or floating rate notes are not PRIIPs and that features such as an exotic currency, a guarantee, a put or a call would not, on their own, result in such securities being characterised as PRIIPs (to the extent made available to retail investors). However, consensus in relation to other vanilla debt securities may take some time to emerge. In the meantime, it seems likely that specific legal advice will be sought case-by-case (where transaction timelines allow) or that such securities will, for practical purposes (at least in the IG Eurobond syndication context), be treated as "packaged" as a matter of convenience (where specific legal advice is either not desired or impractical within desired transaction timelines).

Market approach to new vanilla issuance: As briefly alluded to in the Third Quarter edition of this Quarterly Report, ICMA is working (ahead of late 2016 debt programme updates/supplements) on practical means for vanilla issuers to generically avoid MiFID II retail investors, especially where securities are treated as "packaged" for practical purposes as noted above – in the expectation that the PRIIPs KID is an unworkable concept at least in the vanilla context (see prior editions of this Quarterly Report, notably the 2014 Third Quarter edition). Such practical means would include updated selling restrictions (sales limited to MiFID II professionals), related warning legends and probable additional order book diligences.

Secondary vanilla trading/legacy bonds: It is possible that secondary traders may take a practical approach similar to their new issue counterparts for convenience: treat all securities as potentially "packaged" (absent market consensus or specific conclusion/advice otherwise) and only deal with MiFID II professionals in the absence of KID produced by the issuer. This would be equally applicable for legacy securities issued prior to the coming into application of the PRIIPs regime (in respect of which it seems highly unlikely that issuers will produce a KID).

JAC work: On 19 September, the Joint Associations Committee (JAC) on retail structured products filed (with ICMA's support) a response to a UK FCA Consultation Paper on changes to disclosure rules in the FCA Handbook to reflect the direct application of the PRIIPs Regulation.

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Market Abuse Regulation: primary markets

Several months into the new regime, ICMA continues to work to facilitate market consensus around MAR's soundings regime that preserves smooth and swift execution of new Eurobond issues.

In the meantime, ESMA published on 13 July its final report on MAR guidelines, including guidelines for persons receiving market soundings. These sounding guidelines *inter alia* envisage regulators and investors "must make every effort to comply" and that sounded investors will co-sign minutes of any otherwise unrecorded sounding (or draft their own minutes) and keep records of their own assessments as to whether sounded information constitutes inside information or not.

ICMA has delayed its previously targeted summer publication of updated Chapter 9 and Appendix 15 on stabilisation in the ICMA Primary Market Handbook, pending publication of the UK's domestic stabilisation regime (expected in October).

Further background is set out on page 27 of the ICMA Quarterly Report for the Third Quarter, and in the Foreword by Mandy DeFilippo of Morgan Stanley in this edition for the Fourth Quarter.

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ECP market

ABCP: As reported in Issue 42 of the ICMA Quarterly Report, on 6 June 2016 the European Parliament's *rapporteurs* published a draft STS report and an associated draft CRR revision report, both of which include concerning elements. Translated versions of MEP proposed amendments to both the STS report (volumes one and two) and the CRR report were published in August. These are now in the process of being discussed in the European Parliament, with a view to being able to hold a vote in ECON during November, ahead of a plenary vote on the Parliament's position in December or in January 2017. Unsurprisingly, there are a broad range of amendments tabled, with some being helpful and others of concern.

In the context of ABCP, efforts continue to be made to obtain recognition of the fact that investors look first to the liquidity protection provided by the sponsor bank, with the underlying assets offering incremental protection in case of the failure of the sponsor bank – a dual recourse structure which some consider makes ABCP in many senses akin to covered bonds. This should mean that overly prescriptive rules regarding the underlying assets are unnecessary and more reliance should be placed upon the strong regulation of sponsor banks, including as to their liquidity. The relevance of this line of thinking was made all the more pertinent when, in July 2016, the one remaining partially supported European ABCP conduit converted, meaning that the whole of the European ABCP market is now structured on a fully supported basis.

Investors look first to the liquidity protection provided by the sponsor bank.

On 6 April 2016, the Basel Committee on Banking Supervision (BCBS) published for public comment (by 6 July) a consultative document on *Revisions to the Basel III Leverage Ratio Framework*. Amongst the responses was a combined industry response duly submitted by the Global Financial Markets Association (GFMA), the Institute of International Finance (IIF), International Swaps and Derivatives Association (ISDA), Japan Financial Markets Council (JFMC) and The Clearing House (TCH). In context of ABCP the section of this response letter on pages 33-34 (which is supported by the AFME Data Submission to European Commission: historic liquidity funding for multi-seller ABCP conduits, 12th December 2012, included as Annex 1 at pages 50-67) says:

"We propose a change to the CCFs for off-balance sheet positions for securitizations undertaken by certain banks: We propose that CCFs for off-balance sheet securitization positions should follow not the new proposed 100% CCF, but instead the existing CCF of 50% contained in the Annex in former paragraph 22, as set on page 26 of the Proposal. We believe that 50% is an adequately conservative number for use in the LR to reflect conservatively banks' exposures, even in times of stress. The Association for Financial Markets in Europe has undertaken research with a group of its internationally active large bank members after the credit crisis. This research has previously been shared with the Committee, in the context of other workstreams. This research shows that multi-seller ABCP Conduits drew on unused commitments even during such times of financial stress on average considerably below 50% of the unused commitments; in the case of the AFME research never more than 5.45% of the utilized portion of total commitments."

Allied to this the section of the response letter regarding "Credit conversion factors (CCFs)", on pages 23-24, which, amongst other things, states: "CCFs apply to off balance sheet (OBS) instruments that are key financing tools for consumers and businesses. Such products are a prevalent feature in lending spaces such as project, trade and commodities finance. They provide additional liquidity to meet customers' financing demands even for market based financing (such as facilities to support commercial paper programmes), help avoid procyclical effects that can occur in liquidity stress conditions and represent an important portion of financial firms' banking books."

On 11 July 2016, the BCBS published an updated standard for the regulatory capital treatment of securitisation exposures. By including the regulatory capital treatment for "simple, transparent and comparable" (STC) securitisations, this standard amends the Committee's 2014 capital standards for securitisations. The capital treatment for STC securitisations builds on the 2015 STC criteria published by the BCBS and IOSCO, setting out additional criteria for differentiating the capital treatment of STC securitisations from that of other securitisation transactions.

Compliance with the expanded set of STC criteria should provide additional confidence in the performance of the transactions, and thereby warrants a modest reduction in minimum capital requirements for STC securitisations. The BCBS consulted in November 2015 on a proposed treatment of STC securitisations; and, compared to the consultative version, the final standard has scaled down the risk weights for STC securitisation exposures, and has reduced the risk weight floor for senior exposures from 15% to 10%. The BCBS is currently reviewing similar issues relating to short-term STC securitisations; and expects to consult on criteria and the regulatory capital treatment of such exposures around year-end.

MMFs: As reported in Issue 42 of the ICMA Quarterly Report, the EU's proposed MMF Regulation has now reached the trilogue stage. Given that the Council's text was agreed in June 2016, whilst the Commission's original proposal was made as early as 2013 and the Parliament's stance was already agreed in March 2015, the Council's text appears the better basis to adapt from – as, when considering the possibility for MMFs to invest in ABCP, it broadly ties in with the STS proposals which are pre-dated by the other texts. That said, in order to avoid that the finalisation of the MMF Regulation leaves EU MMFs effectively unable to invest in real-world ABCP structures, there are still some technical details which will need to be satisfactorily resolved in the course of the trilogue process. Given the dominance of MMFs in respect of ABCP investment, this is a crucial matter for the future of this important and flexible corporate financing tool.

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The ICMA Corporate Issuer Forum *by Katie Kelly*

The ICMA Corporate Issuer Forum (CIF), which started in 2013, continues to thrive, and completes the suite of ICMA issuer representation alongside the Financial Institution Issuer Forum and the Public Sector Issuer Forum. The CIF convenes three times per year, in all cases with high attendance and lively participation. Membership comprises senior treasury representatives of the major frequent issuers in the euro markets, spanning the UK, continental Europe, Scandinavia and the US, with new members still joining. The agenda is member-led, encompassing a range of relevant topics (as further explored below), and the opportunity for all members to network with a cross-section of other treasury professionals from across Europe is exceptional.

Due to the confidential nature of discussions and proceedings at the CIF, and the fact that views are exchanged in a non-deal context, the substance of the meetings is of high quality and the debate constructive, with ICMA being able to procure relevant external expertise by leveraging other resources – such as member firms and ICMA committees representing other member constituencies, where appropriate – which may not otherwise be accessible.

Over the last three years, a number of major themes has emerged as key to all the members of the CIF. For instance, matters associated with new issue processes and transaction execution feature heavily, and have been explored many times. Members of the ICMA Primary Markets Practices Committee and the Asset Management and Investors Council have attended CIF meetings to engage in a frank exchange on new issue processes, syndication issues, allocation policies and more.

A perennial focus for the CIF is regulation which is currently impacting the primary debt markets, the effect of some of which is apparent, such as in the case of the Prospectus Regulation, which is high on the agenda of the ICMA Legal and Documentation Committee. In other cases, the regulatory impact on corporates is less obvious, such as the Bank Recovery and Resolution Directive (BRRD), which has a far reaching effect on corporates as potential holders of in-scope liabilities, as highlighted by Ashurst to the CIF in 2016.

In all cases, regulatory authorities welcome engagement with corporate issuers, to whom they generally have relatively little exposure. The CIF represents an ideal channel for direct communication between regulatory authorities and corporate issuers, demonstrated when, for instance, ESMA, the Bank of England and the FCA were able to hear directly from CIF members via the CIF meetings, or members of the CIF were able to participate in a European Commission workshop on corporate bond market liquidity. Mindful of the critical role that corporate issuers have in generating jobs and growth, and the value to the authorities of the direct, joined-up input of this community in shaping smart regulation, ICMA will continue to identify opportunities where the CIF might prove a useful medium for reciprocal communication between regulatory authorities and issuers.

A major focus for the CIF members is the challenge posed by limited secondary market liquidity, which is also high on the agenda of the ICMA Secondary Market Practices Committee (SMPC). Members of the CIF have previously participated in the SMPC meetings, allowing all sides of the market to explore market-led solutions to address the liquidity issue. CIF members have also helpfully contributed to studies, such as *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market*, and its follow-up study, *Remaking the Corporate Bond Market*, both of which focus on liquidity and the challenges faced by the European investment grade bond market.

The expertise of members of the CIF also proved invaluable when it came to the ICMA Panda bond report, which ICMA is conducting as part of a working group together with NAFMII. The aim of the study is to explore key considerations, attractions and barriers with respect to issuance of Panda bonds, and is based on, among other things, the experience and perceptions of current – and potential – Panda bond issuers. Likewise, members of the CIF have proved a useful resource for the development of a corporate annex to the Global Master Repurchase Agreement, and are represented on the Green Bond Principles Executive Committee.

The high level of participation among members indicates strong demand for this forum, and with membership increasing, the CIF remains an invaluable platform for constructive debate, open exchange and substantive output. Similarly, the input of CIF members means that ICMA is equipped to represent all sides of the securities chain in an informed and joined-up manner. ICMA is very grateful for the continued enthusiasm and candour of CIF members, and will continue to seek opportunities to ensure that the voice of the corporate issuer is fully represented.

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ICMA Primary Market Handbook updates

ICMA published a number of updates to the ICMA Primary Market Handbook in July 2016, as described in an ICMA circular to members dated 28 July 2016 (login details required).

The substantive amendments were as follows:

1. In Chapter 5, Bookbuilding and launch, R5.10 was amended to add that the announcement of the closing or going subject of an orderbook should be announced 15 minutes ahead unless otherwise agreed with the issuer; and R5.13(a) was amended to clarify that prior agreement of any disclosure of investor demand is in order to help compliance with disclosure being required by law to be clear, fair and not misleading and so being representative.
2. The provisions regarding pricing references for new Sterling bonds in Chapter 7, Pricing, were amended to (i) update R7.3 to clarify that the gilts Sterling benchmark presumption applies to gilts of £10 billion or more and (ii) give additional background information in a new provision 7.3A on certain existing gilts considered inappropriate as benchmarks.
3. A revised Appendix A1, Agreement Among Managers version 1 was published. The main purpose of the amendments was to extend the scope of application of the Agreement Among Managers version 1 to certain issues underwritten on a several basis, as well as those underwritten on a joint and several basis. A number of other amendments were made to update the ICMA Agreement Among Managers version 1. The amended version applies in respect of all issues using it where the Confirmation to Managers was sent on or after 1 September 2016. The previous version continues to be available to ICMA members and Handbook online subscribers on the ICMA website.
4. A new paragraph 18 on the handling of erroneous allocations was added to Appendix A12, Pre-sounding, bookbuilding and allocations.
5. Chapter 9, Stabilisation and Appendix A15, Stabilisation materials were amended to (i) provisionally delete the substance of Appendix A15 and (ii) highlight that both these Handbook sections are under review further to the entry into application of the EU's new Market Abuse Regulation but that ICMA members and Handbook online subscribers can obtain the draft updated Handbook materials from ICMA staff pending completion of the review.
6. A new Appendix A9a on negative interest rates was published in order to provide guidance on the implications of negative interest rates on payments under vanilla bonds.

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Other primary market developments

Italy Article 129 reporting requirements: The Bank of Italy responded positively to ICMA's joint letter to the Bank of Italy regarding the forthcoming post-transaction reporting rules that, broadly speaking, will apply to certain debt securities offered to Italian investors or issued by Italian issuers. The position for firms distributing non-Italian issuers' securities to Italian investors is significantly improved. For example, the entry into force of the reporting obligations has been delayed from 1 October 2016 to 1 January 2017, provided that information relating to relevant securities placed between 1 October 2016 and 31 December 2016 should be filed by 20 January 2017. In addition, those firms benefit from an exemption from certain ongoing reporting obligations and the ability to report relevant information for each deal at once (broadly speaking, within 20 days of the closing date), rather than needing to report different information at different times, as previously envisaged.

Alternative Performance Measures: ESMA's *Guidelines on Alternative Performance Measures (APMs)* apply to, among other things, PD-compliant prospectuses published on or after 3 July 2016. For the purposes of ESMA's guidelines, APMs are (broadly) financial measures of financial performance, other than financial measures specified in an applicable financial reporting framework. ESMA's examples of APMs include: EBITDA, operating earnings, cash earnings, earnings before one-time charges, net debt, or autonomous growth. The guidelines are aimed at promoting the usefulness and transparency of APMs included in PD prospectuses or EU regulated information, and further the general principle that PD prospectuses must be "easily analysable and comprehensible". There is detailed guidance relating to ESMA's view that any APMs should be (among other things) defined, meaningfully labelled, reconciled to financial statements, displayed with no greater prominence than measures stemming directly from financial statements, accompanied by comparatives for corresponding previous periods and the relevance and reliability of any APMs should be explained.

It would seem that issuers will either need to ensure that any APMs in their PD prospectuses (including any documents incorporated by reference) comply with ESMA's Guidelines or remove APMs from their prospectuses.

In addition, in light of the Omnibus II RTS Article 12(d), which states that information disclosed in an oral or written form about the offer to the public or admission to trading on a regulated market, whether for advertisement or other purposes, shall not contain APMs concerning the issuer unless they are contained in the prospectus, issuers may wish to consider the ESMA Guidelines on APMs when preparing any advertisements/other relevant disclosures, including any advertisements that may be prepared after the publication of a base prospectus. It is also worth noting Q.100 of ESMA's Q&A on Prospectuses, which suggests that where an issuer discloses an APM which is not included in the prospectus at the request of a participant at a live presentation (eg. a roadshow/interview), the issuer should include that information in the draft prospectus before it is approved and published. If the prospectus has already been published, the issuer should either publish a prospectus supplement or decline to provide the requested information. (Note that the new MAR soundings regime may be relevant also.)

Separately, we understand that the SEC issued several new and revised interpretations of its longstanding rules for disclosure using Non-GAAP Financial Measures in May 2016.

US Contractual Stay proposals: ICMA is liaising with SIFMA and The Clearing House in relation to consultations regarding contractual stay proposals launched by the US Federal Reserve and Office of the Comptroller of the Currency (OCC) in order to support advocacy efforts in relation to excluding underwriting agreements from the scope of the proposed rules. This follows ICMA's engagement on the UK PRA's contractual stay rules, as reported in previous editions of this Quarterly Report (see, for example, the Third Quarter 2016 edition).

BRRD Article 55: ICMA responded to the EBA Interim Report on MREL, highlighting the practical difficulties faced by members of ICMA's primary market constituency that underwrite and manage syndicated, vanilla debt securities issues in implementing contractual recognition clauses under BRRD Article 55.

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Secondary Markets

by Andy Hill and Elizabeth Callaghan

Central bank corporate bond purchase programmes

The ECB's Corporate Sector Purchase Programme

As of 23 September 2016, the value of purchased bonds under the ECB's Corporate Sector Purchase Programme (CSPP) was just under €27.9 billion. As of 31 August 2016, the split between secondary market and primary market purchases was 93.5%:6.5%. The Programme was launched on 8 June 2016 and is currently set to run as part of the ECB's overall Asset Purchase Programme (APP) until at least the end of March 2017.

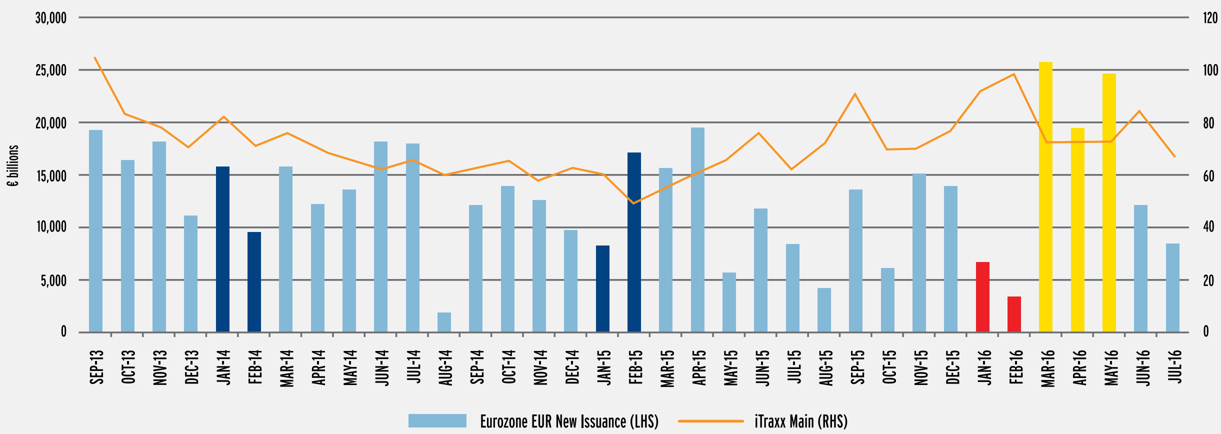
At the meeting of ICMA's Investment Grade Corporate Bond Secondary Market Practices Committee (SMPC) on 10 August 2016, participants noted that the effects of the purchases could already be felt in the secondary market with some eligible bonds already feeling "squeezed". In particular, members reported that the auto and utilities sectors were most impacted. In general, they felt that spreads had not tightened much further since the initial tightening following the announcement and details of the Programme, but rather it was becoming more difficult to find offers in eligible bonds. It was also suggested that any issues with liquidity were exacerbated by the fact that the European credit repo market had become relatively dysfunctional.

