International Capital Market Association

ICMA

QUARTERLY REPORT

ASSESSMENT OF MARKET PRACTICE AND REGULATORY POLICY

INSIDE:

THE TRANSITION FROM LIBOR

IMPROVING EUROPEAN CORPORATE BOND MARKETS

MIFID II/R IMPLEMENTATION

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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 around 530 member firms in 60 countries.

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.

FEATURES:

01:
The transition from LIBOR
By Paul Richards

02:
Improving European corporate bond markets
By Andy Hill

03:
MiFID II/R Implementation
All articles highlighted with

M

CONTENTS

M This symbol indicates articles referring to MiFID II/R

Chief Executive's review of 2017 and outlook for 2018

By Martin Scheck

Introduction

2017 can be characterised as "the year of implementation". The cycle of new regulation designed to address the global financial crisis a decade ago is coming to an end and our members, globally, are now struggling to implement the relevant legislation and ensure compliance. MiFID II/R is the most obvious example but by no means the only one.

This is against a backdrop of geopolitical tensions and concerns over market fragmentation, but on the other hand economic growth in all major regions, a gradual reduction in quantitative easing, and gradual tightening of the ultra-loose monetary policy through selective interest rate rises by some central banks. In the US there is also a trend under the new Administration to re-evaluate just how far the "regulatory pendulum has swung", which could help the capital markets function more effectively. Another trend has been the increasing focus by policy makers globally, and capital market practitioners, on sustainability.

At ICMA our focus is on the day-to-day market practices in the international debt securities markets and the surrounding regulatory framework and market infrastructure. We are committed to serving our broad and growing membership of issuers, intermediaries, asset managers and investors, infrastructure providers and others as we support well-functioning capital markets to ensure they can play a full role in financing the economy.

The breadth of our membership (now more than 530 institutions), encompassing large and small entities from all different segments of the fixed income market located in over 60 different countries, is a core strength of ICMA. By working with our network of members, often through our active regional committees and at other times through our market practice and regulatory committees, councils and working groups, we hear of concerns in the markets at a very early stage allowing us to address them in a timely fashion.

Core areas for ICMA are the primary markets, secondary markets, short-term markets (in particular repo and collateral) and the green and social bond markets. Cross-cutting themes are a focus on ensuring that the capital markets are as integrated as possible, and on electronification of processes within each core area. Wherever possible we integrate representation from all member categories into our committees – this ensures that buy-side, issuer and other participants' views are considered. And where this is not possible we run specific committees to address issues from a specific segment viewpoint – for example our three issuer forums, and our Asset Management and Investors Council.

This sets the scene for a brief review of ICMA's activities in 2017 before we look ahead to 2018.

Review of 2017

A key role for ICMA in 2017 has been to help our members interpret, clarify and implement the MiFID II/R package to be ready for the January 2018 deadline. This impacts all areas of the market affecting almost all our members whether located in Europe or not. We have been particularly involved of late on primary and secondary market aspects and also the research unbundling discussion – following intensive early intervention, repo is largely out of scope. We have commented extensively in the Quarterly Report, answered many questions on our Legal and Regulatory Helpdesk, conducted questionnaires leading to research notes, continued to discuss in all our committees and in innumerable bilateral discussions with members, cooperated and coordinated with other trade associations, worked with national and international regulators, created a resource hub on our website with Frequently Asked Questions and created a monthly MiFID II/R newsletter distributed to all our members. In addition, we have held workshops in almost every single European financial centre, as well as Hong Kong and Singapore, on MiFID II/R which have been attended by over 1,000 individuals from member firms. This has been augmented by conference calls to those centres we have not been able to visit in person.

Despite all this we remain concerned about a number of aspects of MiFID II/R which could have unforeseen impacts on the market, and which may well work against the objectives of Capital Markets Union. The availability of research on the SME sector following the implementation of research unbundling is one such, as is the possibility that retail investors will find they have fewer possibilities to purchase bonds of high credit quality entities directly in the future. We need to monitor these and many other aspects as we go further into 2018 since inevitably certain aspects of MiFID II/R will need to be reassessed and adjusted once the impacts are known. Accordingly, we expect this work to continue well into 2018.

Whilst MiFID II/R remains a mammoth project, there have been many other projects for ICMA in 2017.

In the primary market a complex and challenging ongoing project is the PRIIPs Regulation – again we have been helping to clarify and interpret this Regulation and in particular trying to ascertain which bonds are within scope and which are not. We continue to represent our members' views on the forthcoming Prospectus Regulation and make sure the widely used ICMA Primary Market Handbook is up-to-date.

Our work with primary market practitioners is extensive, with active committees in the UK, Hong Kong, the Nordic region and Switzerland. The comparative review of new issue processes in Russia and internationally is nearly finalised and we released, in conjunction with NAFMII in China, a report on the panda bond market based on a survey of members from our issuer forums. New issue processes are as ever subject to intense scrutiny, and we have been providing input to the FICC Markets Standards Board as well as through our membership of the European Commission's High-Level Expert Group on Corporate Bond Markets.

We continue to monitor the state of liquidity in the secondary market and expanded this work on to Asia during 2017. Clearly MiFID II/R is the main regulatory focus, but we have also kept abreast of CSDR developments – we continue to argue that the mandatory buy-in regime is flawed and should not be implemented as it currently stands.

During 2017, we refined and updated the ICMA buy-in rules contained in our Secondary Market Rules and Recommendations, which make them more effective in cases of non-settlement. Our discussions with regulators and policy makers on the state of the secondary markets have been ongoing. They do not always agree with the view of the market, but we are seeing a growing realisation that the liquidity available is unlikely to be sufficient in times of crisis or severe volatility.

Repo is fundamental to the workings of the capital markets largely due to the increasing importance of collateral in the financial system, and ICMA's European Repo and Collateral Council has had an exceptionally busy year. 2017 started badly with a breakdown of the repo market over the 2016 year-end, which led us to publish a research report on the breakdown. This was instrumental in gaining a thorough insight into the reasons for the breakdown and helped to mitigate the situation over the following quarter-ends, including over the 2017 year-end. We released an update to the guide to best practices in the European repo market before Christmas and this will help with an update of the Asian guide in early 2018. We also released the first edition of an Asian repo survey this year and will build on this prototype with an annual survey in Asia along the lines of the authoritative European repo survey we have been running for the last 16 years.

In all these areas technological change is fast taking hold and we review these with our members in each committee, and through our electronic trading and platform working groups, and through our repo operations working group. We have provided mapping directories of the technological solutions in each area and kept these updated during 2017. They can be found on our website. The last was released in November – *The FinTech Mapping Directory for Bond and Repo Operations*. It already contains over 100 different solutions.

The fourth core area is the green and social bond markets. Working through the Green and Social Bond Principles Executive Committee, we released updated Green Bond Principles and the first Social Bond Principles in June at the GBP AGM in Paris, which attracted some 700 participants. Work in this area continues to expand and is truly global. We have been working with an extensive range of policy makers globally – in China for example and with the ASEAN Capital Market Forum (the combined regulatory forum for the regulators of the ASEAN countries). In Europe we have been an active participant in the European Commission's High-Level Expert Group on Sustainability, providing input on standards and labels, as well as on relevant taxonomies and other aspects of the market. We expect the full report to be published early in 2018.

A recent highlight was the conference we organised in Tokyo in November on the growth of the green bond market, jointly with the Japan Securities Dealers Association. It attracted over 400 delegates and was the first of its kind in the country.

We also founded in 2017 the Global Green Finance Council, a group of associations covering a broader set of disciplines than simply the bond markets. This facilitates the leveraging of expertise gained over the last few years in the bond markets into other important sectors such as the loan markets.

With the many official sector interactions, the Secretariat of the Green and Social Bond Principles and the many working groups within that, as well as the GGFC referred to above, our engagement in this sector continues to grow and is resource intensive. We are grateful to the members of the GBP and of ICMA for their generous support, which includes a long-term secondee from the EIB.

Before moving on I want to comment on the engagement of our buy-side members. Wherever possible they provide their perspective in our cross-industry groups – for example our Secondary Market, Repo and Collateral and Green Committees. However, the buy-side group, our Asset Management and Investors Council, which focuses specifically on issues relating to our buy-side members, has had a strong performance this year running two conferences and dealing with a wealth of important topics for our buy-side members. We continued our cooperation with EFAMA, jointly publishing a well-received report on *Leverage in Investment Funds*. This is just one of many initiatives, including further work on infrastructure finance, covered bonds, securitisation, and bail-in.

A recurring theme throughout the year has been the challenge for capital markets represented by the Brexit negotiations. ICMA's approach has been to examine the impact that Brexit would have on the way the capital markets operate and the impact on the Capital Markets Union initiative of the EU. You may have seen the series of Quarterly Assessments published in our Quarterly Report. We facilitate discussion and the exchange of information in all our committees, amongst market participants and with the official sector. Of course, the Brexit discussions are one manifestation of a critical theme for ICMA which cuts across all our work – the promotion of global coherence in capital markets and the avoidance of fragmentation. This remains a topic for 2018 and beyond.