It was also noted that investors were moving further down the credit curve as liquidity conditions tightened in investment grade (IG) names, which was one of the intended outcomes of the CSPP. However, it was also pointed out by one of the buy-side members that not all investor mandates allow them to invest in sub-IG credits, and that these funds are naturally disadvantaged by the Programme. However, a counter view put forward was that the CSPP is helping corporate bond market liquidity by driving an increase in new issuance and so supply, while also putting a bid (the "ECB put") beneath the market.

The ECB will be attending the next meeting of the SMPC in London on 3 November 2016 to discuss the impacts of the CSPP with market participants.

Members interested in joining the SMPC should reach out to its secretary at ICMA, Andy Hill.

Primary & Secondary market performance of € non-financial IG corporate bonds



Data sources: ECB and Bloomberg/Markit

The above chart shows monthly total investment grade non-financial corporate issuance by euro area domiciled corporates issuing in euro, as well as the average monthly index rate for the on-the-run iTraxx main (IG) euro index. Credit markets sold-off sharply at the start of 2016, and new issuance levels dropped significantly. Credit spreads tightened and issuance levels picked up dramatically from March as a direct consequence of the announcement of the ECB's CSPP.

Bank of England Corporate Bond Purchase Scheme

On 4 August 2016 the Bank of England announced the launch of its Corporate Bond Purchase Scheme, with further details published on 12 September 2016. The purpose of the Corporate Bond Purchase Scheme (CBPS) is to impart monetary stimulus by lowering the yields on sterling corporate bonds, thereby reducing the cost of borrowing for companies; by triggering portfolio rebalancing into other assets by sellers of assets; and by stimulating new issuance of sterling corporate bonds.

The Bank of England will look to purchase, over an 18-month period, up to £10 billion of sterling investment grade bonds "representative of issuance by firms making a material contribution to the UK economy". Financials will not be included. Purchases will be executed by reverse auction in the secondary market, and bonds will not be eligible until one month after issuance. Based on the Bank's eligibility criteria, the current secondary market pool of bonds is around £110 billion (face value). The CBPS began on 27 September 2016.

ICMA is in contact with the Bank of England and will continue to monitor closely the impacts of the scheme on market functioning and liquidity.

Further details and publications relating to both the ECB and Bank of England corporate bond purchase programmes can be found on the ICMA website.

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Bond trading market structure and the buy side

The driving force behind the transformation of trading market structure in fixed income is the buy side. The catalyst for the buy side is the combination of regulation, including Basel III and MiFID II and the shifting role of buy-side traders. The onerous regulatory environment, with its capital requirements and MiFID II preparations, has created a terrain of less capital commitment from the sell side, a withdrawal of sell-side firms from certain business areas and overall lower available liquidity in the markets.

Against this regulatory background, the buy side is adapting. The buy side is now in the lead, triggering technological innovation in the attempt to solve or mitigate liquidity challenges. This is viewed in two ways: first, in buy-side execution where the buy side can be seen as price makers on innovative incumbent trading venues, as partners in a buy-side/sell-side consortium (creating electronic trading standards) or providers of liquidity through scraping technology for anonymous (no market impact) trading. Second, the buy-side trader role is changing to one of portfolio advisory. Quite often, a buy-side trader can be found proactively advising his or her portfolio managers regarding liquidity matters, ranging anywhere from selection of trading venues to derivative hedging to the shaping of portfolio components based on market intelligence. Basically, the buy side has migrated from a traditionally passive role to a forceful market participant in fixed income trading.

More than ever, the focus today is on the agility necessary to access bond liquidity across multiple counterparties and trading platforms, while using a variety of protocols. Current buy-side trading strategies are now more advanced and really a case of "horses for courses". What may be the right course for one trade, may not be the right course for another. The protocols and platforms that are being used by buy-side traders are dependent on the characteristics or the "conditions" of the trade. Examples of some of these trade conditions follow:

- *Time sensitive – illiquid:* requires strategies or protocols that involve some form of bilateral negotiation such as voice OTC, OTC market making or RFQs.
- *Time sensitive – liquid:* requires multilateral low-touch protocols such as all-to all (fixed time, *ad hoc* or continuous) auctions with no concern about market impact as information leakage is not important.

Often it is heard from regulators that there is no evidence that liquidity has deteriorated, whereas market structure technology development says that the evidence is to the contrary.

- *Non-time sensitive – illiquid:* requires protocols that are a combination of multilateral and bilateral, with an anonymous twist. The order can sit and wait for the other side or at the very least the best price. The order interacts anonymously with other participants but there is an electronic negotiation phase before execution. There is no market impact as there is zero chance of information leakage.
- *Non-time sensitive – liquid:* requires trading multilateral protocols that are low-touch, such as Central Limit Order Book (CLOB) or Smart Order Routing (SOR) technology to multiple CLOBs. These strategies will have more in common with equity instruments than most fixed income instruments. The key element to point out is that equities are more about electronic trading (speed) whereas fixed income is more about the "automation" of trading or optimisation.

Besides buy-side behavioural changes, it is important to look at the link between liquidity and technology. Often it is heard from regulators that there is no evidence that liquidity has deteriorated, whereas market structure technology development says that the evidence is to the contrary. After all, why spend all the time, money and effort to develop solutions to problems that do not exist? The buy side, which is facing the lion's share of liquidity challenges today, is actively shaping protocols and working with trading venues and IT firms to tailor-make functionality. The idea is that this electronic innovation can assist with sourcing, aggregating, crossing, routing or optimising whatever little liquidity there is out there.

The buy side is investing in or sponsoring new services and solutions in order to carry out its advisory trading roles and responsibilities. The technology is widespread: everything from software algos like "fuzzy matching" to outsourced trading. Many of these new services and solutions are not hindered by the fragmented IT legacy of many of the large incumbents. They are more responsive to solving or mitigating liquidity challenges in fixed income markets. The key software and platform developments triggered by the buy side are as follows:

"Fuzzy matching": Software which can identify a bond that matches closely the characteristics of the bond which the buy side or sell side is trying to source. This technology is the best proof yet that there is a liquidity problem. Buy-side traders and portfolio managers are giving up on accessing certain bonds and trying for ones that *nearly match* the wanted criteria.

Information Networks (INs): sourcing and aggregating liquidity: IN firms provide an aggregation layer, offering the trader two key sets of functionality: (i) a global view of liquidity and (ii) a choice of trading protocols and execution mechanisms from which to select. The trader uses this layer to obtain an accurate, timely view of available liquidity across markets. INs use a high degree of technology embedded in the buy side and sell side's internal systems.

Execution Management System (EMS): Execution Management Systems (EMSs) are software applications used by institutional traders (traditionally on the sell side but now the buy side) designed to display market data and provide seamless access to trading destinations for the purpose of executing trades. Often they contain broker-provided and independent algorithms, global market data and technology that is able to help predict certain market conditions. One of the important features of an EMS is that it can manage orders across multiple trading destinations such as MTFs, broker-dealers, crossing networks and electronic information networks. EMSs also connect the front office to the back office (through Order Management Systems), achieving efficiencies, cost reduction and risk mitigation.

Liquidity scorecards: The buy side is already working with this to an extent today. In the future, it will become more commonplace and standardised. The likelihood is that rating agencies *might* take this up in order to truly standardise liquidity ratings. However today, this functionality is built in to some trading venues and data providers.

Consortium-owned networks between buy side and sell side: Collaborative efforts between the buy side and sell

This technology is the best proof yet that there is a liquidity problem.

side where market participants are coming together in the attempt to create liquidity in the bond markets. The hope is to enable greater transparency of trading interests across the marketplace between buyers and sellers of bonds. The relationship is made up of banks and asset managers. Across the network, directly connected buy sides access pre-trade indications from participating sell sides. The buy side can receive pre-trade indications from multiple banks in a standard format using a single connection (ie FIX protocol).

Niche trading: The buy side is routing trades to banks that are developing electronic specialised expertise and are becoming known for trading and making markets in certain asset classes or regions: eg LATAM or automotive.

*Inter-dealer broker (IDB) hybrid voice/electronic***:** IDBs are reinventing themselves and actively building solutions that are interacting with buy-side inventory, either by direct FIX API connectivity or existing Order Management System infrastructure. They are offering a variety of trading protocols eg CLOBs or auction-based, volume matching tools that enable buy and sell-sides to trade anonymously at a predetermined or dynamic mid-price, across multiple liquidity pools with integrated back office, technology and infrastructure.

Multi-asset trading: As banks and buy sides review their bottom lines more, it has become obvious that some IT and skill-sets can be shared. It is too expensive to have totally separate infrastructure carrying out trades that would ultimately benefit from sharing of knowledge between asset classes. Multi-asset desks can provide high touch and low touch trading based on the needs of the trade, *regardless of instrument*.

Buy-side price-makers: The buy side is starting to place firm prices on Central Limit Order Books (CLOBs) and other agency-only trading venues. However, the buy side is not placing firm prices in large sizes. Hedge funds *may* step in (providing it suits their trading strategies) and provide larger sized bond pricing, bolstering available liquidity as price making is more conducive to a hedge fund's business model than an asset manager's. Traditional asset managers will not step in as market makers.

Internal fund crossing portal: A workflow efficiency tool enabling the buy side to execute internal fund crosses at an independently determined mid-price, creating "internalised liquidity".

All-to-all: This is the true definition of "multilateral trading" (connecting dealers, investors and other market participants on a centralised all-to all platform). All-to-all brings together pre- and post-trade information from a number of market data sources and electronic platforms and routes transactions through one all-to-all platform, creating a buy-side/sell-side firm liquid marketplace. (Today, this is suitable for small sizes that are liquid).

Central Limit Order Books (CLOBs): CLOBs are an example of all-to-all but with built-in electronic limits. CLOBs are popular in small sizes and liquid trades. This is due to the fact that neither the buy side nor the sell side wants to leave a large/illiquid price available to be traded against. It is thought that CLOBs may end up assisting price discovery as a "reference price" (even though the average trade size will be small) for anonymous trading platforms.

Anonymous trading platforms (multilateral): Anonymity is attractive to market participants who want to complete large transactions without drawing attention to their trades, since such attention could impact market prices. These trading venues are anonymous and/or semi-lit and can be buy side to buy side or buy side to sell side. Price formation is in the dark (non-transparent) as the anonymity protects participants. The success risk for these trading venues or platforms is that a trading venue can match a buyer and a seller in the dark but they need to have an idea of a mid-price (comparison "reference price") to trade successfully. Most believe there will be somewhere between 6% and 10% of all bond trades carried out on these platforms.

"Super trading desks" or "outsourced trading": A few large regional buy sides are creating centralised super-desks offering efficiency and lower operational risks. These out-sourced trading desks are accessing more easily sell-side market making capabilities (balance sheet) and global reach. An outsourced trading provider will be able to evidence best execution to regulators and trade report to the public for its clients in a scalable manner. The ability to measure best execution and broker performance as well as buy-side trader performance will be offered through transaction cost analysis (TCA). Further benefits are regulatory process control through management of transparency thresholds under MiFID II and "reg-tech" costs.

No one knows where the reinvention of the buy side will take fixed income market structure development in the future. However, this is one to watch as the buy sides are adjusting their behaviour with each other as well as with sell-side broker-dealers due to the twin tidal forces of regulatory pressures and low liquidity environment. Increasingly, the buy side is becoming more shrewd and knowledgeable not only in the use of technology but also by expanding business practices into price making (not to be confused with market making), providing target prices at which it is willing to trade. This is the start for a buy-side seismic shift away from passive patterns of behaviour of the past towards a more proactive one of the future.

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ICE Data Services Liquidity Tracker

ICE Data Services has established a means of tracking liquidity conditions in fixed income markets, in response to a request from ICMA.

ICE Data Services Liquidity Indicators

The model is based on ICE Data Services' Liquidity Indicators, which are designed to provide an independent view of near-term relative liquidity, defined as "the ability to exit a position at or near the current value." The indicators use a transparent methodology to assign a liquidity ratio to an individual security, based on the interaction between projected price volatility and trade volume capacities.

ICE Data Services provide estimates of trade volume capacity, future price volatility, days to liquidate, and market price impact. Liquidity ratios for all securities are ranked from least liquid to most liquid, and scored between 0 and 10 (with 10 being the most liquid). These scores, based on ICE Data Services' extensive evaluation and reference data, are updated daily.

ICE Data Services Liquidity Tracker

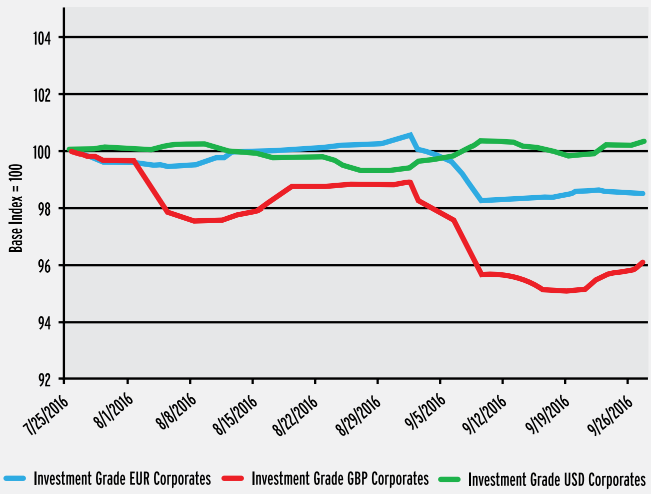
The ICE Data Services Liquidity Tracker is based on the average liquidity ratios of an extensive basket of securities for each market segment. The current number of underlying ISINs used to calculate the tracker are: IG USD 16,643; IG EUR 2,790; IG GBP 638; HY USD 12,633; HY EUR 1,952; HY GBP 456. Investment grade is determined by a minimum BBB- rating from one of the three main rating agencies, and includes financials and non-financials.

The starting reference point for the tracker is 25 July 2016, where it is assigned a value of 100. Data is then run on a look-back basis to determine relative changes in market liquidity since the reference date. To ensure continuity in the data series, only issues active at the reference date are included in the ICE Data Services Liquidity Tracker.

Using the Tracker

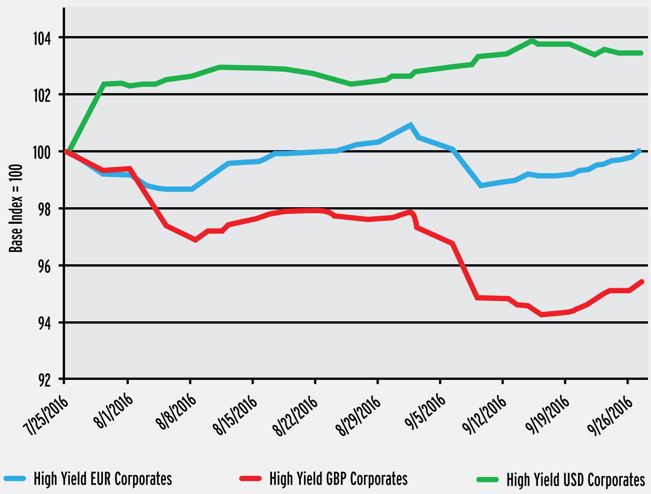
With the permission of ICE Data Services, ICMA intends to publish and monitor the ICE Data Services Liquidity Tracker on a quarterly basis. There is also the possibility of extending the ICE Data Services Liquidity Tracker to other asset classes, including sovereign bonds, as well as creating a more granular sector based tracker.

ICE Data Services Liquidity Tracker: IG Corporates



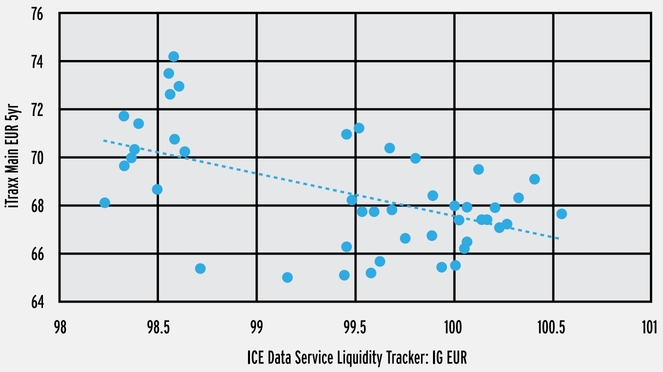
Source: ICE Data Services

ICE Data Services Liquidity Tracker: HY Corporates



Source: ICE Data Services

Market Liquidity vs Credit Spreads



Data sources: ICE Data Services and Bloomberg/Markit

Interpreting the Tracker data

The data suggests relatively stable liquidity conditions since July for both the US IG and HY markets. Perhaps not surprisingly, the GBP IG and HY markets saw a sharp decline in liquidity directly following the outcome of the Brexit vote, before stabilizing in late August. Both the EUR and GBP markets then show a steep decline at the beginning of September, before again levelling out, and improving slightly toward the end of the month. While it is difficult to attribute causality with any degree of certainty, this decline in EUR and GBP liquidity conditions seems to coincide with a market sell-off and a widening of credit spreads.

The above chart plots the ICE Data Services EUR IG Tracker against the iTraxx 5-year EUR main index over the same period. Again, perhaps not too much should be inferred in terms of correlation, but the clusters on the top left (higher spreads and lower liquidity) and the bottom right (lower spreads and higher liquidity) seem to suggest not only a relationship between market levels and liquidity, but also a tendency for both credit spreads and liquidity conditions to "gap".

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"The data suggests relatively stable liquidity conditions since July.

Market Abuse Regulation: Investment Recommendations

The EU Market Abuse Regulation (MAR) final draft Regulatory Technical Standards for Investment Recommendations were submitted by ESMA to the European Commission in September 2015, and adopted by the European Commission in March 2016. Following approval by the European Council and European Parliament, the Regulation came into effect on 3 July 2016. It is important to note that ESMA has not yet released Level 3 Q&A for MAR Investment Recommendations. No firm Level 3 Q&A date has been announced. Further background on the Investment Recommendations under MAR is available on page 35 of the ICMA Quarterly Report for the Third Quarter.