Another topic which will stretch into the future is the important discussion about benchmark reform. This touches all segments of most countries' economies – bond markets, loan markets, mortgages, derivatives to mention a few. We are involved from the perspective of cash bond markets and are chairing the Bond Sub-Group of the Sterling Risk-Free Rate Working Group in the UK, backed by the Bank of England and the Financial Conduct Authority, charged with the transition from LIBOR to a new benchmark. There are a host of unanswered questions and we envisage this initiative gathering momentum throughout 2018, also as other jurisdictions develop their own alternative reference rates. There needs to be a globally coordinated approach to such a fundamental change in market structure across the major currency blocks and we will involve ourselves in that as much as we can, given its importance to all categories of our membership.

This is by no means the only official sector group in which ICMA is represented – already mentioned is our active involvement in two of the European Commission's High-Level Expert Groups – Corporate Bond Markets and Sustainability. In addition, our participation in various contact groups of the European Central Bank, the ESMA Stakeholders Group and others, is indicative of close contacts (and an all-important credibility) with regulators and policy makers.

The scope of work in 2017 has been immense and as you can imagine our output is driven by the input we receive from our members – well over 1,500 individuals are engaged on our committees. In addition, the support we receive from our 15 regional committees is simply invaluable in setting our agenda. They are our eyes and ears on the ground.

Geographically, our reach continues to develop. Of course, Europe remains our centre of gravity but in Asia our activities are expanding, driven by a growing membership (we welcomed eleven new members from the region in 2017) and deeper engagement. As already mentioned, this year saw the first ever Asian repo survey which will now become an annual fixture, an expansion of our secondary market work to Asia and real progress in the green finance space in both China and the ASEAN countries. We worked with the Asian Capital Markets Forum for example in developing ASEAN green bond guidelines which were launched in November and reference closely the Green Bond Principles. The education joint venture in China continues well with around 1,000 Chinese individuals taking part annually. We also stepped up our activities in Africa – largely based around repo and primary markets – and the Gulf.

As in previous years you will be aware of the many events we hold (over 70 in 2017 in some 23 different countries) and I hope you were one of the over 8,000 individuals who participated. These are an essential part of ICMA's service, allowing for information exchange and networking. Free to our members, details of forthcoming events can be found on our website and we are grateful to our regional committees for the guidance they provide as to what is most relevant in their region.

We remain committed to providing high-quality executive education for market participants. This year has seen a record number of delegates – at nearly 1,000. Specific tailored "in-house" courses for both member firms and non-member firms have seen a surge of interest.

The internationalisation of our two outreach initiatives – the ICMA Women's Network and the ICMA Future Leaders Committee – continued in 2017 with events in many

European financial centres; and, not to be neglected, some exciting events in London – such as the recent discussion on "Unconscious Bias" which attracted a record audience. We very much appreciate the support of our members in hosting these events and to the steering committees for driving the two initiatives.

Outlook for 2018

Looking ahead we can already see plenty on the agenda for 2018.

We can expect further rate rises, a further reduction of QE, and progress on Brexit – with hopefully a clear transition period. We can confidently predict continued uncertainty over the implementation of the MiFID II/R package and PRIIPs and most likely a range of consequences which are not as yet foreseen, which will keep us extremely busy helping members. We envisage further growth in the green and social bond markets globally, and further work on the remaining regulatory topics impacting our four core areas. The transition from the IBORs to alternative reference rates will be a major topic – and there will of course be a continuation of the other market practice workstreams in which we are currently involved. Technological change will throw up opportunities, change the services we need to provide and the way in which we provide them. Fragmentation remains a real concern, leading to inefficiencies and raising costs for participants which feed through to the real economy.

At ICMA we have a clear strategy, endorsed by our Board, with regard to the areas in which we serve our members. The wealth of input from our members to spot trends early and identify market problems quickly is immensely valuable. We need to remain nimble and flexible to adjust our agenda to accommodate such input. It is also important to work constructively with the authorities and with other associations to ensure maximum efficiency.

Our mission remains to promote well-functioning and resilient cross-border bond markets, which are essential to fund economic growth and development. With the support of our members we are well placed to do this. I want to thank ICMA's Board and our staff for all their efforts in 2017, and to thank our members for your support. I look forward to working with you again in 2018.

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Our mission remains to promote well-functioning and resilient cross-border bond markets, which are essential to fund economic growth and development.

The transition from LIBOR

By Paul Richards

Summary

As background for ICMA members, this Quarterly Assessment introduces some of the issues that need to be addressed in implementing the transition from LIBOR to near risk-free rates, in six main sections: the future of LIBOR; the introduction of near risk-free rates in place of LIBOR; the differences between secured and unsecured reference rates; the differences between overnight and term rates; transition issues relating to legacy financial instruments; and transition issues relating to new financial instruments.