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MiFID II/MiFIR

Background: Generally speaking, MiFID II concerns the framework of trading venues and structure in which financial instruments are traded. MiFIR on the other hand, concentrates on regulating trading venues and structuring its operations: so, "who" the market structures are, "what" they trade and then "how" they trade. Regarding trading, the issues that ICMA is covering and considers to be the most important for members are the pre- and post-trade transparency regulations and best execution obligations.

RTS: The European Commission has adopted most if not all of the Regulatory Technical Standards. The adoption status of the RTS has been published.

Timeline: Owing to the ESMA database IT build, an implementation date delay has been approved by the Commission from 3 January 2017 to 3 January 2018.

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It is important that the ICMA Buy-in Rules continue to serve as an efficient and practical remedy.

ICMA Buy-in Rules: consultation with members

On 5 September 2016, ICMA launched a consultation of its members to review and potentially update the ICMA Buy-in Rules under the Secondary Market Rules & Recommendations. This is in response to feedback from members with respect to the efficiency of the existing buy-in process in the current market environment.

ICMA's consultation with members

The consultation focuses on a number of key areas with respect to the ICMA Buy-in Rules, in particular:

- the requirement (or not) to appoint a buy-in agent;
- flexibility in the timing of the buy-in; and
- the potential for buy-in auctions.

More information on the consultation and the need to review the Rules is provided in a background paper available on ICMA's website. To respond to the survey, interested members should use the electronic survey link, also available on ICMA's website. Alternatively, they should contact Andy Hill, who can provide them with the relevant link. Member firms are able to submit multiple responses, across impacted business areas and trading desks. The deadline for responses to the consultation is the close of business on 21 October 2016.

Following the closing of the consultation period, ICMA will publish an aggregated and anonymized summary of the results of the consultation, along with any recommendations for revisions to the Rules, and which will be made available to the membership. Any recommendations will be reviewed and subject to approval by the Secondary Market Practices Committee at its next meeting on 3 November 2016. Any changes to the Rules will come into force shortly after this date.

CSD Regulation mandatory buy-ins

ICMA is aware that CSD Regulation, which was passed into law in September 2014, introduces a harmonized buy-in regime across the EU, and that this is expected to come into force by early 2019. Once implemented, this is expected to supersede the ICMA Buy-in Rules in the case of trades that are in scope of the EU regulation. Meanwhile, it is important that the ICMA Buy-in Rules continue to serve as an efficient and practical remedy available to participants in the cross-border bond markets in the event of settlement fails.

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Repo and Collateral Markets

by David Hiscock and Alexander Westphal

Leverage Ratio

On 3 August 2016, the EBA published its report on the impact assessment and calibration of the Leverage Ratio (LR), recommending the introduction of a LR minimum requirement in the EU to mitigate the risk of excessive leverage. The EBA's analysis suggests that the potential impact of introducing a LR requirement of 3% on the provision of financing by credit institutions would be relatively moderate, while overall it should lead to more stable credit institutions; and this will inform the work of the European Commission on potential legislative proposals, currently anticipated for publication in November, on LR.

The EBA's report includes input from the ESRB with regard to the potential impact of a LR on market liquidity (Annex III). The introduction to this ESRB contribution includes the observation that the most recent discussions on the introduction of a LR have focused on the topic of market liquidity. It notes that some industry participants and other observers are investigating whether financial markets have become less liquid or more prone to episodes of severe illiquidity, with some pointing to post-crisis regulatory reform as having affected the supply of liquidity and intermediation services by broker-dealers in a significant way; and goes on to note that the LR, which has been introduced in some key jurisdictions (US, Switzerland and UK) and is expected to be introduced more widely from 2018, has come under particular criticism for constraining broker-dealers' balance sheets particularly with respect to low margin business such as SFTs.

The conceptual discussion then notes that, all things being equal, in normal market conditions the LR may make some market liquidity-related activities less attractive for a part of the banking sector and result in increased capital costs for firms with low average risk weights; and that this might particularly affect holding inventory in markets where the expected returns are relatively low such as sovereign bonds and high quality corporate bonds, and intermediating SFTs. Prior to its conclusions, this ESRB contribution then includes a section regarding market makers' feedback on factors affecting their market making capacity and market liquidity and a section outlining the ESRB's associated empirical investigation

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Haircuts

Article 29.3 of the EU SFTR states: "By 13 October 2017, the Commission shall submit a report to the European Parliament and to the Council on progress in international efforts to mitigate the risks associated with SFTs, including the FSB recommendations for haircuts on non-centrally cleared SFTs, and on the appropriateness of those recommendations for Union markets. The Commission shall submit that report together with any appropriate proposals. To that end, ESMA shall, by 13 October 2016, in cooperation with EBA and the ESRB and taking due account of international efforts, submit a report to the Commission, to the European Parliament and to the Council, assessing: (a) whether the use of SFTs leads to the build-up of significant leverage that is not addressed by existing regulation; (b) where appropriate, the options available to tackle such a build-up; (c) whether further measures to reduce the pro-cyclicality of that leverage are required. ESMA's report shall also consider the quantitative impact of the FSB recommendations."

ESMA has accordingly been studying the topic of haircuts and has sought some market input to better inform its understanding of existing haircut practices and levels; and is looking back at the FSB's applicable work. In October 2014, the FSB published its regulatory framework for haircuts on non-CCP cleared SFTs, which aims to limit excessive leverage build-up outside the banking system and to reduce its procyclicality. This framework consists of (a) qualitative standards for methodologies used by SFT market participants to calculate haircuts on the collateral received; and (b) numerical haircut floors that will apply to non-CCP cleared SFTs in which financing

The majority of repos are based upon government securities – which showed quite minor changes in average haircuts.

against collateral other than government securities is provided to entities other than banks and broker-dealers (referred to for simplicity as "non-banks"). This framework was then expanded by the FSB, in November 2015, to also include numerical haircut floors to apply to non-bank-to-non-bank SFTs.

In addition to the framework document, the FSB also published a background document entitled *Procyclicality of Haircuts: Evidence from the QIS1*. This clearly illustrates (as can be seen in the following extract) that the biggest increases in average haircut levels during the financial crisis related to that sub-set of repos where securitisation assets were being used as the collateral. As can be seen from the semi-annual ICMA European repo market survey reports, in the European repo market there was little use of such collateral in repos, with the majority of repos being based upon government securities – which showed quite minor changes in average haircuts.

Notwithstanding the FSB's work and conclusions, there is a persistent suggestion that there may be a case for the EU to adopt rules in respect of haircuts which would go further than the FSB's recommendations. In particular, on 6 June 2016, the ESRB held an international conference on the macroprudential use of margins and haircuts. The keynote speech, given by Vítor Constâncio, Vice President, ECB, includes proposals for macroprudential tools to be used for controlling haircuts and margins across SFT (and derivative) markets. Yet it needs to be adequately recognised that, whilst haircuts protect one party to a repo, they create exposure for the other; and markets risk being disrupted if the EU adopts haircut rules which go beyond the FSB proposals. The discussion on "macroprudential considerations" later in this section of the ICMA Quarterly Report includes more information relating to this matter.

On 4 October 2016, ESMA duly published its Article 29.3 report to the Commission. While remaining cautious when considering the introduction of new quantitative regulatory requirements on SFTs, ESMA recommends to:

- introduce the FSB's qualitative standards in the methodology used to calculate haircuts;
- address the procyclicality of collateral haircuts in CCPs in the context of the EMIR review;
- assess the possible extension of the FSB's scope for numerical haircut floors, in particular to government bonds, and the calibration of these floors using SFTR data which will become available in 2018; and
- assess procyclicality and the potential need for further policy tools once sufficient data becomes available.

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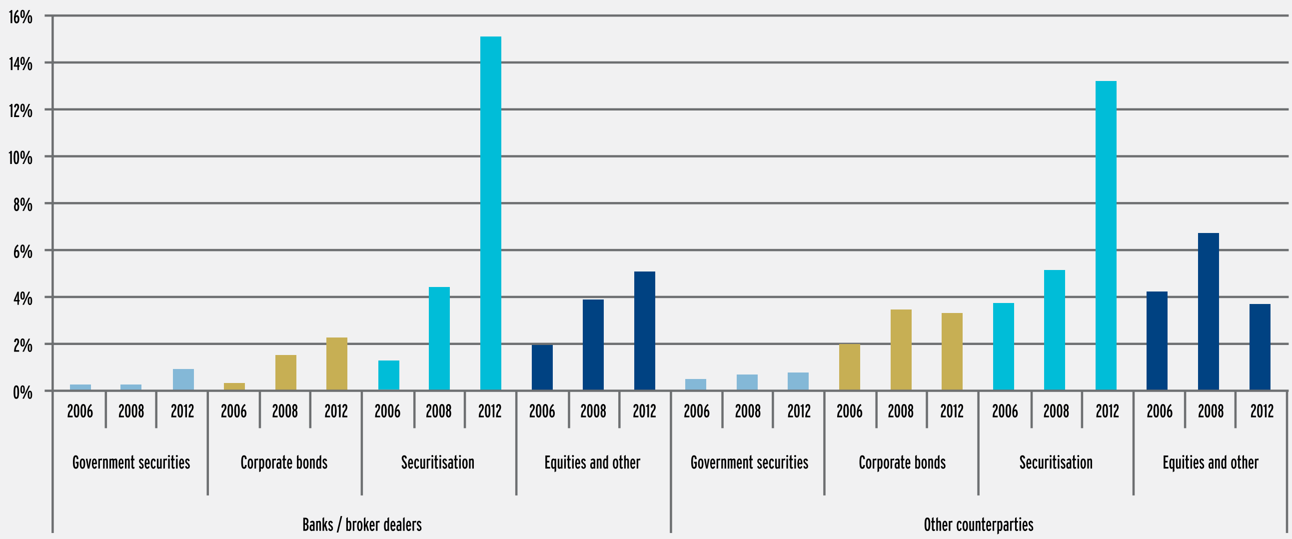
Average Haircut



Source: FSB

SFT Regulation

On 30 September 2016, ESMA published its long awaited second consultation on draft Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) under the EU SFT Regulation (SFTR), following up on a first consultation published in March 2016. Most importantly, the draft RTS and ITS specify the details of the upcoming reporting framework for SFTs, but also cover some related aspects around the registration of trade repositories, transparency and availability of data and data access levels. Besides specifications required under the SFTR, the consultation also includes selected amendment proposals to existing RTS under EMIR which aim to align the EMIR regime for derivatives with the proposed SFTR framework. The deadline for stakeholders to respond to the consultation is 30 November 2016. The ICMA ERCC will prepare and submit a response to the consultation. Taking into account feedback received, ESMA will then finalise the draft technical standards and submit them to the Commission for endorsement. Once both RTS and ITS are adopted, firms will have another year to prepare before the actual reporting starts (currently expected in 2Q 2018)

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Asset segregation and custody services

On 15 July 2016, ESMA published a Call for Evidence (for comment by 23 September) on Asset Segregation and Custody Services under AIFMD and the UCITS Directive. ESMA first consulted on asset segregation under the AIFMD in December 2014. However, given the majority of respondents objected to the two options on which ESMA consulted, coupled with the fact that the new UCITS V Directive has recently introduced asset segregation requirements which are broadly aligned to the AIFMD, ESMA has decided to carry out a further consultation. This Call for Evidence has a broader scope than the initial consultation as it also covers asset segregation rules under the UCITS Directive and any residual uncertainty on how the depositary delegation rules should apply to CSDs.

ESMA's work on Asset Segregation and Custody Services had previously been discussed at the, 21 June, joint meeting in Vienna of the ICMA ERCC Committee and the ISLA Board, where it was agreed that in principle the ICMA ERCC supported ISLA's concerns. Consistent with this agreement, on 23 September, the ICMA ERCC submitted its formal response to this ESMA Call for Evidence. The ICMA ERCC's response flags the importance of repo and collateral markets; and highlights that these already face significant stress which is bearing on the liquidity of the market. It then observes that there is a risk to make this worse with the asset segregation requirements and expresses full support for ISLA's more detailed response to this Call for Evidence.

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The Counterparty Gap

On 27 September 2016, the ICMA ERCC published a new study, *The Counterparty Gap*, authored by John Burke, on the trade registration models used by European CCPs for repo transactions. This study was published alongside the latest semi-annual ICMA ERCC General Meeting, at which the author publicly presented this piece of work, highlighting the conclusions and recommendations it has led to.

The majority of European repo market activity is already CCP cleared and it is expected that this amount will grow as more market participants become directly involved in the CCP clearing process. The ICMA ERCC believes it is important to increase the level of awareness of how the sometimes complex process flow that supports CCP activity is structured and, where possible, to educate and inform market participants on any areas of risk.

This short new study focuses on a specific issue ("the counterparty gap") that emerged from a broader analysis of CCPs' trade registration models. The issue relates to risk borne by market participants arising from different trade registration models and the different timings and procedures used by the CCPs to manage trade acceptance and trade rejection scenarios. The analysis covers trades that are executed via automated trading systems, traded bilaterally or executed on a name give-up basis via voice brokers.

The study contains agreed recommendations from the ICMA ERCC on a number of changes to market best practice that, when adopted, could reduce the risk to market participants arising from the counterparty gap issue. By working together now to clarify the position regarding the counterparty gap issue, market participants and infrastructure providers will achieve an enhanced operating and risk management environment for CCP cleared business and ensure that any future increase in CCP activity, eg for dealer-to-client trades, can be managed more comfortably.

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Secured benchmarks

On 19 July 2016, the FSB published *Reforming Major Interest Rate Benchmarks*, which provides a progress report on implementation of its July 2014 recommendations to reform major interest rate benchmarks. The report finds that, since the last progress report published in July 2015, administrators of key interbank offered rates (IBORs) have continued to take steps to implement the recommendations. While substantial progress has been made, the reforms of the IBORs have not been completed; and administrators should now focus on transition and decide how to anchor rates in transactions and objective market data as far as practicable.

Additionally, one of the key recommendations set out in the report of the Official Sector Steering Group (OSSG) of regulators and central banks in July 2014 was for authorities to encourage the development of risk-free rates (RFRs) for benchmarks. It is considered that OSSG members have now made good progress in identifying potential RFRs; but that more progress remains to be achieved in identifying RFRs and promoting their use where appropriate – where groups have been set up to identify a single alternative and to promote its use, the final choice has yet to be made and transition planning is still in preliminary stages.

Chapter 3 of the July 2016 report (starting at page 20 of the report and 22 of the pdf file) covers the topic of "developments in RFR benchmarks", including the potential utilisation of secured benchmarks – the chapter comprises an initial overview, followed by individual sections on US dollar; euro (with specific mention of the ERC and the continuing work of EMMI); Japanese yen; sterling; Swiss franc; Australian dollar; Canadian dollar; Hong Kong dollar; Singapore dollar; and South African rand. The OSSG will continue to monitor progress in reforms to interest rate benchmarks, and will prepare a final report for publication by the FSB in 2017.

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MiFID II/MiFIR: repo

The EU's incoming MiFID and MiFIR rules (published in the *Official Journal* of the EU on 12 June 2014) will govern the trading of securities and, to some extent will impact on repo activities. During the course of September 2016, ICMA has published an updated Q&A paper on *MiFID II/R and Repo*. This highlights that the key aspects of the regulation that impact repo markets are best execution reporting obligations, transacting with retail clients and, to a limited extent, transaction reporting. There are no pre- or post-trade reporting (transparency) obligations with respect to securities financing transactions (SFTs), the definition of which includes repos..

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Macroprudential considerations

On 19 July 2016, the ESRB published a strategy paper entitled *Macroprudential Policy Beyond Banking: an ESRB Strategy Paper*. The paper asserts that the ESRB has a leading role in the development of the macroprudential policy strategy and instruments to address risks beyond the banking sector; and, included amongst key tasks summarised for the ESRB and its members in the short to medium term, are to use new data that will become available under existing legislation, such as SFTR, to monitor market trends and risks to financial stability; and to contribute to the development of new macroprudential instruments, such as instruments that address liquidity mismatches at investment funds and the procylicality of initial margins or haircuts, especially in SFTs and derivatives.

Reviewing sources of systemic risk, paragraph 17 in the paper describes how brokers and dealers may adjust haircuts in a procyclical manner and illustrates how this may be problematic by producing a chart (figure 3), which shows the dramatic increase in haircuts on AA-rated mortgage-backed securities at the time of the financial crisis. Considering policy options, paragraph 31 then outlines how macroprudential margin and haircut requirements can limit procyclicality and constrain the build-up of leverage via SFTs and derivatives; and suggests that setting margins and haircuts in a conservative or countercyclical manner may help to contain the build-up of leverage as well as reduce the impact of margin calls during stress events.

In context of a review of EU legislation, paragraph 40 flags that EU regulations for derivatives and SFTs do not yet provide for the macroprudential use of margins and haircuts by authorities, whilst noting that work is underway at the ESRB to set out how such tools could work in practice. Table 4, on page 23, indicates that, relating to SFTR, ESRB members should enhance risk monitoring based on new granular data (once available) and form a data hub on SFTs in the EU; and that legislative authorities should not only review the options for transposition of the FSB recommendations on minimum haircut requirements on non-centrally cleared SFTs, but also add elements for the macroprudential use of margins and haircuts.

On 27 July 2016, the ESRB published the first *EU Shadow Banking Monitor*, which presents an overview of developments in the European shadow banking system to assess potential risks to financial stability; and identifies a number of issues that can be a source of, and amplify, systemic risks. In section 1.4 (at page 11), relating to activity-based mapping of shadow banking, this includes a short section on repo markets, including reference to the ICMA European repo market survey. It notes that:

- "repos contribute to a high degree of interconnectedness between MFIs because the majority of transactions are interbank, but they also reflect links between MFIs and OFIs";
- "the volume of open maturity transactions which would mitigate run risk appears limited"; and "besides, repos are generally short-term instruments, and both lenders and borrowers can easily decide to withdraw from funding at short notice" ("around 30% of repo transactions have a maturity shorter than a week and 60% shorter than a month") – yet "the size and trading activity of repo markets imply that liquidity risk is limited under normal market conditions, but this may vary across markets"; and
- "the very limited information available on repo transactions and exposures makes it challenging to assess what might happen under stressed market conditions."