Introduction

1 Benchmark reform is a global issue. The Financial Stability Board, which has overseen global benchmark reform since 2014 drawing on IOSCO's earlier work, has called for the development of near risk-free rates for use as alternatives to the London Interbank Offered Rate (LIBOR) and other similar IBORs.[1] LIBOR has been regulated by the FCA since April 2013.[2] The FCA's Chief Executive, Andrew Bailey, set a deadline for the transition from LIBOR in a speech on 27 July 2017, in which he said that the current panel banks had agreed voluntarily to sustain LIBOR until the end of 2021, but that the FCA would no longer intend to use its powers to persuade or compel banks to submit contributions for LIBOR after the end of 2021.[3] Nor does the EU Benchmark Regulation, which came into effect in January 2018, permit the FCA to compel banks to submit contributions indefinitely.[4]

2 In the case of many LIBOR benchmarks, the underlying market which LIBOR seeks to measure – the market for unsecured wholesale term lending to banks – is not sufficiently active. Consequently, there is not a sufficient number of observable transactions, with the result that panel banks submitting transactions data need to rely on expert judgement. In the FCA's view, it is potentially unsustainable, but also undesirable, for market participants to rely indefinitely on reference rates that do not have active underlying markets to support them.[5] Many panel banks are themselves reluctant to provide submissions which are based on judgement rather than actual transactions data, given the potential risk this creates. LIBOR will not necessarily cease to exist at the end of 2021 – that will be a matter for the IBA and the panel banks – but publication of LIBOR will no longer be guaranteed. The market therefore needs to plan for an orderly transition away from the use of LIBOR to one or more alternatives.

The future of LIBOR

3 In financial markets globally, it is estimated that the value of contracts referencing LIBOR is roughly $350 trillion on

1 See: FSB: *Reforming Major Interest Rate Benchmarks,* July 2014. In the 2014 report, the FSB made recommendations for enhancing existing benchmarks for key IBORs in the unsecured lending markets, and for promoting the development and adoption of near RFRs where appropriate. See also: the Wheatley LIBOR review, 2012; IOSCO: *Principles for Financial Benchmarks,* 2013; IOSCO: *Guidance on Statements of Compliance with the IOSCO Principles for Financial Benchmarks,* 2016; IOSCO: *Use of Financial Benchmarks, 4 December 2017.*

2. ICE Benchmark Administration (IBA) is the administrator of LIBOR. 20 panel banks submit contributions to the benchmark. IBA and the LIBOR submission process are regulated by the FCA.

3. Andrew Bailey, Chief Executive of the FCA, *The Future of LIBOR:* Bloomberg, 27 July 2017. The FCA confirmed on 24 November 2017 that all 20 of the panel banks have agreed to support the LIBOR benchmark, ensuring the sustainability of the rate until 2021.

4. The EU Benchmark Regulation was published on 30 June 2016, and is fully applicable from 1 January 2018.

5. Andrew Bailey, Chief Executive of the FCA: *The Future of LIBOR:* Bloomberg, 27 July 2017.

a gross notional basis. LIBOR is quoted in five different currencies: sterling; US dollars; euro; Swiss francs; and Japanese yen. Derivatives represent much the largest proportion of market exposure when calculated on a gross notional basis. In the cash markets, the main financial instruments referencing LIBOR include floating rate notes, syndicated loans and bilateral corporate loans, term wholesale deposits, overdraft and trade finance facilities, covered bonds, capital securities, perpetuals and securitisations, as well as retail and commercial mortgages. Many financial instruments referencing LIBOR in the cash markets have a maturity date beyond the end of 2021.[6]

4 As the administrator of LIBOR, the IBA's aim is to ensure the integrity of the benchmark determination process and also to ensure that LIBOR will remain an effective interest rate benchmark over the long term. The IBA is understood to be fully committed to the evolution of LIBOR, and to consider that, if the need for any subjective decisions from panel banks can be reduced, this will help ensure LIBOR's continuation post-2021; and the IBA is also understood to welcome the development of alternative interest rate benchmarks to provide choice and better alignment between appropriate benchmarks and market needs, and to be willing to work with all stakeholders to help establish new reference rates.

5 Given the drawbacks to LIBOR and the risks that LIBOR may cease to be published, the authorities have decided to encourage the market to move away from LIBOR to near risk-free rate benchmarks. The other reason why the authorities need to be involved is that there is substantial market inertia in the use of LIBOR. So long as financial instruments referencing LIBOR benefit from a concentration of liquidity, the adoption of alternatives is a challenging task.[7] It is a particular challenge in the cash markets, where LIBOR is widely used for different maturity terms (eg one, three or six months).[8]

6 Although the LIBOR deadline is four years away, the market needs to start making preparations for the transition from LIBOR now: both by agreeing on successor risk-free benchmark rates in the overnight and the term market and by working out how the transition should take place to the new benchmarks in an orderly way. The transition from LIBOR will need to be coordinated globally, and communicated globally across financial markets, in view of the global use of the LIBOR benchmark.[9] Given the inter-relationship between the cash bond market and the derivatives market used as a hedge, work on both product areas needs to proceed in parallel rather than being carried out in different product areas in isolation.

The introduction of near risk-free rates

7 The authorities have two main motivations for the development of near risk-free rates (RFRs) in place of LIBOR: (i) to increase choice and improve market effectiveness, since for many transactions RFRs may be more appropriate for users than LIBOR; and (ii) to recognise that there is a structural weakness in LIBOR arising from the lack of unsecured term deposit transactions – and therefore a continued reliance on judgement.[10]

- In the first case, RFRs may be more appropriate for users than LIBOR for transactions in which the bank credit component of LIBOR is neither necessary nor appropriate. Derivatives markets in particular could be more effective if there was liquidity in alternative reference rates.[11]
- In the second case, term deposit markets which underpin LIBOR fixings are no longer a liquid source of bank funding. Even a reformed LIBOR would rely on expert judgement to supplement transactions data. More widespread use of robust transactions-based benchmarks would improve the resilience of the financial system.[12]

Secured and unsecured reference rates

8 While there is agreement between the authorities in the five main jurisdictions in which IBORs are used on the need to choose successor RFRs, in some cases the

6. In the UK, there are more than £200 billion of SME and corporate loans, around £125 billion of FRNs and £200 billion of structured debt which are referenced to sterling LIBOR. Source: Bank of England (6 July 2017). In the case of sterling FRNs, 152 bonds have a maturity of less than one year; 267 have a maturity of 2-5 years; 29 have a maturity of 6-10 years; and 71 have a maturity of over 10 years. Source: Bloomberg (2017) data derived from "SRCH function" and available at Bloomberg. (Accessed: 19 December 2017).

7. Chris Salmon, Executive Director, Markets, Bank of England: *The Bank and Benchmark Reform:* Roundtable on Sterling Risk-Free Reference Rates, 6 July 2017.

8. Of the £125 billion FRNs outstanding, 23 bonds with £8 billion outstanding reference one month LIBOR; 466 with £115 billion outstanding reference three month LIBOR; 30 bonds with £3 billion outstanding reference six month LIBOR. Source: Bloomberg: *op. cit.*

9. The Official Sector Steering Group has been tasked by the FSB to help coordinate the transition to RFRs globally.

10. Mark Carney, Governor of the Bank of England: Roundtable on Sterling Risk-Free Reference Rates, 6 July 2017.

11. In its report published in July 2014, the FSB concluded that, particularly for derivatives transactions, nearly risk-free reference rates are in many cases more suitable than reference rates that include a term bank credit risk component, such as LIBOR.

12. Chris Salmon, Executive Director, Markets, Bank of England: Roundtable on Sterling Risk-Free Reference Rates, 6 July 2017.

RFRs preferred are secured and in other cases they are unsecured, and some jurisdictions are more advanced in their choice of RFRs than others:

- *Sterling:* In the case of sterling LIBOR, the Working Group on Sterling Risk-Free Reference Rates has chosen a reformed Sterling Overnight Index Average (SONIA).[13] This is an unsecured overnight rate based on real transactions administered, calculated and published by the Bank of England. The Bank has instituted a reform process to strengthen SONIA, with a switchover planned to the reformed SONIA from 23 April 2018.[14]
- *US dollars:* The US Alternative Reference Rates Committee has recently chosen the Securities Overnight Financing Rate (SOFR), a secured overnight Treasury repo rate which is expected to be published daily by the Federal Reserve Bank of New York, beginning during the first half of 2018, as its preferred alternative to US dollar LIBOR.
- *Swiss francs:* The Swiss National Working Group has chosen the Swiss Average Rate Overnight (SARON), an overnight secured rate, administered by SIX Swiss Exchange, as its preferred RFR.
- *Japanese yen:* The Japanese Study Group on Risk-Free Rates has chosen an uncollateralised overnight call rate (ie an unsecured rate), calculated and published by the Bank of Japan.
- *Euro:* In the euro area, where the Euro Overnight Index Average (EONIA) and the Euro Interbank Offered Rate (EURIBOR) are widely used, the European Commission, ECB, ESMA and FSMA announced on 21 September 2017 that a new working group would be set up to identify and adopt an RFR which could serve as an alternative to current benchmarks. No decisions have yet been taken. The ECB also announced on 21 September that it intends to produce before 2020 a euro unsecured overnight rate based on data already available to the Eurosystem.[15]