Alongside this, the ESRB also published an Occasional Paper, *Assessing Shadow Banking – Non-bank Financial Intermediation in Europe*, which applies both an "entity-based" approach and an "activity-based" approach when mapping the broad shadow banking system in the EU. Section 3 (at page 26) of this paper concerns activity-based mapping of shadow banking in Europe, with section 3.1 (at page 27) covering the topic of SFTs and section 3.1.1 (at page 28) then specifically addressing repo markets:

- within the introductory paragraphs of section 3, it is asserted that "SFT markets contribute to maturity and liquidity transformation within the financial system. It is also noted that multi-layered network exposures may arise in derivatives or SFT markets as well as in underlying collateral markets, giving rise to interconnectedness and potential contagion risks";
- in section 3.1 it is then stated that "Understanding the extent to which SFT markets contribute to shadow banking risks (eg by analysing the maturity structure of securities on loan for maturity transformation, or the type of assets in which cash collateral is reinvested for liquidity transformation) should usefully complement the entity-based approach, as a significant amount of these activities are carried out off-balance-sheet"; and
- further, in section 3.1.1 it is stated that: "Repos may contribute to an overreliance on short-term funding – an unstable source of funding that tends to dry up when market conditions deteriorate. However, evidence from the academic literature suggests that volumes in the repo market remained relatively resilient in recent periods of stress. That said, conditions may vary by market."

However, evidence from the academic literature suggests that volumes in the repo market remained relatively resilient in recent periods of stress.

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ICMA Ops FinTech Working Group

Technology is reshaping the way financial markets operate. The impact of FinTech is likely to be felt most acutely in the post-trade space, with distributed ledger technology (DLT) attracting much attention among both market participants and media. Besides DLT, there is a whole raft of other technology solutions and tools that have emerged. Technology has an important role to play when it comes to alleviating existing frictions in the banks' back offices and contributing to a more efficient post-trade lifecycle. Conscious of the importance of the developments in the FinTech space, members of the ERCC Operations Group decided to set up a new Working Group, chaired by Sanjiv Ingle (Société Générale), to focus specifically on technology in the area of post-trade. The main objective of the new FinTech Working Group (WG) will be to develop a better understanding of existing tools and emerging FinTech solutions, including through greater interaction with the relevant providers. This complements ICMA's efforts to promote automation and efficiency in trade processing, reflected in many of the recent ERCC Ops initiatives, including those focused on matching and affirmation, trade confirmations or collateral messaging. While formally set up as a sub-group under ICMA's ERCC Operations Group, the scope of the new group goes beyond repo and also covers solutions in the cash bond space. Participation in the FinTech WG is furthermore not restricted to ERCC Ops members, as the Group aims to serve as an open forum for ICMA members to exchange information on this rapidly moving and fluid market. The FinTech WG will meet on a regular basis, approximately every 6 weeks. The initial session was held on 23 September 2016, hosted by Société Générale in London.

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31st ICMA European repo survey

ICMA's European Repo and Collateral Council has released the results of its 31st semi-annual survey of the European repo market. The survey, which calculates the amount of repo business outstanding on 8 June 2016 (prior to the Brexit vote in the UK) from the returns of 67 offices of 63 financial groups, mainly banks, sets the baseline figure for market size at €5,379 billion, a 4.1% decrease on the December 2015 figure of €5,608 billion and a year on year decrease of 1.6% from the survey in June 2015.

The decline in the baseline figure since the previous survey largely reflects the reduced number of survey participants. However, a comparison of a constant sample of survey participants shows a small, largely seasonal, rise of 0.5% since December but a year-on-year decline of 1.6%, confirming that the overall trend for repo market activity continues to be downward.

This long term reduction in repo activity may be attributed to the impact of regulation, including new liquidity and leverage regulations. However, the survey shows that global systemically important financial institutions (G-SIFIs) with strong investment banking franchises have taken the opportunity to increase the size of their repo books, perhaps because there is scope provided by the phased implementation of these new regulations. National differences in the implementation of the new rules may have also created opportunities for some banks. If this is the case, then further contraction can be expected in the market.

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Review of the *Guide to Best Practice in the European Repo Market*

By Lalitha Colaco-Henry

Early this year, ICMA set up a standing working group to review proposed updates to the *Guide to Best Practice in the European Repo Market* (the "Guide"). The working group consists of members of the ERCC Committee, the ERCC Operations Group, ICMA staff and the Guide's author, Richard Comotto.

The Guide seeks to foster a fair and efficient repo market by recommending the adoption of best practices aimed at avoiding uncertainty or disagreement about transactions or delay and disruption to repo trading and settlement. The Guide also seeks to codify market conventions, where this is thought to be helpful for market participants.

The Guide, in its current format, was originally published in March 2014. The 2014 version superseded previous repo trading practice guidelines that had been published more than decade earlier and several subsequent recommendations issued by ICMA and the ERCC. The March 2014 version of the Guide was subsequently updated in July 2015.

The working group is currently finalising the latest series of updates to the Guide to provide further clarity as required. Some of the more significant updates to the Guide include a new section on confirmations. There is also new guidance on negative interest rates, partial delivery, the treatment of open repos that run for extended periods and netting. We anticipate that the Guide will be available in October.

The Guide will continue to be updated periodically to reflect evolution in the agreed understanding of best practice as the market develops. The most up-to-date version of the Guide will be available on the ICMA website to download and print. It will be for repo market participants to ensure that they check the ICMA website regularly to ensure that they are using the most up-to-date version of the Guide.

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Asset Management

by Patrik Karlsson and Dr. Nathalie Aubry-Stacey

The buy side and ICMA

ICMA is one of the few trade associations with a European focus that has both buy-side and sell-side representation. Of a total of around 500, ICMA currently has around 160 members from the buy side. Buy-side members have always been part of the membership of ICMA, especially through the trading desks of private banks. However, in recent years, ICMA has taken concrete steps to consolidate the buy-side/sell-side nature of its membership and ensure that this is a recognised unique selling point, especially in the trade association landscape. Indeed, engagement with the buy side is now essential and boundaries between activities of the sell side and the buy side are now blurred in areas that have traditionally been the preserve of the sell side, such as repo and liquidity provision.

As a result, ICMA has grown its buy-side membership and expertise by providing dedicated resources to asset management and investment issues, and actively encouraging further collaboration with traditionally sell side-only regulatory activities of ICMA. To reflect the growing importance of the buy side in the marketplace in general and to add substance to ICMA output to public authorities, ICMA decided in 2008, as a first step, to set up the Asset Management and Investors Council (AMIC), and increase the number of Board members from buy-side institutions. The Council was established to represent the views of, and add value to, the buy-side members of ICMA by discussing investment issues of common interest, reaching a consensus and recommending any action that ICMA should take. The AMIC is now a fully structured Council encompassing about 250 contacts. The AMIC organises semi-annual conferences, quarterly Executive Committee meetings and manages sub-committees/working groups.

The AMIC is the only independent voice for the buy side within ICMA, and the most representative in terms of numbers. However, buy-side members are also welcome to be involved in other ICMA activities that have traditionally only involved the sell-side.

As a second step to attract more buy-side members, some working groups were built on the basis of a joint buy-side/sell-side membership from the start, eg the European Corporate Debt Private Placement Joint Committee, the AFME/ICMA joint Infrastructure Working Group, and more recently the Electronic Trading Working Group and the Green Bond Principles Executive Committee. These groups were formed with the help of AMIC members as well as contacts from industry experts.

As a third step, and as a more recent move, buy-side members – whether members of AMIC or not – have been encouraged to participate in committees and working groups that have traditionally only involved sell-side members. Examples include the Secondary Market Practices Committee (SMPC) and the European Repo and Collateral Council (ERCC).

It is also worth noting that in other areas of ICMA, the buy side has never been neglected even though members are not allowed to sit on committees. On the primary market side, the Secretariat has organised New Issue Process Roundtables in various countries since 2010 (there have been 12 roundtables so far and it is likely that there will be more in the future). These roundtables gather syndicate representatives, investors and issuers to discuss topics such as pre-sounding and allocation. On the issuer side, the issuers' forums have been keen to engage with buy-side speakers in meetings or discuss common topics. The Bail-in Working Group and the Financial Institution Issuer Forum (FIIF) have already held discussions on potential areas of convergence in the future. There is scope for more cooperation between the AMIC and these forums in the future.

Buy-side members – whether members of AMIC or not – have been encouraged to participate in committees and working groups that have traditionally only involved sell-side members dealing with secondary market issues and repo and collateral markets issues. Still, in these groups the buy side remains a minority.

As far as concrete steps, a buy-side co-chair is in the process of being approved by the Secondary Market and Practice Committee to represent a broader market view, and in the long term attract more buy-side interest. The European Repo and Collateral Council has already identified that not having more buy-side members on its Council and Committee is an issue of concern. This no longer reflects the repo market, which in recent years has seen growing buy-side participation, and there is a shared willingness from ICMA, the ERCC Committee, and also buy-side members, to take concrete steps to increase buy-side participation in the activities of ERCC.

On the primary market side, *ad hoc* discussions with buy-side members have been held. However, absent a separate buy-side working group (to complement the dedicated issuer and underwriter groups), there is no systematic way for ICMA buy-side members to form opinion and comment on regulatory and market developments and feed them into ICMA responses, or draft their own responses and statements on primary market developments. A separate buy-side working group supported by the AMIC would need to be considered to engage with the existing issuer/underwriter committees and so build cross-constituency primary markets coverage.

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Covered bonds: harmonisation and transparency

The ECBC Plenary Meeting took place on 14/15 September 2016 in Düsseldorf. The key issues addressed during discussions and presentations included, among others, harmonisation and transparency. The harmonisation of covered bond legislation is still a well-discussed topic. Whereas there are advantages in harmonisation of legislation, since it would be conducive to transparency and help the research work required for each investment, there are many who believe that harmonisation would hamper innovation in the covered bond market. Unsurprisingly, the issues of harmonisation and transparency have now also found their way into the discussion of conditional pass-through (CPT) structures. This is a discussion investors welcome.

The harmonisation issue is likely to remain under the spotlight in the covered bond world in the next few months. The European Banking Authority (EBA) announced at the meeting that it planned to send a recommendation on harmonisation of covered bond legislation to the European Commission before the end of the year. However, it remains to be seen whether the Commission will concur with the EBA's recommendations or whether there will be a legal requirement for EU Member States to harmonise their legislation.

The European Commission is in fact conducting its own further analysis of the covered bond market. Following on from the public consultation on the covered bond market last year, to which members of the Covered Bond Investor Council submitted a detailed reply, the European Commission has now hired an external consultant to further study this topic as part of the Capital Markets Union initiative. The initial public consultation revealed a broad consensus amongst market participants that there was no significant evidence of failings in the covered bond market over the course of the crisis but that this did not necessarily imply that the market would not benefit from some form of regulatory intervention. Opinions were divided over the form that this should take, for example whether a principles-based covered bond directive was needed or whether voluntary market-led initiatives were sufficient.

ICMA anticipates that this study will look into the policy options that were presented in the public consultation last year, assess the way in which they might improve the functioning of the market, and what costs they may imply. The initial contract for the consultation specified a six month time-line, suggesting that a report might be available by March 2017.

As far as market initiatives are concerned, it is worth noting that an increasing number of covered bond issuers who have been awarded the Covered Bond Label are now regularly publishing information regarding their cover pools in accordance with the new international, harmonised reporting standards introduced by the Covered Bond Label Foundation (Harmonised Transparency Template, HTT). Based on current data from the Covered Bond Label Foundation, 93 cover pools of 78 different issuers have been awarded the Covered Bond Label, and the new HTT is available for 59% of the cover pools.

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STS securitisation

The debate on the European Commission's proposal on Simple, Transparent and Standardised (STS) Securitisation continues. Since the previous report in the ICMA Quarterly Report, the European Parliament has made some further progress in its deliberations on the proposal, but the process is considerably slower than industry had hoped when the Commission issued its proposal and the Council swiftly approved its own version of the Commission's proposal last year.

The *rapporteur*, Paul Tang MEP (S&D, Netherlands) issued his first report on 6 June 2016. The report contained a number of difficult proposals for industry. The headline change is to the risk retention requirement, raising it to 20 % instead of the current 5%. The *rapporteur* also proposes to publish investor holdings, which would be difficult in an OTC market. Furthermore, the *rapporteur* bans any use of third parties in the STS certification process, a key issue for investors.

In July, other MEPs in the ECON Committee tabled their own amendments (numbering 483 in total). The other amendments contain many suggestions supported by investors, including on third party certification and on investor due diligence. However, other amendments that were tabled are more difficult, such as even higher retention requirements, a ban on third parties providing STS certification or public disclosure of investor holdings.

MEPs are now discussing compromise amendments with a view to agreeing a report by the end of year. However, there are already reports of a delay to the process, by as much as six to nine months. This would mean a vote in trilogue could be achieved only by late 2017. Not only would this set back the timetable for STS securitisation, it would also delay crucial reforms to Solvency II on capital levels for insurance investors in securitisation, because the European Commission has indicated that it would not propose these changes until trilogue agreement on STS is finalised.

The AMIC Working Group has drafted a position paper on why investors need securitisation, called the "investor narrative". The AMIC Secretariat has also compiled a paper of European Parliament amendments indicating red lines where the suggestions are unacceptable to investors, and where AMIC can support the proposed approach.

The industry has continued its cross-industry coordination efforts through the European Securitisation Coordination Group (ESCG). AMIC has been involved in the drafting of further position papers to rebut some of the less helpful ideas in the European Parliament.

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Bail-in: buy-side concerns

By Katie Kelly

Following on from a discussion paper sent to the European Central Bank (ECB) in July 2015, the ICMA Bail-In Working Group (BIWG) sent a further discussion paper to the ECB in September 2016, setting out further buy-side perspectives on certain aspects of bail-in. This paper was also sent to the European Commission and the Single Resolution Board (SRB).

In brief, the paper highlights the importance of consistent, clear communication and harmonised disclosure requirements, with limited loopholes that might create conflicts or contradictions, while urging regulators to recognise that imposing state aid rules without flexibility may lead to further risk aversion and confusion.

The paper recognises that the health of the European banking system and its ability to lend are absolutely crucial for economic growth generation, hence the importance of resolving the non-performing loan situation throughout the euro area, and stresses that proposals to address the non-performing loan situation in certain jurisdictions would be welcome, mindful of the significant accomplishments thus far to improve disclosure and harmonisation of accounting for bad loans.

When it comes to the methodology by which subordination of bail-inable debt will be achieved across the EU Member States, the paper considers that the future development and success of the market for regulatory capital instruments would be best served by a high degree of standardisation and homogeneity, including a common framework for achieving subordination. Similarly, a regulatory requirement for parity of reporting and transparency of a bank's debt structure, including asset encumbrance levels, would help to ease concerns over consistency of information.

Finally, given the potential re-characterisation of a bondholder's position from a creditor to an owner, the paper calls for a wider debate around the governance of banks and the roles of all stakeholders, including a comprehensive review of rights and obligations – for instance, providing bondholders under certain circumstances with limited voting rights on dividend policy, remuneration and board nominations.

Members of the BIWG are meeting with representatives of the European Commission and the SRB in October 2016, and with members of the ECB's Single Supervisory Mechanism in November 2016, to discuss the substance of the discussion paper.

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Green Bond Principles: an innovation at the core of the market

by Nicholas Pfaff, Valérie Guillaumin and Peter Munro

Voluntary principles for green finance as embodied by the Green Bond Principles (GBP) were endorsed in the September 2016 G20 communiqué. The GBP also featured prominently in a new report prepared for the G20 Green Finance Study Group (GFSG) on green bonds, cementing its standing as the overarching guidelines for the green bond market. It also confirmed the GBP community as a partner of choice for developmental initiatives in the green bond market, as the market continued to grow and broaden its appeal in markets and public policy circles. The GBP membership now stands at 121, complemented by 74 observers. The GBP also received an award for innovation in a new series of awards announced by *GlobalCapital*.

G20 communique endorses voluntary principles for green finance

The September 2016 G20 communiqué illustrates growing G20 support for green finance. It includes support for voluntary principles and international collaboration, which are exemplified by the GBP, as well as attention to impact, which is supported by the GBP recommendations on impact reporting: "We believe efforts could be made to provide clear strategic policy signals and frameworks, promote voluntary principles for green finance, expand learning networks for capacity building, support the development of local green bond markets, promote international collaboration to facilitate cross-border investment in green bonds, encourage and facilitate knowledge sharing on environmental and financial risks, and improve the measurement of green finance activities and their impacts."

The GBP's relevance is also highlighted in a new report on *Green Bonds: Country Experiences, Barriers and Options,* contributed to the G20 through the GFSG. The lead authors of this report were the Green Finance Committee of China Society for Finance and Banking, the Climate Bond Initiative, OECD and ICMA.

The GFSG report places the GBP at the heart of the market and provides an overview of other relevant players in the realm of guidelines and standards: "The green bond market is underpinned by voluntary guidelines and standards, as well as more recently by rules and regulations in some jurisdictions such as China, India and France. At the core, there are the Green Bond Principles (GBP), a set of voluntary guidelines elaborated by key market participants under coordination of the International Capital Market Association (ICMA) acting as secretariat. This is complemented by the work of the Climate Bonds Initiative (CBI), as well as by the work of multilateral and other development finance and government institutions. A number of private and academic organisations provide assurance on alignment with the GBP and/or on Climate Bonds Certification, as well as on the eligibility of environmental projects. Some are also developing different types of green ratings."

The report assesses an array of barriers to scaling up the green bond market as well as identifying emerging options for progress.

GBP wins award for "Most Valuable Innovation"

In September 2016, *GlobalCapital,* a leading capital markets publication, announced the results of a poll for its inaugural Sustainable and Responsible Capital Markets Awards. The extensive poll was conducted among issuers, investors, investment banks and other market participants.

Voluntary principles for green finance as embodied by the Green Bond Principles were endorsed in the September 2016 G20 communiqué.

The ICMA Green Bond Principles, 2016 – the latest edition of the Principles published in June 2016 – won the award for the "Most Valuable Innovation for the Green/SRI Bond Market".

Such an award, based on a wide range of views from market stakeholders, underlines the breadth of support for the GBP and its continued quest for innovation, to address market needs.

Launch of GBP Resource Centre: transparency standardized and simplified

The GBP Secretariat has just completed the launch of the GBP Resource Centre, containing new standardized disclosures from issuers and external reviewers.

One conclusion of the 2015-16 GBP public consultation was that the market, and investors in particular, would value a more standardized and compact form of disclosure, to ease green bond analysis and comparisons. This is seen as valuable for scaling up green bond investment.

The GBP ExCom demonstrated its responsiveness to market needs by developing two disclosure templates – an information template designed for issuers' self-disclosure of GBP alignment, and an external review form.