9 Each jurisdiction has chosen the most appropriate overnight rate for its respective market, based on observable transactions so as to minimise the need to rely on expert judgement. In the UK, a key factor in the choice of SONIA was that transition of the Overnight Indexed Swap (OIS) market would not be required, while the choice of a secured RFR would have required the transition of existing SONIA-referenced OIS onto the new RFR, which would have been difficult to achieve.[16]

10 But the choice of secured rates in some jurisdictions and unsecured in others may have implications for markets across currencies. For example, a potential concern arises in the loan market, where drawings in different LIBOR currencies under the same facility are currently priced at the same margin. If different benchmarks – eg secured and unsecured – are used for different currencies, this may require different margins per currency. Publication times for different rates may also vary across currencies.

Overnight and term rates

11 In all cases, the RFR benchmarks that have been proposed are overnight rates. They have been chosen in preference to term rates because they represent the deepest and most stable markets in which the most observable transactions take place, and because the use of expert judgement can be kept to a minimum. Two main questions need to be considered in relation to term LIBOR: (i) whether current market practice for the use of term LIBOR needs to change to accommodate RFRs; and (ii) whether it is practicable to develop robust term RFRs from overnight RFRs:

- In economic terms, overnight rates and term LIBOR are not the same. Under current market practice (eg in the sterling floating rate note market), term LIBOR is a forward-looking rate, including a bank credit risk element for the term concerned, to which an agreed margin or spread is added representing the credit risk of the borrower borne by the investor. The LIBOR rate is fixed at the start rather than the end of the interest period. By contrast, the overnight RFR benchmarks proposed are not forward looking, and do not have a term credit element. A forward-looking term rate with front-end fixing provides certainty to both issuers and investors as the payments are known in advance, whereas this is not the case with backward-looking overnight rates. Floating rate notes are traded on the basis of known interest payments at the next interest payment date. If the rate is not fixed at the start of an interest period, it needs to be clear how, for example, floating rate notes can in practice be traded.

13. "The Group's decision does not create binding obligations for any market participants. Instead it is intended to act as a signal of market support for a particular benchmark (SONIA), and a platform to promote its broader adoption as an alternative to sterling LIBOR.": The Working Group on Sterling RFRs: *SONIA as the RFR and Approaches to Adoption,* June 2017.

14. Will Parry, Senior Manager, Sterling Markets Division, Bank of England: *The Development and Implementation of the Reform of SONIA,* 29 November 2017.

15. FSB: *Progress Report,* 10 October 2017.

16. Bank of England record of Roundtable on Sterling Risk-Free Reference Rates: 6 July 2017.

- In the UK, the Working Group on Sterling Risk-Free Rates considered in its June 2017 report whether a term RFR can be produced from SONIA and noted that broad adoption of SONIA will be easier to achieve if complementary interest rate products are available: for example, three-month sterling (ie short sterling) futures contracts are amongst the most actively traded instruments in the short end of the sterling interest rate curve.[17]

12 Any successor RFR to term LIBOR will need to be both robust and also acceptable to users, otherwise they may decide to continue to use term LIBOR as long as it continues to be published. An additional consideration is whether the market will accept the replacement of term LIBOR in sterling, if (say) EURIBOR continues to be used for term transactions in euro. This is another area in which international coordination is likely to be important.

Legacy financial instruments

13 In making preparations for the transition from LIBOR, one of the key concerns for market participants is to ensure continuity of contracts for outstanding legacy financial instruments referencing term LIBOR. This involves considering the fallbacks contained in the documentation for the financial instruments concerned. The European Benchmark Regulation requires that supervised entities using benchmarks should have robust written fallback plans.[18]

14 In the case of derivatives contracts, ISDA has been asked by the FSB Official Sector Steering Group to lead an initiative to improve derivatives contract robustness with a view to addressing risks that interest rate benchmarks which are currently widely used are no longer published. The objectives are: to avoid any discontinuity in valuations in the event that a fallback is triggered; to make sure that the contractual provisions are robust; and not to impede, to the extent possible, any efforts towards voluntary transition. With these objectives in mind, ISDA is drafting robust fallbacks for new derivatives contracts referencing IBORs and a future protocol to amend existing derivatives contracts referencing IBORs, which will include these fallbacks. The official sector places great importance on all industry stakeholders entering such protocols, wherever feasible.[19]

15 In the case of legacy financial instruments in the cash market, if a benchmark becomes unavailable, the ultimate fallback in loan agreements is often to an individual lender's cost of funds. In the bond market, the majority of floating rate notes ultimately fall back to a fixed rate at the last available floating rate. These fallbacks were originally intended to provide for temporary unavailability of a benchmark rather than its permanent cessation, and may not be commercially acceptable to market participants if LIBOR ceases to be available permanently.

16 There is a close relationship between the derivatives and cash markets. For example, the issuer of a bond may enter into a back-to-back swap to hedge its position. But unlike the derivatives market, neither the loan market nor the bond market has a protocol system for amendments:

- In the loan market, each individual loan agreement referencing LIBOR may need to be renegotiated and amended to refer to an alternative benchmark rate. There may also be a transfer of value in the event of a change to a different benchmark; and the parties may use the opportunity to renegotiate terms unrelated to LIBOR as well. Provisions may be included in loans to allow for a lower threshold of consent for changes to a benchmark rate (eg consent from a majority rather than all lenders). But these provisions are not always commercially acceptable.
- In the bond market, not only is there currently no protocol mechanism for the amendment of bond terms and conditions but, unlike the syndicated loan market, the ultimate beneficial owners of bonds are not easily identifiable. Amendments to bond terms and conditions ordinarily require bondholder consent via a consent-solicitation process or other liability management exercise. Amendments to interest rate provisions typically require a higher threshold of bondholder consent to be effective. Liability management exercises can be costly and time-consuming for issuers and the outcome cannot be guaranteed. If a discontinuation of LIBOR resulted in the transition to an alternative benchmark requiring legacy contracts to be amended, this would need to be done in a way which minimises the risk of significant market disruption.[20]

17. The Working Group on Sterling Risk-Free Reference Rates: *SONIA as the RFR and Approaches to Adoption*, June 2017.

18. Under Article 28(2) of the EU Benchmark Regulation, which applied from 1 January 2018, a supervised entity (ie including a credit institution or investment firm) that "uses" a benchmark will be required to have "robust written plans" in place setting out what actions will be taken if a benchmark materially changes or ceases to be available and to reflect such plans in its "contractual relationship with clients". LIBOR is a benchmark for these purposes. See Catherine Wade: *Benchmark Reform and the Future of LIBOR: Implications for the Primary Bond Markets:* ICMA Quarterly Report for the Fourth Quarter of 2017, page 16.

19. FSB: *Reforming Major Interest Rate Benchmarks: Progress Report on Implementation of July 2014 FSB Recommendations*, 10 October 2017.

20. See Catherine Wade: *Benchmark Reform and the Future of LIBOR: Implications for the Primary Bond Markets*, ICMA Quarterly Report for the Fourth Quarter of 2017.

17 If LIBOR is sufficiently robust and continues to be available after the end of 2021, there is a separate question whether fallback provisions will be triggered or not:

- If fallback provisions are triggered, it is likely that the current bond terms and conditions will contain one of two mechanisms; screen rate determination or ISDA determination. Screen rate determination is the more widely used option, and is likely to result in the bond becoming a fixed rate note for its remaining life, because the final fallback is the last available rate.
- If fallback provisions are not triggered, interest on legacy bonds will continue to be calculated using LIBOR. Without an amendment to bond terms and conditions, the rate will continue to be determined under the existing terms and conditions.

New financial instruments

18 It will take time for new risk-free rates to be ready for use and accepted in financial markets. Some RFRs have not yet been published (eg SOFR in the US) or are undergoing reform (eg SONIA in the UK). Until an appropriate alternative rate has been identified and has gained market acceptance, it may not be clear how best to amend documentation. At the moment, there is some evidence of changes in bond terms and conditions on new issues, but not yet any consistency of approach. Some issuers have also taken the precaution of introducing additional risk factor language in new bonds to highlight any risk that may arise if LIBOR ceases to be published.

19 A priority in the market is therefore to be clear whether, and if so when, there will be an appropriate successor to term LIBOR:

- Until there is an appropriate successor rate, market participants may continue to use LIBOR for maturities beyond 2021. If so, this will increase the number of legacy transactions affected by any transition from LIBOR at a later stage.
- Alternatively, market participants may consider that there is currently too much uncertainty to issue new bonds referencing LIBOR for maturities beyond 2021. This concern may be particularly relevant for manufacturers under the MiFID II/R product governance regime.

Conclusion

20 Following the official decision to replace LIBOR with risk-free rates, this assessment has summarised some of the issues that need to be addressed in order to ensure a smooth and orderly transition.