The GBP Secretariat is aggregating online such templates, as well as many external reviews, now that a significant range of market participants have started to use these formats.

Self-regulation at work: next public consultation to build on GBP Working Group insights

The annual GBP public consultation is now a firm fixture in the GBP calendar. This year's exercise will build on the strong response in 2015-16. The new consultation is scheduled to run in 4Q 2016, and will aim to capture essential themes for further market development, and to provide input for any revisions that may come in the regular update of the self-regulatory framework that the GBP offer.

The consultation will build on the productive initiative to establish a range of working groups in 2015-16, each dedicated to a key theme in market development and delivering a range of updates to the GBP's latest June 2016 edition. The working groups, formed by GBP members who worked in consultation with a wider range of market stakeholders, will be advising on relevant questions for the public consultation.

If you are interested in giving feedback to this forthcoming consultation and are not yet a member or observer, please complete the application form on the ICMA website and send it to the GBP Secretariat at greenbonds@icmagroup.org.

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Silk Road Bonds

By Simon Choi, CEO of Dagong Global Credit Rating (Hong Kong) Co. Ltd., and Ricco Zhang, Director, Asia Pacific, ICMA

In 2013, a "Belt and Road" development strategy was announced by the Government in China, the key objective of which is to provide much needed infrastructure along major economic corridors within Asia and extending to the Middle East, Africa and Europe, thereby promoting economic growth and improving living standards. Of course, developing infrastructure requires raising significant amounts of finance, which is difficult in countries with less developed financial markets, where connectivity with the international capital market is underdeveloped.

On 8 September 2016, ICMA and Dagong Global Credit Rating Group (Dagong) jointly hosted a conference – *Belt and Road Summit: Financing Through Silk Road Bonds* – in Hong Kong, at which the concept and challenges of "Silk Road Bonds" were explored. Silk Road Bonds are intended to be an internationally recognised asset class, appealing to investors due to highly sought-after yield and diversification benefits, while capable of being scaled to provide the volume of funding required for "Belt and Road" infrastructure.

Without doubt, it will require concrete efforts and consensus among the key stakeholders and the capital markets to make the concept of Silk Road Bonds a reality. "Belt and Road" infrastructure and Silk Road Bonds already benefit from high level support from the official sector, regulatory bodies, multilateral organisations as well as from the industry, whose ideas, views and expertise will serve as essential building blocks in their evolution. In addition, ICMA and Dagong have set up a Silk Road Bond Working Group in Hong Kong to help drive the development of Silk Road Bonds.

The Working Group, which had its inaugural meeting in September, comprises financial institutions, multilateral development banks, law firms, credit rating agencies and audit firms which are active in Asian markets – a combination which ensures as wide and diverse a pool of expertise as possible. Its main areas of focus will be: engagement with the key stakeholders whose support is critical to the success of the initiative, including the Chinese authorities, authorities of other "Belt and Road" countries, multilateral development banks and investors; agreement of a set of principles for the issuance of Silk Road Bonds; and assessment of the risk appetite amongst investors.

The Silk Road Bond Working Group is currently refining the definition of Silk Road Bonds, with a focus on "use of proceeds" to ensure that the proceeds are actually benefiting "Belt and Road" infrastructure. Other priorities of the Working Group will be the additional credit risk of the issuing countries, third party certifications and potential external support mechanisms, for example from sovereigns or supranationals.

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Guide to infrastructure financing in Asia

By Katie Kelly and Mushtaq Kapasi

The *ASIFMA-ICMA Guide to Infrastructure Financing in Asia* (the Asian Guide), produced jointly by an ASIFMA Infrastructure Working Group together with ICMA, was released to great acclaim in August 2016. The Asian Guide is largely based on the European version of the *Guide to Infrastructure Financing*, produced by an AFME/ICMA Infrastructure Working Group in June 2015, but is targeted at the Asian market and, as such, benefits hugely from local input from banks, investors, law firms, rating agencies and other market participants.

Mindful that Asia Pacific infrastructure investments are long-term investments which require consistent and transparent regulatory policy from regulators and public sector authorities, the Asian Guide is designed to provide practical guidance and information on raising debt finance through banks and the capital markets for funding the immense amount of infrastructure required in Asia, taking account of planning and procurement issues on the transaction process. The Asian Guide also highlights how local initiatives from, for instance, the Asian Infrastructure Investment Bank, the International Finance Corporation, the Asian Development Bank and the Credit Guarantee and Investment Facility can help infrastructure projects through funding, credit enhancement and/or guarantees.

Meanwhile, in Europe, the AFME/ICMA Infrastructure Working Group is continuing in its efforts to engage with procurement agencies and other issuers across Europe to present the Guide and demystify the capital markets, while also engaging with regulatory authorities and policy makers on matters such as calibration of infrastructure as an asset class in line with the Capital Markets Union agenda, and providing industry support for the Investment Plan for Europe.

In terms of Capital Markets Union, the European Commission has indicated that further amendments to Solvency II are being considered in relation to insurers' investments in infrastructure corporates, and has also proposed lowering the capital charges that will apply to banks when they invest in infrastructure assets.

The European Commission recently released a Communication called *Strengthening European Investments for Jobs and Growth*, which anticipates a second phase of the European Fund for Strategic Investment (EFSI, which was part of the initial Investment Plan for Europe), and a new European External Investment Plan, which is expected to address infrastructure funding challenges in the EU neighbourhood and Africa.

The EFSI was established for an initial period of three years with the aim of mobilising at least €315 billion of strategic investments. According to the Communication, the EFSI has helped to mobilise close to €116 billion across 26 EU Member States in less than one year, benefitting more than 200,000 small and medium-sized enterprises. The European Commission has now committed to doubling the size of the EFSI in this second phase, both in terms of duration and financial capacity. To enhance the firepower of the EFSI even further and reach the aim of doubling the investment target, the Commission is calling upon Member States to also contribute to the EFSI as a matter of priority.

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The Guide provides practical guidance on raising debt finance through banks and capital markets for funding the immense amount of infrastructure required.

International Regulatory Digest

By David Hiscock

G20 financial regulatory reforms

On 21 July 2016, the FSB met in Chengdu to discuss current vulnerabilities and progress in addressing priority areas and deliverables for the G20 Leaders' Summit in Hangzhou in September, including:

- supporting the full, timely and consistent implementation of post-crisis reforms, while remaining ready to address any material unintended consequences;
- addressing new and emerging vulnerabilities in the financial system, including potential financial stability risks associated with market-based finance, misconduct, and the reduction in correspondent banking relationships;
- promoting robust financial infrastructure, by working with the CPMI and IOSCO to assess policies on CCP resilience, recovery and resolvability, and to recommend any necessary improvements; and
- promoting effective macroprudential policy making, by examining jointly with the IMF and the BIS lessons learned from national and international experience.

This latest FSB Plenary also discussed the draft second annual report, which was published ahead of the September G20 Summit and provides updated country-by-country information on progress in implementing reforms. Associated with this, the FSB has examined evidence on potential changes in market liquidity in corporate and sovereign fixed income markets. To date, it finds there is limited evidence of a decrease in market liquidity conditions in normal times, but there is some evidence of less depth in some sovereign and corporate debt markets, raising questions about the resilience of those markets under stressed conditions. On balance, the FSB perceives that the evidence to date is that the reforms have reduced the likelihood that a deterioration in market liquidity could result in wider financial stability problems.

On 24 July, the FSB published a letter from Mark Carney, Chair of the FSB, which was sent to G20 Finance Ministers and Central Bank Governors ahead of their meeting in Chengdu on 23-24 July. The letter outlines the progress the FSB is making in advancing its priorities for 2016:

- promoting a coordinated programme of reforms to deliver resilient sources of market-based finance, including addressing structural vulnerabilities associated with asset management activities;
- developing robust financial market infrastructure, including assessing policies on CCP resilience, recovery and resolvability, and recommending any necessary improvements; and
- supporting effective macroprudential arrangements, by drawing lessons from national experiences of the practical application of macroprudential policy frameworks and tools working in partnership with the IMF and BIS.

A communiqué was issued following from the G20 Finance Ministers and Central Bank Governors meeting in Chengdu. Regarding ongoing financial regulatory reform, paragraph 9 includes that:

- we remain committed to finalising remaining critical elements of the regulatory framework and the timely, full and consistent implementation of the agreed financial reforms, including Basel III and the TLAC standard as well as effective cross-border resolution regimes;

- we reiterate our support for the work by the BCBS to finalise the Basel III framework by the end of 2016, without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field; and we look forward to the BCBS comprehensive QIS that will inform the final design and calibration of the framework – we will continue to enhance the monitoring of implementation and effects of reforms to ensure their consistency with our overall objectives, including by addressing any material unintended consequences;
- we look forward to the FSB's second annual report on the implementation and effects of the financial regulatory reforms to be presented at the, 4-5 September, Hangzhou Summit;
- we will continue to address the issue of systemic risk within the insurance sector; and we welcome the work towards the development of an Insurance Capital Standard (ICS) for internationally active insurers;
- we welcome the ongoing joint work by the IMF, FSB and BIS to take stock of international experiences with macroprudential frameworks and tools, to help promote effective macroprudential policies, and look forward to the report to be published ahead of the Hangzhou Summit;
- we welcome the FSB consultation on proposed policy recommendations to address structural vulnerabilities from asset management activities;
- we continue to closely monitor, and if necessary, address emerging risks and vulnerabilities in the financial system, including those associated with shadow banking, asset management and other market-based finance; and
- we encourage members to close the gap in the implementation of the PFMIs and accelerate their actions on OTC derivatives markets reforms; and we look forward to the consultation papers under the agreed work plan on CCPs' resilience, recovery planning and resolvability to be published ahead of the Hangzhou Summit.

On 25 July, the FSB published its third annual report, which provides an update on the activities of the FSB and its annual accounts for the financial year April 2015-March 2016. During the course of the year the FSB has agreed the final components of the most important policy tools to fix the fault lines that led to the financial crisis. The report provides an update on the key activities, publications and decisions by the FSB during the course of the year.

On 18 August, the FSB published two final guidance papers, *Guiding Principles on the Temporary Funding Needed to Support the Orderly Resolution of a G-SIB* and *Guidance on Arrangements to Support Operational Continuity in Resolution*. These guidance papers are intended to assist the resolution planning work of authorities and firms, as part of the policy agenda to end too-big-to-fail through the removal of impediments to the orderly and effective resolution of firms.

Alongside these, the FSB also published its fifth report to the G20 on progress in resolution, *Resilience Through Resolvability – Moving from Policy Design to Implementation*. This report reviews what has been achieved so far and sets out further actions to fully implement the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (*Key Attributes*) and ensure that all G-SIFIs are resolvable. It also reports the findings from the second round of the Resolvability Assessment Process (RAP) for G-SIBs and the initial results from the first RAP for G-SIIs.

The FSB identified the following priorities for the remainder of 2016 and 2017 to help further advance progress:

- develop further guidance on CCP resolution, building on the recently published discussion paper on *Essential Aspects of CCP Resolution Planning* which identifies elements that are considered to be core to the development of effective resolution strategies and plans for CCPs;
- finalise the remaining elements of the TLAC standard, including guidance on the implementation of internal TLAC and final proposals on TLAC holdings and TLAC disclosures;
- develop further guidance to support the resolution planning work of authorities and firms, including on ways in which access to financial market infrastructures can be maintained in resolution and on the operational execution of bail-in; and
- develop a *Key Attributes* assessment methodology for insurers and monitor implementation of the guidance on *Developing Effective Resolution Strategies and Plans for Systemically Important Insurers*.

On 31 August, the FSB published, ahead of the 4-5 September G20 Summit in Hangzhou, a letter from its Chair, Mark Carney, to G20 Leaders and the second annual report on the *Implementation and Effects of the G20 Financial Regulatory Reforms*. The letter sets out four main points:

- The G20 financial reforms are working – in the face of recent shocks the financial system has continued to function effectively, dampening aftershocks rather than amplifying them.
- The financial system is changing to rely more on markets and less on banks – this is a major positive development, but one that also raises new vulnerabilities which the FSB will address with its continued work to promote resilient market-based finance.
- Ongoing support of the G20 Leaders is required to implement the reforms fully, consistently and promptly – in

particular support is required from G20 Leaders to implement the critical measures to end too-big-to-fail.

- Developments in recent years raise the importance of new measures to support a more resilient, inclusive globalisation built on sustainable cross-border investment.

The FSB's second annual report concludes that implementation progress remains steady but uneven, and that the strengthened resilience due to the reforms has stood the global financial system in good stead. The largest internationally active banks are considerably more resilient than before the crisis, and remain on track to meet the Basel III capital and liquidity standards; and, importantly, this improvement has been achieved while maintaining the overall provision of credit to the real economy. Implementation of policies to end too-big-to-fail has advanced the most for G-SIBs, but substantial work remains to build effective resolution regimes and to operationalise resolution plans for cross-border firms. Progress has also been made in strengthening the resilience of financial markets, although additional efforts are needed to implement reforms to OTC derivatives markets and to transform shadow banking into resilient market-based finance – in this respect, work is ongoing to strengthen market infrastructure and address vulnerabilities in market-based finance and asset management activities.

The report includes further analysis on three areas identified in last year's report as meriting close attention: market liquidity; effects of reforms on emerging market and developing economies; and maintaining an open and integrated global financial system. On market liquidity, the report concludes that there is limited evidence of a broad deterioration in market liquidity, although there is some evidence of less depth in certain sovereign and corporate bond markets. The report also highlights key challenges that G20 Leaders need to address to ensure the full, timely and consistent implementation of the reforms, including: (i) putting in place legal powers to share information across borders and to give prompt effect to foreign resolution actions; (ii) removing legal barriers to reporting OTC derivatives to trade repositories and to authorities' access to such data; and (iii) removing other legal, data and capacity constraints that could hamper implementation efforts. The FSB, in collaboration with the standard-setting bodies, continues to enhance the analysis of the effects of reforms; and policies will be adjusted where necessary to address material unintended consequences.

The Leaders of the G20, met for a Summit in Hangzhou, China on 4-5 September, following which a communiqué was issued. The ongoing process of financial regulatory reform is addressed in paragraph 18 of the communiqué, which includes that the G20 Leaders:

- remain committed to finalising remaining critical elements of the regulatory framework and to the timely, full and consistent implementation of the agreed financial sector reform agenda, including Basel III and the TLAC standard as well as effective cross-border resolution regimes;
- reiterate their support for the work by the BCBS to finalise the Basel III framework by the end of 2016, without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field;
- welcome the second annual report of the FSB on implementation and effects of reforms, and will continue to enhance the monitoring of implementation and effects of reforms to ensure their consistency with the G20 Leaders' overall objectives, including by addressing any material unintended consequences;
- will continue to address the issue of systemic risk within the insurance sector; and welcome the work towards the development of an Insurance Capital Standard (ICS) for internationally active insurers;
- are committed to full and timely implementation of the agreed OTC derivatives reform agenda, and will remove legal and regulatory barriers to the reporting of OTC derivatives to trade repositories and to authorities' appropriate access to data;
- encourage members to close the gap in the implementation of the PFMIs and welcome the reports by the CPMI, IOSCO and FSB on enhancing CCP resilience, recovery planning and resolvability;
- recognising the importance of effective macroprudential policies in limiting systemic risks, welcome the joint work by the IMF, FSB and BIS to take stock of international experiences with macroprudential frameworks and tools and to help promote effective macroprudential policies; and
- welcome the FSB consultation on proposed policy recommendations to address structural vulnerabilities from asset management activities; and will continue to closely monitor, and if necessary, address emerging risks and vulnerabilities in the financial system, including those associated with shadow banking, asset management and other market-based finance.

On 9 September 2016, the FSB published new information on its website on the implementation of the G20 financial regulatory reforms:

- Jurisdiction profiles: a new query function that allows users to obtain, for individual FSB jurisdictions, a summarised status of implementation across all reform areas.
- FSB jurisdictions' survey responses on the status of implementation of reforms in other (non-priority) reform areas. These responses have been uploaded to the multi-year

query function that allows users to filter information by area of reform, jurisdiction and year. All survey responses can also be found in the FSB's webpage on national/regional responses by jurisdiction.

On 11 September 2016, the Group of Central Bank Governors and Heads of Supervision (GHOS) announced that progress is being made in finalising post-crisis regulatory reforms to reduce excessive variability in risk-weighted assets; and endorsed the broad direction of the BCBS's reforms. The GHOS discussed the BCBS's ongoing cumulative impact assessment and reaffirmed that, as a result of this assessment, the BCBS should focus on not significantly increasing overall capital requirements.

When the BCBS published the revised supervisory framework for measuring and controlling large exposures (LE) in April 2014, it noted that by 2016 it would review the appropriateness of setting a LE limit for exposures to qualifying CCPs (QCCPs) related to clearing activities; and would review the impact of the LE framework on interbank exposures to ensure there are no unavoidable adverse consequences for the implementation of monetary policy. The BCBS has completed its review and decided to maintain the previously announced treatment for both types of exposure – so the framework, which takes effect from 1 January 2019, will (a) exempt from the LE limit exposures to QCCPs related to central clearing; and (b) apply the LE limit to interbank exposures (ie no exemption will apply). These two elements are now covered, along with responses to other FAQs on the LE framework in a new LE FAQ published by the BCBS on 28 September 2016.

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European financial regulatory reforms

The European Council published the outcome of the ECOFIN meeting, held in Brussels, on 12 July 2016. Amongst other things, on the completion of work on post-crisis banking reform, the Council:

- reiterated its support for the work by the BCBS to refine elements of the Basel III framework by the end of 2016, to ensure regulatory certainty, its coherence and effectiveness, while preserving the risk sensitivity of banking regulation;
- stressed the importance that the BCBS carefully assesses the design and calibration of this reform package, on the basis of a comprehensive and transparent quantitative impact analysis, taking into account in its global calibration also the distribution of its impact on the different banking models and across jurisdictions;
- noted that the reform package would not be expected to result in a significant increase in the overall capital requirements for the banking sector, therefore, not resulting in significant differences for specific regions of the world.

The Council also briefly took stock of the EU's Banking Union, as concerns (i) implementation of agreed rules in national laws and regulations; and (ii) ongoing work on financing arrangements for the SRF. It noted that significant progress had been made since January 2016. Additionally, the Council was updated as concerns work on legislative proposals on financial services. In support of this, a July 2016 secretariat note on progress on financial services legislative dossiers was presented.

The FICC Markets Standards Board (FMSB) published its 30 June 2016 letter, written by the Chair, to the Fair and Effective Markets Review (FEMR) Principals following the first anniversary of the FMSB. The FMSB was set up by market practitioners following the FEMR to improve conduct in the wholesale FICC markets. In its conclusions the letter states that the FMSB has made considerable progress on a number of fronts over the past year; and that the challenge now is to sustain the momentum which has developed. The FMSB is unique and gives a real opportunity to change practices in the wholesale markets, which will, over time, contribute to strengthening the reputation of, and trust in, financial markets and the institutions that serve them.

Following on from this, on 28 July, the Chairs of the FEMR published a full implementation report to the Chancellor of the Exchequer, the Governor of the Bank of England and the Chairman of the Financial Conduct Authority, detailing the significant progress that has been made to implement the Review's recommendations. The report's conclusions include that in the past year significant progress has been made in taking forward the FEMR recommendations; and that, encouragingly, action is taking place within firms and at an industry level that is consistent with the sentiment and spirit of the FEMR recommendations. But the job is far from done. Firms must create, both individually and collectively, cultures that place integrity, professionalism and high ethical standards at their core to ensure that behaviours are not limited to complying with the letter of regulation or laws.

On 3 August, the EBA published its report on the impact assessment and calibration of the Leverage Ratio (LR), recommending the introduction of a LR minimum requirement in the EU to mitigate the risk of excessive leverage. The EBA's analysis suggests that the potential impact of introducing a LR requirement of 3% on the provision of financing by credit institutions would be relatively moderate, while, overall, it should lead to more stable credit institutions. The analysis developed by the EBA combines a quantitative assessment with qualitative discussions

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and has aimed at calibrating the LR appropriate for the EU banking sector; and this EBA report will inform the work of the European Commission on potential legislative proposals on LR.

Considering possible differentiation of the LR by business models, size or systemic relevance, the EBA did not find a strong indication of differences in the degree of exposure to the risk of excessive leverage across different types of credit institutions; but did find that a higher LR requirement may be warranted for G-SIIs, which do show a higher exposure to the risk of excessive leverage. The report also flags that while the Basel LR standard is fitting well with the EU banking sector, the specificities of certain business models already covered by other EU prudential regulations should be taken into account – this is particularly the case for CCPs and CSDs, which the EBA recommends be exempted. The EBA did not find arguments to exempt certain credit institutions from being subject to compliance with a 3% LR minimum requirement on the basis of their limited size; but will specifically explore more in detail a reduced frequency and/or granularity of reporting requirements in future updates of the ITS on LR reporting.

Finally, the report includes input from the ESRB with regard to the potential impact of a LR on market liquidity (Annex III). The focus of the ESRB's work on this has been to (i) set out the conceptual channels by which regulation, in particular the LR, may affect banks and thereby their role in facilitating liquid markets; and (ii) to investigate whether there is any empirical evidence of an impact due to the anticipation of a LR requirement. Three pages of conclusions summarise the ESRB's key messages from its work. Overall, this preliminary analysis suggests there may be some costs associated with the LR for broker dealers, but that there are also expected to be benefits – the LR may help to ensure that banks can sustain the provision of services that are important to market liquidity, particularly taking account of stressed periods. The analysis presented in this paper should be the starting point for future, deeper theoretical and empirical investigation into this question.

The European Commission published a list of planned initiatives, which shows the state of play as of 1 September 2016. DG FISMA initiatives in this list in the policy area of Capital Markets include:

- possible legislative proposal amending the CRR to incorporate modifications to the Basel framework (eg NSFR and Leverage Ratio) and findings from various reviews required under CRR, foreseen for adoption in November 2016;
- report from the Commission to the European Parliament and the Council on national barriers to free movement of capital which prevent a fully integrated CMU and roadmap for their removal, foreseen for adoption in 4Q 2016;
- comprehensive revision of the EU macroprudential policy framework, foreseen for adoption in Q1 2017;
- potential initiative on an integrated covered bond framework, foreseen for adoption in 4Q 2017; and
- initiative on EU personal pension framework, foreseen for adoption in 4Q 2017;

In addition, DG FISMA initiatives in this list in the policy areas of Financial Services and Financial Stability include:

- follow-up to the Call for Evidence on the EU regulatory framework for financial services, foreseen for adoption in 3Q 2016;
- Commission Delegated Regulation on revised calibrations for corporate infrastructure investments by insurance and reinsurance undertakings under Solvency I, foreseen for adoption in September 2016;
- Commission proposal for a Regulation of the European Parliament and of the Council on the recovery and resolution of CCPs, foreseen for adoption in November 2016;
- Communication on recovery and resolution for other non-bank institutions (accompanying the proposal on the recovery and resolution of CCPs), foreseen for adoption in November 2016;
- Commission Delegated Regulation on the contributions to the administrative expenditures of the SRB, certain timing aspects of *ex ante* and *ex post* contributions to the SRF, the administration of the SRF and its investment strategy, foreseen for adoption in November 2016;
- White Paper on the revision of the financing model for the ESAs, foreseen for adoption in 4Q 2016;
- Proposal for a Council Decision on the conclusion of an international

agreement on mutual access to, and exchange of information on, derivative contracts held in trade repositories, foreseen for adoption in 1Q 2017; and

- multiple items relating to the adoption of various technical standards, for MAR, MiFIR and MiFID II.

On 14 September 2016, on the occasion of President Juncker's 2016 State of the Union address, the European Commission adopted a Communication that sets out the next steps to accelerate the completion of the CMU, a flagship project of the Juncker Commission to boost jobs and growth in Europe. The Communication calls for:

1. rapid completion of the first CMU measures, including swift implementation of the securitisation package and finding an agreement on the modernisation of the Prospectus rules;
2. acceleration of the next phase of CMU, in which regard the Commission will present shortly a proposal on business restructuring and insolvency to speed up recovery of assets and give companies a second chance if they fail the first time around; and will knock down tax barriers that are hampering the development of capital markets – encouraging Member States to remove withholding tax barriers and encourage best tax practices in promoting venture capital, such as increasing equity financing over debt; and
3. development of further priorities, including development of personal pensions markets and other retail financial services; establishment of an expert group to develop a comprehensive European strategy on sustainable finance, both to support investment in green technologies and to ensure that the financial system can finance growth in a way that is sustainable; working to develop a co-ordinated policy approach that supports the development of FinTech in an appropriate regulatory environment; and considering the further steps in relation to the supervisory framework that are necessary to reap the full potential of CMU .

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Financial benchmarks

On 19 July 2016, the FSB published *Reforming Major Interest Rate Benchmarks* which provides a progress report on implementation of its July 2014 recommendations to reform major interest rate benchmarks. This report finds that, since the last progress report published in July 2015, administrators of key interbank offered rates (IBORs) have continued to take steps to implement the recommendations. The most progress has been made by the three major benchmarks of EURIBOR, LIBOR and TIBOR; but member authorities represented on the Official Sector Steering Group (OSSG), benchmark administrators and market participants from other jurisdictions, including Australia, Canada, Hong Kong, Mexico, Singapore and South Africa, have also continued to take steps to improve the existing interbank rates in their own jurisdictions.

While substantial progress has been made, the reforms of the IBORs have not been completed. Administrators should now focus on transition and decide how to anchor rates in transactions and objective market data as far as practicable.

One of the key recommendations set out in the OSSG report in July 2014 was for authorities to encourage the development and use of risk-free rates (RFRs) for benchmarks, given that there are certain financial transactions, including many derivatives transactions, which are better suited to reference rates that are closer to risk-free. It is important that RFRs are identified because the volume of transactions in the IBORs underlying markets are low and at risk of declining further; and OSSG members have made good progress in identifying potential RFRs. The OSSG will continue to monitor progress in reforms to interest rate benchmarks, and will prepare a final report for publication by the FSB in 2017.

On 12 August 2016, the European Commission announced the adoption of an Implementing Regulation establishing a list of "critical" benchmarks, ie those indexes that are of particular importance for financial markets and consumer contracts. EURIBOR, one of the most important interest rate indexes in the EU, is the first to be included in this list; but the Commission will review and update the list regularly and will include, in due course, other benchmarks that fulfil certain criteria.

This Implementing Regulation enables supervisors to make use of certain provisions of the EU Benchmarks

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Regulation (BR) in advance of its entry into application in 2018. This ensures that supervisors are in a position to allow the continuation of critical benchmarks where their cessation would have a severe adverse impact on market participants and undermine the functioning and integrity of markets. In particular, classifying EURIBOR as a critical benchmark will facilitate supervisors in requesting data contributions from banks, if they deem it necessary to ensure the benchmark's representativeness.

On 29 September 2016, ESMA published a Consultation Paper (for comment by 2 December) regarding its draft RTS/ITS which will implement the EU RB. The key provisions of ESMA's draft RTS/ITS cover both benchmark contributors and administrators:

- procedures, characteristics and positioning of the oversight function;
- appropriateness and verifiability of input data;
- transparency of methodologies applied;
- governance and control requirements for supervised contributors;
- provisions for significant/non-significant benchmarks; and
- provisions for recognition by third country administrators.

The Consultation Paper also includes the actual draft legal text and a preliminary high-level cost-benefit analysis. ESMA will consider the feedback to the consultation and finalise the draft RTS/ITS in order to submit them to the European Commission by 1 April 2017.

Credit Rating Agencies

On 13 July 2016, ESMA published a Consultation Paper (for comment by 22 August) on guidelines on the validation and review of CRAs' methodologies. The purpose of the draft guidelines is to clarify ESMA's expectations regarding how CRAs should validate and review their methodologies. ESMA aims to achieve a consistent application of validation and review measures across CRAs through the demonstration of the discriminatory power, predictive power and historical robustness of their methodologies. The draft guidelines also identify the measures that CRAs should implement when validating and reviewing their methodologies with limited quantitative evidence.

The CP is accompanied by a Feedback Statement, which outlines the main issues that were highlighted in response to the Discussion Paper on these guidelines published in December 2015. The initial proposals have not been substantially altered and this consultation focuses on the changes that have been made in response to the feedback received.

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OTC (derivatives) regulatory developments

The European Commission's implementing decision, of 1 July 2016, on equivalence for certain US regulated markets under EMIR was published in the *Official Journal*, triggering its entry into force on 21 July. Having thereby deemed those boards of trade designated by the US CFTC as contract markets in the US as being equivalent to regulated markets as defined in Article 4.1 (14) of EMIR, any derivatives contracts traded on such venues will not be deemed OTC derivatives for the purposes of EMIR.

On 13 July 2016, ESMA published a Consultation Paper (for comment by 5 September) proposing to change the phase-in period for central clearing of OTC derivatives applicable to financial counterparties with a limited volume of derivatives activity under EMIR. ESMA proposes to amend EMIR's Delegated Regulations on the clearing obligation to prolong, by two years, the phase-in for financial counterparties with a limited volume of derivatives activity – those ones classified in Category 3 under EMIR Delegated Regulations. Extending the phase-in period for these financial counterparties will help these firms mitigate the difficulties they are encountering in connecting to CCPs.

ESMA has found that there is quite an important number of counterparties with a limited volume of derivatives activity and that their overall contribution to the OTC derivative markets in terms of volume remains limited. This may enable a delay of the clearing obligation for these counterparties while not compromising the EMIR objective of reducing systemic risk. In developing the technical standard ESMA will also consult the ESRB and, where necessary, the competent authorities of third-countries.

On 16 August 2016, the FSB published a discussion note which seeks comment (by 17 October) on aspects of CCP

Further action is required, particularly on implementing margin requirements and platform trading commitments.

resolution that are considered core to the design of effective resolution strategies. The discussion note covers a number of aspects of CCP resolution planning, including timing of entry into resolution; adequacy of financial resources; tools for returning to a matched book and allocating default and non-default losses; application of the "No Creditor Worse Off" safeguard and treatment of the CCP's equity in resolution; and cross-border cooperation and effectiveness of resolution actions. Responses to the discussion note will assist the FSB in developing standards or guidance for CCP resolution planning, resolution strategies and resolution tools; and the FSB will consult on proposals for such standards or guidance by early 2017.

The FSB also published, jointly with the BCBS, CPMI and IOSCO, a progress report on the workplan to enhance the resilience, recovery planning and resolvability of CCPs; and, alongside this, the CPMI and the IOSCO published a consultative report (for comment by 18 October) on resilience and recovery of central counterparties, plus a report on the financial risk management and recovery practices of 10 derivatives CCPs. Additionally, a data collection exercise on the interdependencies in CCP clearing was launched, as part of a study on independencies that began last year.

On 26 August 2016, the FSB published two reports on the implementation of key aspects of reforms to the OTC derivatives market. They show that although progress continues to be made, further action is required, particularly on implementing margin requirements and platform trading commitments, and on removing legal barriers to trade reporting and authorities' access to data held by trade repositories.

The OTC Derivatives Market Reforms: Eleventh Progress Report on Implementation sets out progress on implementation of the reforms to the OTC derivatives market agreed by the G20. Trade reporting requirements for OTC derivatives and higher capital requirements for non-centrally cleared derivatives (NCCDs) are mostly in force and central clearing frameworks are being implemented. By contrast, current indications are that a substantial number of jurisdictions will not have margin requirements for NCCDs in force in accordance with the internationally agreed implementation schedule for these reforms, while platform trading frameworks are relatively undeveloped in most jurisdictions. Authorities continue to note a range of implementation challenges, many of which FSB members are seeking to address through international workstreams.

FSB Members' Plans to Address Legal Barriers to Reporting and Accessing OTC Derivatives Transaction Data provides a summary of FSB member jurisdictions' planned actions to remove legal barriers to reporting complete transaction information to trade repositories and to authorities' access to data held in trade repositories. The FSB had published a thematic peer review of OTC derivative trade reporting in November 2015, which identified a number of remaining legal barriers in FSB member jurisdictions in this regard. FSB members had therefore agreed as a follow up that, by June 2018, all jurisdictions should remove barriers to full reporting of trade information and have a legal framework in place to permit authorities' access to data in accordance with their mandates. The report finds that while some work is in progress to remove barriers to both reporting of, and access to, complete OTC derivatives transaction information, significant work remains across FSB member jurisdictions to achieve this, including that concrete plans to address the barriers have yet to be formulated in a number of cases.

On 9 September, the three ESAs published their Opinion addressed to the European Commission expressing disagreement with its proposed amendments to the final draft RTS on risk mitigation techniques for OTC derivatives not cleared by a CCP, which were originally submitted for endorsement on 8 March 2016. Following the European Commission's Communication on 28 July 2016, of its intention to endorse the ESAs' final draft RTS with amendments, the ESAs issued an Opinion rejecting some of the proposed changes. In particular, the ESAs disagree with the European Commission's proposal to remove concentration limits on initial margins for pension schemes and emphasise that these are crucial for mitigating potential risks pension funds and their counterparties might be exposed to. On 4 October 2016, the European Commission adopted the draft RTS submitted by the ESAs with amendments.

On 20 September, ESMA published a Discussion Paper (for comment by 21 November) regarding the trading obligation under MiFIR. This trading obligation will move OTC trading in liquid derivatives onto organised venues, with the intention of increasing market transparency and integrity alike. MiFIR outlines the process for determining which derivatives should be traded on-venue, so the current consultation is therefore seeking stakeholder's feedback on the options put forward by ESMA on how to calibrate the trading obligation. ESMA will use the feedback received to continue working on implementing MiFIR's trading obligation and, if deemed appropriate, draft technical standards specifying which derivatives should be subject to the trading obligation.

On 27 July, ESMA announced an update of its Q&A on practical questions regarding EMIR. This updated Q&A includes a new answer in relation to reporting of trades cleared by a clearing house which is not a CCP under the EMIR definition. The purpose of this document is to promote common supervisory approaches and practices in the application of

EMIR, by providing responses to questions posed by the general public, market participants and competent authorities. The content of this document is aimed at competent authorities under EMIR, to ensure that in their supervisory activities their actions are converging along the lines of the responses adopted by ESMA. It should also help investors and other market participants by providing clarity on the requirements under EMIR.

ESMA's list of CCPs authorised to offer services and activities in the EU, in accordance with EMIR, was last updated on 19 September 2016; but its list of third-country CCPs recognised to offer services and activities in the EU was last updated on 28 September. ESMA's *Public Register for the Clearing Obligation* under EMIR was last updated on 19 September; and its (non-exhaustive) list of CCPs established in non-EEA countries which have applied for recognition was last updated on 23 August.

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Market infrastructure

By Alexander Westphal

ECB: market contact groups

In November 2015, at one of its previous meetings, members of the Contact Group on Euro Securities Infrastructures (COGESI) decided that more detailed work is needed to assess the scope for further harmonisation in the area of collateral management. At their latest regular bi-annual meeting, held on 18 February 2016, COGESI members reiterated this intention and created three sub-groups to undertake the work, covering the following areas that had been identified as key priorities: (i) collateral mobility, (ii) collateral holding and segregation and (iii) collateral messaging. As member of the COGESI, the ICMA ERCC is actively involved in all three work streams, and is leading the work on collateral messaging. On 28 June 2016, a dedicated workshop was held in Frankfurt to take stock of the first months of work undertaken by the three sub-groups. Since then, the work has further progressed. The next occasion for COGESI members to review the work and discuss the way forward will be the next regular COGESI meeting which is scheduled for 30 November 2016.

As member of the COGESI, the ICMA ERCC is actively involved in all three work streams, and is leading the work on collateral messaging.

On 27 September 2016, members of the Money Market Contact Group (MMCG) met in Frankfurt for their latest quarterly meeting. While no documents have been published yet for that meeting, a summary and the presentations of the previous meeting of the Group, held on 9 June 2016, are now available on the group's webpage. During the June meeting MMCG members reviewed, as usual, the main recent developments in money markets, including market expectations in relation to the roll-out of the ECB's TLTRO II programme, announced on 5 June 2016. In addition, the ECB provided an update on the implementation of the Money Market Statistical Reporting Regulation (MMSR). The presentation included a first high-level analysis of the data collected by the ECB since the start of reporting on 1 April 2016. Finally, members also received an update from the ECB on the ongoing reform of the EURIBOR benchmark. The next regular meeting of the MMCG is scheduled for 12 December 2016.

The latest meeting of the Bond Market Contact Group (BMCG) was an *ad hoc* conference call on 27 June to discuss the impact on euro area bond markets of the UK's vote to leave the EU. The market reaction was generally considered as orderly and members observed no panic in the markets. A summary of the call is available on the BMCG webpage. The call was held only a few days after the latest regular meeting of the BMCG on 21 June. A summary of that meeting as well as all the presentations are available on the Group's webpage. BMCG members will meet again on 12 October 2016. The agenda for the next meeting includes a discussion on the impact of upcoming regulations on derivatives markets, as well as an exchange of views on the depth and liquidity of bond markets. Members will also look at the impact of reinvestments in the context of the ECB's Asset Purchase Programme (APP) and will discuss the outlook for bond markets.

Eurosystem: vision on the future of financial market infrastructure

The Eurosystem continues its strategic reflections on the future financial market infrastructure in Europe. On 26 September 2016 at the SIBOS conference in Geneva, Yves Mersch, member of the ECB's Executive Board, provided an update on the state of the initiative. The Eurosystem's strategy on the future development of its market infrastructure centres around three components:

- a consolidation of TARGET2 and TARGET2-Securities (T2S)
- settlement services to support instant payments
- a potential Eurosystem collateral management system.

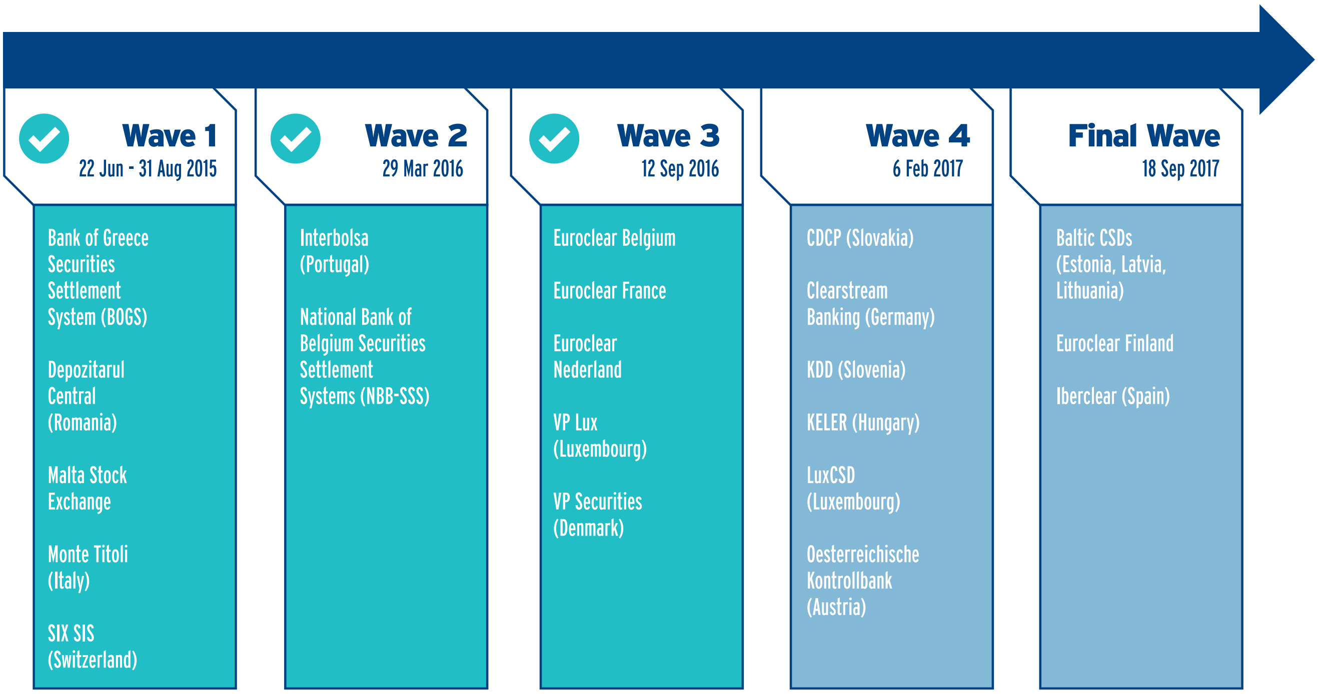
As a first concrete output of the initiative, the Eurosystem published in February 2016 a public consultation on the integration of TARGET2 and T2S and the related RTGS services offered to market participants. The ERCC Operations Group submitted a short response to this consultation. Taking into account feedback received from stakeholders, the Eurosystem plans to follow up in the course of 2017 with another consultative report on this issue. In parallel, the Eurosystem is also further assessing the business case for the other two proposed projects. In relation to instant payments, the Eurosystem plans to consult with market participants on the necessity of extending settlement operating hours for a subset of its regular settlement services up to 24/7/365 to allow for real-time settlement of instant payments by November 2017. Finally, the Eurosystem is also assessing the potential benefits of developing a common collateral management system for managing eligible assets used as collateral in the Eurosystem credit operations and the scope for such a service.

The strategic reflections also feature in the editorial of a new newsletter published by the ECB's Directorate General Market infrastructure and Payments (DG/MIP) on 26 September 2016. *MIP OnLine* aims to update readers on the main recent developments in the field of financial market infrastructure and payments and will be published three times a year. Besides the editorial on the future of market infrastructure by Marc Bayle, Director General of DG/MIP, the first edition also includes an update on T2S as well as a piece about Distributed Ledger Technology. On the payments side, the newsletter covers E-invoicing and an article on the role of TARGET2.

ECB: TARGET2-Securities (T2S)

The T2S platform continues to gain traction. On 12 September 2016, five further CSDs joined the common settlement platform: Euroclear's three ESES CSDs from Belgium, France and the Netherlands, as well as VP's two CSDs from Denmark and Luxembourg. T2S migration Wave 3 was the largest migration to date, bringing settlement volumes in T2S to around 50% of the total transaction volume expected after the end of full migration in 2017. Apart from a few teething problems, market participants experienced a generally smooth migration process. The next migration wave (Wave 4) is planned for 6 February 2017.

T2S Migration Plan



Sources: ECB

In terms of ongoing harmonisation work in the context of T2S, the *Mid-year Update 2016*, published on 5 September 2016, provides a comprehensive overview of where the different T2S markets stand in relation to the implementation of the T2S harmonisation standards. The report shows generally high levels of compliance with the 16 harmonisation standards, however with some remaining gaps in particular in relation to corporate actions.

In terms of governance, the T2S Advisory Group (T2S AG), the main advisory body to the Eurosystem on T2S-related issues, had its latest regular meeting on 5-6 July. Members of the Group received updates on ongoing T2S operations and discussed the T2S programme status, from a Eurosystem as well as from a CSD perspective. In addition, the different harmonisation workstreams reported back on their work. This included input by the Eurosystem to external initiatives such as the European Post Trade Forum, where the ECB is represented and actively contributes to the work. Another important issue discussed at the AG meeting was financial technology. In particular, members discussed the Eurosystem's contribution to ESMA's recent discussion paper on Distributed Ledger Technology (DLT), and also reviewed the planned extension of the mandate of the Harmonisation Steering Group (HSG) to explicitly cover financial innovation in general and DLT more specifically. As usual, the AG meeting also included updates from the different T2S technical groups. Noteworthy in this context is that T2S has set up a CSDR Task Force, led by the CSDs involved, which is looking at CSDR implementation in the context of T2S. Finally, the Eurosystem presented a plan to review the current contact group structure in the infrastructure space, proposing among other things to merge the current T2S AG with the COGESI. All presentations and a summary of the meeting are available on the ECB's website. The next meeting of the T2S AG is scheduled for 29-30 November 2016.

"While not initially part of the EPTF, both ICMA and ISLA were formally added to the membership in September 2016.

On 1 August 2016, the ECB published updated versions of a number of key technical and functional T2S documents, including the T2S User Handbook (version 2.2). The updated documents are available on the ECB website.

European Commission: European Post-Trade Forum (EPTF)

The EPTF was established in early 2016 in the context of the Capital Markets Union (CMU) project to help the Commission undertake a broader review of remaining barriers to cross-border clearing and settlement in Europe. Members of the Group include European financial industry associations, the ESCB, ESMA as well as a few independent experts. While not initially part of the EPTF, both ICMA and ISLA were formally added to the membership in September 2016. ICMA will be represented through Godfried De Vidts, Chairman of the ERCC. As regards ongoing work of the EPTF, this is split in two phases, first a general stocktaking exercise of the existing post-trade landscape, followed by a second phase which will focus concretely on identifying remaining barriers. This second phase covers both a review of progress towards removing barriers that had been identified in the two Giovannini reports of the early 2000s as well as the identification of any new barriers that have emerged since then. Building up on the work done by the Forum, the Commission is expected to prepare a final report by spring 2017.

Global Legal Entity Identifier System (GLEIS)

Since February 2016, the Global LEI Foundation (GLEIF), the operating arm of the GLEIS, publishes on a monthly basis Data Quality Reports containing detailed assessments of the overall level of data quality within the LEI system. This includes aggregate quality scores but also information on the best performing Local Operating Units (LOUs), the entities which are responsible for the actual issuance of LEIs.

The total number of LEIs issued globally by the 28 LOUs has continued to increase and has reached 465,000 by October 2016. A search engine is available on the GLEIF website and provides access to all the LEIs issued to date and the related corporate information. LEI records themselves have also been further enhanced to include consistent references to local registration authorities, the local authoritative source associated with a legal entity. On 31 August 2016, the GLEIF published a list of 652 business registers and other relevant registration authorities with a unique code attributed to each of them.

BIS: Committee on Payments and Market Infrastructures (CPMI)

As previously reported, jointly with IOSCO the CPMI is working on harmonised standards in relation to Unique Trade Identifiers (UTIs) and Unique Product Identifiers (UPIs) for OTC derivatives. On 18 August 2016, CPMI-IOSCO published the second consultative report on the *Harmonisation of the UPI*. While the first consultation, published in December 2015, focused on the reference database or classification system for OTC derivatives, the current second consultation addresses the format of the UPI code, as well as content and granularity of the UPI data elements.

As part of their mandate to monitor the implementation of the 2012 *Principles for Financial Market Infrastructures* (PFMI), on 16 August 2016 CPMI and IOSCO published a number of important documents in relation to CCPs. First, a *Report on the Financial Risk Management and Recovery Practices of 10 Derivatives CCPs* was published as part of the ongoing Level 3 assessments which aim to assess consistency in the outcomes of PFMI implementation measures in the different jurisdictions. Secondly, CPMI-IOSCO also published a consultative report with further guidance in relation to the resilience and recovery of CCPs which aim to complement the PFMI. Stakeholders have time until 18 October 2016 to submit their comments on this report. Both documents form part of the broader global regulatory agenda in relation to OTC derivatives and CCPs.

On 29 September 2016, the CPMI published the latest statistics on payment, clearing and settlement systems in the CPMI countries (2015 figures – preliminary release). The publication contains detailed tables for each individual country as well as a number of comparative tables.

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Macroprudential risk

On 4 July 2016, *Experiences with the Ex Ante Appraisal of Macroprudential Instruments*, a report submitted by a study group established by the CGFS, was published. The report provides an overview of the experiences central banks have gathered with *ex ante* appraisals of macroprudential instruments and identifies areas where further analytical development would be particularly useful. It starts with a description of different approaches policy makers have used to produce quantitative and operational objectives for macroprudential policy, and a classification of the analytical methodologies employed in appraisals. The main part of the report then discusses how these different methodologies have been used in practice to assess the impact of macroprudential instruments in different stages of practical decision-making.

Published on 12 July, *Assessing the Costs and Benefits of Capital-Based Macroprudential Policy* is an ESRB working paper, in which the authors discuss a model to quantify the costs and benefits of capital-based macroprudential policy measures. The authors findings illustrate that capital-based measures are transmitted both via their impact on the banking system's resilience and via indirect macro-financial feedback effects. The feedback effects relate to dampened credit and asset price growth and, depending on how banks move to higher capital ratios, can account for up to a half of the overall effectiveness of capital-based measures. Moreover, the authors document significant cross-country spillover effects, especially for measures implemented in larger countries. Overall, their model helps understanding of how and through which channels changes in capitalisation affect bank lending and the wider economy; and can thus inform policy makers on the optimal calibration and timing of capital-based macroprudential instruments.

On 19 July, the ESRB published a strategy paper entitled *Macroprudential Policy Beyond Banking: an ESRB Strategy Paper*. The ESRB considers that whilst macroprudential policy for the banking sector is already operational, the policy strategy, regulatory data and instruments required to address risks beyond the banking sector need further enhancement. Accordingly, this strategy paper analyses the current legal and institutional framework governing macroprudential policies beyond banking and proposes a comprehensive policy strategy to address financial stability risks. This includes the presentation of short-term policy options and a long-term agenda for macroprudential policy beyond banking.

The paper indicates that addressing risks beyond banking requires macroprudential instruments that apply to both lenders and borrowers, targeting entities and activities; and that the move to a more market-based financial system underscores the need for a broader set of macroprudential instruments. It also suggests that macroprudential instruments to address financial stability risks beyond the banking sector should be part of a wider macroprudential policy strategy; and asserts that the ESRB has a leading role in the development of the macroprudential policy strategy and instruments to address risks beyond the banking sector.

On 27 July, the ESRB published the first *EU Shadow Banking Monitor*, which presents an overview of developments in the European shadow banking system to assess potential risks to financial stability – this is the first report in an annual series that will contribute to the monitoring of a part of the financial system that has experienced significant growth in recent years. The ESRB has identified a number of issues that can be a source of and amplify systemic risks:

- financial leverage, in particular in hedge funds, but also in real estate funds;
- systemic interconnectedness, which is especially pronounced between MMFs and the banking system; and
- maturity and liquidity transformation,

which are a concern, especially for some bond funds.

Alongside this, the ESRB also published an Occasional Paper, *Assessing Shadow Banking – Non-bank Financial Intermediation in Europe*. Complementing the *EU Shadow Banking Monitor*, this Occasional Paper describes in further detail the monitoring framework developed by the ESRB for assessing shadow banking activities in Europe. The paper applies both an "entity-based" approach and an "activity-based" approach when mapping the broad shadow banking system in the EU. In turn, the analysis focuses primarily on examining liquidity and maturity transformation, leverage, interconnectedness with the regular banking system and credit intermediation when assessing the structural vulnerabilities within the shadow banking system in Europe. It is considered that this approach appears the most appropriate for the purpose of assessing shadow banking related risks within the EU financial system.

On 1 August, the European Commission launched a public consultation, for comment by 26 October, to gather feedback and evidence on the functioning of the EU macroprudential framework. The goal of the EU macroprudential framework is to ensure the stability of the financial system as a whole and to allow EU Member States to address specific financial stability risks. As this complex framework was developed progressively over a number of years, the Commission now wishes to avoid any overlaps and inconsistencies that may have arisen between the various constituent parts; which is why, although the majority of responses are expected to come from the national authorities within Member States (as they are tasked with implementing macroprudential policy day to day), the Commission is also seeking the opinions of interested and affected groups – such as members of the industry, banks, trade bodies, interested academics, as well as consumer organisations.

The applicable framework is currently made up of five separate pieces of EU legislation: two ESRB Regulations, CRD IV, CRR and the SSM Regulation. By addressing all five component parts in a comprehensive review, the Commission aims to eliminate any possible inconsistencies. The consultation includes a broad range of questions on narrowing and refining the scope of existing macroprudential instruments (such as capital buffers), making the rules more consistent with one another, as well as examining the role and organisational structure of the ESRB and its relationship with the ECB.

On 30 August, ESMA published its *Report on Trends, Risks and Vulnerabilities No. 2, 2016* (TRV) on EU markets, which covers market developments from January to June 2016, together with its *Risk Dashboard No. 3, 2016*. In this latest risk report ESMA indicates that its overall assessment of risk levels in EU markets under its remit remains unchanged. Market and credit risks remain very high – the highest level – while liquidity and contagion risk remain high. Nonetheless, the risk outlook has deteriorated following the result of the UK referendum on EU membership. Market, liquidity and contagion risks may increase going forward, as political and event risks have intensified, and the macroeconomic environment may deteriorate. The deteriorating liquidity risk outlook reflects increased fund outflows following the referendum, leading to the suspension of redemptions in a number of open-ended funds holding UK commercial property.

Complementary to this, on 7 September, the Joint Committee of the ESAs published its *Report on Risks and Vulnerabilities in the EU Financial System*. This report focuses on recent developments concerning the low growth and low yield environment and its potential effects on financial institutions' profitability and asset quality, and highlights concerns related to the interconnectedness in the EU financial system. These risks have persisted for some time and can be related to lasting effects of the 2007 financial crisis. However, the EU financial system is also vulnerable to more immediate risks such as the result of the UK referendum on EU membership which has added political and legal uncertainties to those already affecting the financial system.

On 31 August, the IMF, FSB and BIS released a new publication on *Elements of Effective Macroprudential Policies*. This document, which responds to a G20 request, takes stock of the international experience since the financial crisis in developing and implementing macroprudential policies and will be presented to the G20 Leaders' Summit in Hangzhou. Following the global financial crisis, many countries have introduced frameworks and tools aimed at limiting systemic risks that could otherwise disrupt the provision of financial services and damage the real economy. Such risks may build-up over time or arise from close linkages and the distribution of risk within the financial system.

Experience with macroprudential policy is growing, complemented by an increasing body of empirical research on the effectiveness of macroprudential tools. However, since the experience does not yet span a full financial cycle, the evidence remains tentative. The wide range of institutional arrangements and policies being adopted across countries suggest that there is no one-size-fits-all. Nonetheless, accumulated experience highlights – and this paper documents – a number of elements that have been found useful for macroprudential policy making. The document includes some data on the use of macroprudential tools; illustrative examples of institutional models for macroprudential policy making; and a brief summary of some of the empirical literature on the effectiveness of macroprudential tools.

On 2 September, the FSB and the IMF jointly published the *Second Phase of the G20 Data Gaps Initiative*

> **Since the experience does not yet span a full financial cycle, the evidence remains tentative.**

(DGI-2): First Progress Report. This progress report updates on work by participating countries and international organisations to address post-crisis data gaps and presents the action plans for each of the recommendations agreed for further work. The main objective of DGI-2 is to implement the regular collection and dissemination of reliable and timely statistics for policy use; but DGI-2 does also include new recommendations to reflect evolving policymaker needs. Its 20 recommendations are clustered under three main headings: (i) monitoring risk in the financial sector (ii) vulnerabilities, interconnections and spillovers and (iii) data sharing and communication of official statistics.

The action plans in the progress report have been developed by the Inter-Agency Group on Economic and Financial Statistics (IAG) in consultation with the authorities of the participating economies, and set out specific targets for the implementation of the DGI-2 recommendations through the five-year horizon of the initiative. The recommendations where the FSB will coordinate the work, jointly with other international organisations, include a plan to investigate the possibility of a common data template for global systemically important insurers. Additionally, DGI-2 will work to enhance data collection on the shadow banking system by contributing to the FSB monitoring process. The FSB will seek further improvements to derive a narrow measure of shadow banking and will develop standards and processes for collecting and aggregating data on SFTs at the global level.

On 13 September, the BCBS published the results of its latest Basel III monitoring exercise. Data have been provided for a total of 228 banks, comprising 100 large internationally active banks ("Group 1 banks", defined as internationally active banks that have Tier 1 capital of more than €3 billion) and 128 "Group 2 (ie other) banks". On a fully phased-in basis, data as of 31 December 2015 show that all Group 1 banks meet the Basel III risk-based capital minimum Common Equity Tier 1 (CET1) requirements as well as the target level of 7.0% (plus the surcharges on G-SIBs as applicable). Under the same assumptions, there is no capital shortfall for Group 2 banks included in the sample for the CET1 minimum of 4.5%; and for a CET1 target level of 7.0%, the shortfall remained constant at €0.2 billion since the previous period.

The monitoring reports also collect bank data on Basel III's liquidity requirements. Of the banks in the LCR sample, 85.6% of the Group 1 banks and 82.9% of the Group 2 banks reported an LCR that met or exceeded 100%, while all banks except for one bank each in Group 1 and Group 2 reported an LCR at or above the 60% minimum requirement that was in place for 2015. Also, as of December 2015, 79.6% of the Group 1 banks and 87.0% of the Group 2 banks in the NSFR sample reported an NSFR that met or exceeded 100%, while 95.9% of the Group 1 banks and 97.2% of the Group 2 banks reported an NSFR at or above 90%.

Alongside this, the EBA published its tenth report of the CRDIV-CRR/ Basel III monitoring exercise on the European banking system. Overall, the results of this exercise show a further improvement of European banks' capital positions, with only a very small number of institutions showing potential capital shortfalls. The analysis of the Leverage Ratio shows that there has been a continuous increase in the last periods and that a significant number of institutions in the sample would be constrained by the minimum Leverage Ratio requirement (3%) rather than by risk based standards. Also, 91% of the banks in the sample show an LCR above the full implementation minimum requirement applicable since January 2018 (100%); and around 79% of participating banks already meet the minimum NSFR requirement of 100%.

Published on 19 September, *Macroprudential Policy with Liquidity Panics* is an ESRB working paper, in which the authors analyze the optimality of macroprudential policies in an environment where the role of the banking sector is to efficiently allocate liquid assets across firms. Informational frictions in the banking sector can lead to an interbank market freeze, with firms then reacting to the breakdown of the banking system by inefficiently accumulating liquid assets by themselves. This reduces the demand for bank loans and bank profits, which further disrupts the financial sector and increases the probability of a freeze, inducing firms to hoard even more liquid assets. The authors find that liquidity panics provide a new rationale for stricter liquidity requirements, as this policy alleviates the informational frictions in the banking sector and paradoxically can end up increasing aggregate investment; whilst, on the contrary, policies encouraging bank lending can have the opposite effect.

On 23 September, the BIS made available a compendium volume of 17 papers presented at the joint Central Bank of the Republic of Turkey / BIS / IMF conference on "Macroprudential policy: effectiveness and implementation challenges" held in Istanbul during Turkey's Presidency of the G20. These papers address the history, theory and practical implementation of macroprudential policies. They analyse, *inter alia:* the nature of interactions with other policies (notably monetary policy and microprudential regulation); how macroprudential policies can cope with external shocks and what cross-border spillover effects arise; and the effectiveness of various macroprudential policy tools. Several country case studies are presented.

The General Board of the ESRB held its 23rd regular meeting, on 22 September; and highlighted the further weakening of financial institutions' balance sheets as the main risk to financial stability in the EU. The short-term risks related to the UK's EU referendum materialised, leading to significant but short-lived volatility, and financial markets quickly recovered. The General Board emphasised that addressing the challenges facing European banks should remain a top priority for EU policymakers.

As in previous meetings, the General Board discussed potential vulnerabilities and risks in the EU financial system related to the low interest rate environment. The General Board endorsed the publication of the ESRB report, which discusses the macroprudential issues and structural changes related to the low interest rate environment. This report, which will be published in the autumn, outlines the ESRB's assessment of potential risks to EU financial stability and proposes options for macroprudential policy responses.

The General Board also discussed the mandate and strategy of the newly created ESRB High-Level Task Force on Safe Assets. This task force, which is chaired by Philip Lane, Governor of the Central Bank of Ireland, will investigate the potential creation of sovereign bond-backed securities, which could comprise senior and junior claims on a diversified portfolio of sovereign bonds. In addition, the General Board exchanged views on possible improvements to the EU macroprudential policy framework.

On 22 and 23 September, the ESRB held its first annual conference. Topics included macroprudential policy stance and experiences, low interest rates and their implications for financial stability, derivatives and systemic risk, and safe assets. Mario Draghi, in his capacity as ESRB Chair, opened the conference and give a keynote address; and further keynote speeches were given Valdis Dombrovskis, Vice-President of the European Commission and Stefan Ingves, Sveriges Riksbank (in his capacity of Chair of the ESRB's Advisory Technical Committee). These speeches, together with a number of presentations and webcast recordings have subsequently been made available.

On 26 September, the ESRB hosted its second shadow banking workshop, with the aim of gathering the views of policy makers, academics and market participants from different jurisdictions on developments within the shadow banking system. The first two workshop sessions considered the systemic risks associated with leverage, liquidity and fragility within the shadow banking system as well as with its increased interconnectedness to the banking sector; whilst the third session focused on operational issues related to macroprudential policy beyond banking. Finally, a high-level policy panel, chaired by Vítor Constâncio, ECB Vice-President, provided an opportunity to discuss the possible implications and the role of different entities within the CMU in Europe.

On 29 September, the ESRB released the 17th issue of its Risk Dashboard, which is a set of quantitative and qualitative indicators of systemic risk in the EU financial system. Overall, this reports that market-based indicators of systemic risk have stabilised at somewhat elevated levels after sharp increases over the summer months. Bank profitability improved slightly in the second quarter of 2016, but was somewhat below the level one year ago; and banks' central bank funding continued to decrease in fragile euro area countries. Also, whilst the total assets of EU credit institutions continued to decline in the first quarter of 2016, assets of investment funds and OFIs and in particular insurance companies and pension funds continued to grow.

The ESRB publishes an overview of measures of macroprudential interest, of which it is aware, in the EU/EEA. This includes information regarding capital conservation buffers, countercyclical capital buffers, global systemically important institution buffers, other systemically important institution buffers, systemic risk buffers, reciprocation (recognition) measures and a series of other measures. This overview was most recently updated on 17 August.

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ICMA Capital Market Research

The Counterparty Gap: A Study for the ICMA European Repo and Collateral Council on the Trade Registration Models used by European Central Counterparties for Repo Transactions
Published: 27 September 2016
Author: Prepared for ICMA by John Burke, independent consultant

Remaking the Corporate Bond Market: ICMA's 2nd Study into the State and Evolution of the European Investment Grade Corporate Bond Secondary Market
Published: 6 July 2016
Author: Andy Hill, ICMA

Evolutionary Change: The Future of Electronic Trading in European Cash Bonds
Published: 20 April 2016
Author: Elizabeth Callaghan, ICMA

Perspectives from the Eye of the Storm: The Current State and Future Evolution of the European Repo Market
Published: 18 November 2015
Author: Andy Hill, ICMA

Impact Study for CSDR Mandatory Buy-ins
Published: 24 February 2015
Author: Andy Hill, ICMA

The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market
Published: 25 November 2014
Author: Andy Hill, ICMA

Continually Working to Develop Efficient and Effective Collateral Markets
ERC Occasional Paper
Published: 4 September 2014
Author: David Hiscock, ICMA

Covered Bond Pool Transparency: the Next Stage for Investors
Published: 21 August 2014
Author: Prepared for ICMA by Richard Kemmish Consulting Ltd

Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity
Published: 3 April 2014
Author: Andy Hill, ICMA

Avoiding Counterproductive Regulation in Capital Markets: A Reality Check
Published: 29 October 2013
Author: Timothy Baker, Senior Adviser to ICMA

Collateral Damage: the Impact of the Financial Transaction Tax on the European Repo Market and its Consequences for the Financial Markets and the Real Economy
Published: 8 April 2013
Author: Richard Comotto, ICMA Centre

Economic Importance of the Corporate Bond Markets
Published: 8 April 2013
Author: Timothy Baker, Senior Adviser to ICMA

Events in China and Hong Kong following the G20 Summit in Hangzhou in September

On 6 September ICMA and China (Shanghai) Pilot Free Trade Zone Lujiazui Administration Bureau co-hosted a roundtable on China's Integration in the International Capital Markets, at which CEOs of major Chinese financial institutions, officials and the Lord Mayor of the City of London discussed the outlook for the future participation of China in global financial markets. At the event ICMA and China (Shanghai) Pilot Free Trade Zone Lujiazui Administration Bureau and signed a cooperation protocol.

At the *Belt and Road Summit – Financing Through Silk Road Bonds* in Hong Kong, organised by ICMA with the Dagong rating agency on 8 September the focus was on the financing needs of infrastructure projects in the countries linked by the "One Belt, One Road" initiative and how to bridge the gap in the current system by the creation of a new standardised asset class, the Silk Road Bond.

Diary 2016

DATE	ICMA Workshops
18 October *Register*	European Regulation: An Introduction for Capital Market Practitioners, London, 18 October How much do you know about the new regulations that are already in force and impacting your daily work in the capital market and the ones that are still in the pipeline? Against a background of far-reaching regulatory change ICMA's one-day, fast-track course on European regulation for capital market practitioners gives an overview of the new regulatory landscape for financial institutions in Europe.
27 October *Register*	Bond syndication practices for compliance professionals and other non-bankers, London, 27 October This workshop aims to give compliance professionals an in-depth and thorough understanding of the current practices that are involved in launching a deal in the international debt capital market.
6 December *Register*	Ethics and the Capital Markets, London, 6 December Are we in danger of relying too much on a compliance-driven culture to protect the financial markets, rather than re-establishing a clear ethical culture – both at the individual and the corporate level? This new ICMA Workshop seeks to redress the balance and raise awareness of ethics and bringing ethical values to bear in the financial markets.
7-9 December *Register*	Repo and securities lending under the GMRA and GMSLA, London, 7-9 December The workshop analyses how repo and securities lending transactions operate within the framework provided by the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA), and highlights the issues that need to be addressed by users.

ICMA Conferences and seminars

DATE	ICMA Conferences and seminars
25 October *Register*	The European corporate debt private placement market – its development and role in economic growth, Brussels, 25 October The development of a well-functioning, cross-border private placement market in Europe has picked up momentum over the last 18 months and has become a key part of the discussion on Capital Markets Union. This conference will bring together regulatory authorities, issuers and investors in private placement to review recent developments and progress in creating demand for this asset class.
26 October *Register*	Primary markets from an issuer, investor and a lead manager's point of view, Frankfurt, 26 October This free event on developments in the primary markets, will start with an expert presentation on the ICMA Primary Market Handbook, and followed by a discussion between Frank Czichowski, Treasurer of KfW, and Martin Egan, Global Co-Head Primary and Secondary Markets, BNP Paribas and Chair of ICMA's Primary Market Practices Committee about the current economic, business and regulatory issues facing the market and the outlook for debt issuance in the short to medium term.

Diary 2016

DATE	ICMA Conferences and seminars (cont'd)
2 November *Register*	Developing a Corporate Debt Market, Doha, 2 November, Jointly presented by the Qatar Financial Markets Authority and ICMA, this one-day educational event on Corporate Debt Markets, will look at how a well-functioning corporate bond market can make an important contribution to a country's economic development and consider the conditions that are necessary to encourage companies to use this method of funding.
7 November *Register*	ICMA Asset Management and Investors Council (AMIC) Conference, London, 7 November The AMIC is the voice of ICMA's buy-side membership. Join the AMIC meeting in November for expert views from the cross-border asset management industry on Brexit and the practical implications for capital markets; liquidity in secondary bond markets and coping in a negative interest rate environment. AMIC meetings are open to all ICMA members and to the wider professional investment community, including asset managers, fund managers, private banks, hedge funds, pension funds, insurance companies and sovereign wealth funds.
16 November *Register*	Joint ICMA and SIX Swiss Exchange seminar – Developments in the Green Bond market, Zurich, 16 November This evening seminar presented by ICMA and SIX Swiss Exchange will review developments in the Green Bond market both internationally and in a Swiss context and will include an overview of the Green Bond Principles. The event will be followed by a networking reception.
17 November *Register*	Liquidity in the bond markets, The Hague, 17 November The key drivers behind bond market liquidity, and the extent to which it is becoming more challenging both to provide and source liquidity will be discussed. Followed by a consideration of how this is changing market dynamics and participant behaviour, both for the sell-side and buy-side firms, as well as the evolution of market structure.
23 November *Register*	The 10th ICMA Primary Market Forum, London, 23 November Now in its 10th year, the ICMA Primary Market Forum will bring together issuers, syndicate banks, investors and law firms active in primary debt capital markets to discuss the developments and the outlook for the future.
29 November *Register*	Regulation and electronification – what now? Denmark, 29 November, 2016 Experts from ICMA and the local market will look at two of the key drivers of change in capital markets and how market structure is changing in response to them, with particular reference to electronic trading in secondary bond markets.

ICMA Future leaders

DATE	ICMA Future leaders
3 November *Register*	Regional launch event - The recipe for a successful career in fixed income, Paris, 3 November **HOSTED BY BLOOMBERG.** All ICMA members and interested financial market participants are invited to the first ICMA Future Leaders event in France, featuring keynote speaker: Denis Prouteau, Global Head of Credit, Fixed Income, Natixis.

Diary 2016

DATE

10 November
Register

Introduction to blockchain-enabled business models in finance, Zurich, 10 November
ICMA members are invited to join an ICMA Future Leaders networking event in Zurich after work on Thursday, 10 November. The featured keynote speaker will be Claudio Lisco, Innovation Associate Director at UBS.

ICMA Future Leaders was set up by ICMA to reach out to the "next generation" of market professionals and help them to tap into ICMA's services, which are open to employees of all ICMA member firms. ICMA Future Leaders' events run throughout the year in major European financial centres and are open to fixed income professionals in all areas of the business at ICMA member firms. At these you can meet your peers and be part of the wider ICMA community.

ICMA Womens Network

22 November
Register

ICMA Women's Network
Networking. Progression. Support.

Shaping up – with Julia Hoggett, Head of Wholesale Banking, Supervision Division, FCA London, 22 November **HOSTED BY NOMURA - ICMA MEMBERS ONLY.** The ICMA Women's winter event will feature Julia Hoggett, Head of Wholesale Banking, Supervision Division, FCA.

Drawing on her own experiences working in a number of high profile roles in both the private and public sector, Julia will share her views on the visibility and role of women in financial services, the importance of recognising the contribution made by women and how firms can develop a culture in which women can succeed and fulfil their potential. Structured networking follows the event.

ICMA Lunchtime Capital Market Lectures

Save the Dates!

23 November, Paris. Brexit, impact on the European financial industry and the consequences for the French market place with Christian Noyer, former Governor of the Banque de France. **7 December, London.** Jean-Claude Trichet, former President of the European Central Bank.

Events in 2017

20-22 January
Register

ICMA Annual Charity Ski Weekend 2017, Zermatt, 20 -22 January Organised by the ICMA Switzerland and Liechtenstein region. The ICMA Region for Switzerland & Liechtenstein annual charity ski event is one of the main social gatherings in the calendar year for the Association. Open to all of ICMA's global membership, the weekend attracts well over 150 professionals and provides ICMA members, and non-members the opportunity to combine business, networking and pleasure all in aid of charity.

Save the Date!

The 49th ICMA AGM and Conference, Luxembourg, 3- 5 May, 2017 ICMA members and financial market participants and observers are welcome to attend the 2017 capital market event of the year at the heart of Europe.

Contact **shannelle.rose@icmagroup.org** for sponsorship opportunities.

ICMA Executive Education

Courses 2016

Foundation Qualifications

Financial Markets Foundation Qualification (FMFQ)
London: 2-4 November 2016

Financial Markets Foundation Qualification (FMFQ) Online
Next start date: 1 November (register by 26 October 2016)

Introduction to Fixed Income Qualification (IFIQ)
London: 19-21 October 2016

Introduction to Primary Markets Qualification (IPMQ)
London: 24-26 October 2016

Securities Operations Foundation Qualification (SOFQ)
Brussels: 9-11 November 2016

Securities Operations Foundation Qualification (SOFQ) Online
Next start date: 1 November (register by 26 October 2016)

Advanced Qualifications

ICMA Fixed Income Certificate (FIC)
Barcelona: 23-29 October 2016

ICMA Operations Certificate Programme (OCP)
Brussels: 13-19 November 2016

ICMA Primary Market Certificate (PMC)
London: 21-25 November 2016

Training Programmes

ICMA Guide to Best Practice in the European Repo Market
London: 31 October 2016

Trading & Hedging Short-term Interest Rate Risk
London: 8-9 November 2016

Trading the Yield Curve with Interest Rate Derivatives
London: 10-11 November 2016

Inflation-linked Bonds & Structures
London: 29-30 November 2016

Credit Default Swaps – Pricing, Application & Features
London: 5-6 December 2016

Credit Default Swaps – Operations
London: 7 December 2016

Securities Lending & Borrowing – Operational Challenges
London: 12-13 December 2016

**For more information, please contact:
education@icmagroup.org or visit
www.icmagroup.org/education**

Glossary

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 Council	ICMA Asset Management and Investors
ASEAN	Association of Southeast Asian Nations
ASF	Available Stable Funding
AuM	Assets under management
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
COP21	Paris Climate Conference
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 Redevelopment
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
EFTA	European Free Trade Area
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ELTIFs	European Long-Term Investment Funds
EMDE	Emerging market and developing economies
EMIR	European Market Infrastructure Regulation
EMTN	Euro Medium-Term Note
EMU	Economic and Monetary Union
EP	European Parliament
ERCC	ICMA European Repo and Collateral 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
ETP	Electronic trading platform
ESG	Environmental, social and governance
ETD	Exchange-traded derivatives
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
FICC	Fixed income, currency and commodity markets
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FMSB	FICC Market Standards Board
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
GBP	Green Bond Principles
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
IG	Investment grade
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
PCS	Prime Collateralised Securities
PD	Prospectus Directive
PD II	Amended Prospectus Directive
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-Based Investment Products
PSE	Public Sector Entities
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
RSF	Required Stable Funding
RSP	Retail structured products
RTS	Regulatory Technical Standards
RWA	Risk-weighted assets
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
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
STORs	Suspicious transactions and order reports
STS	Simple, transparent and standardised
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
TMA	Trade matching and affirmation
TRs	Trade repositories
UKLA	UK Listing Authority
VNAV	Variable net asset value

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