The next phase of sterling LIBOR transition work

On 29 November 2017, the Bank of England and the FCA announced the next phase of work with market participants on LIBOR transition: *"From January 2018, the market-led Working Group on Sterling Risk-Free Rates will have an extended mandate and broader participation.*

- *The Working Group's new mandate will be to catalyse a broad-based transition to SONIA over the next four years across sterling bond, loan and derivative markets, so that SONIA is established as the primary sterling interest rate benchmark by end 2021. That reflects concerns about the sustainability of LIBOR beyond 2021, and follows a recent public consultation which confirmed strong support for SONIA as the preferred alternative to sterling LIBOR.*
- *For this next phase of work, it is clear that active engagement will be needed from participants across all relevant sectors and markets. Membership of the Working Group will therefore be broadened to include investment managers, non-financial corporates and other sterling issuers, infrastructure firms and trade associations, alongside banks and dealers. Membership will be by invitation of the Bank and FCA, with further details to be announced in coming weeks.*

A key near-term priority for the Working Group will be to make recommendations relating to the potential development of term SONIA reference rates. This work is already under way and a public consultation is planned for the first half of 2018.

François Jourdain (Chief Compliance Officer, Barclays International) will continue to Chair the Working Group. Frances Hinden (Vice President Treasury Operations, Shell International Ltd) and Simon Wilkinson (Head of LDI Funds, Legal & General Investment Management) have agreed to act as Vice Chairs.

Two new sub-groups will be formed to focus on benchmark transition issues in loan and bond markets. These will be chaired respectively by Clare Dawson (Chief Executive, LMA) and Paul Richards (Head of Market Practice and Regulatory Policy, ICMA). Other sub-groups will be created as necessary to conduct technical work to support the transition effort. Participation in these sub-groups is not limited to Working Group members.

The Working Group will be responsible for raising awareness of transition issues and seeking input from the broadest possible set of stakeholders, for example by establishing open discussion forums focused on particular sectors."

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Improving European corporate bond markets *By Andy Hill*

On 20 November, the European Commission published the final reports of the Expert Group on Corporate Bond Markets. *Improving European Corporate Bond Markets* is a headline summary report which outlines 22 recommendations to improve the functioning of the European corporate bond markets, while *Analysis of European Corporate Bond Markets* is a more detailed, analytical report intended to support the conclusions and recommendations of the headline report.

The Expert Group on Corporate Bond Markets (originally the "Expert Group on Corporate Bond Market Liquidity") was created in late 2016, following concerns raised in the Capital Markets Union Call for Evidence related to European corporate bond market efficiency and liquidity. The 17 members of the Expert Group represent a cross section of industry stakeholders in the European corporate bond markets, covering the entire value chain (issuers, market makers, investors, infrastructure providers, and trade associations). ICMA was pleased to represent its constituents as a member of the Expert Group.

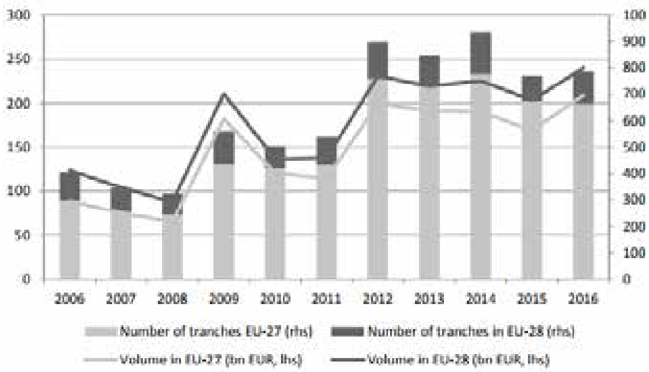
Following 12 months of analysis, the Expert Group's report provides 22 recommendations, both policy and market-focused, intended to improve the functioning of the European corporate bond markets from the perspective of issuers, investors and intermediaries. These recommendations support six key objectives:

- making issuance easier for companies;
- increasing access and options for investors;
- ensuring the efficiency of intermediation and trading activities;
- fostering the development of new forms of trading and improving the post-trade environment;
- ensuring an appropriate level of information and transparency; and
- improving the supervisory and policy framework.

Why do successful European corporate bond markets matter?

Corporate bonds are a well-known and proven source of finance for Non-Financial Corporations (NFCs), which use the funds to finance on-going operations and capital investments. As bond proceeds support investment by European corporates, these financial instruments generate growth and jobs, to the benefit of the whole economy and European citizens. Corporate bonds represent an alternative source of funding for NFCs, contributing to a reduction of dependency on bank financing. The prominence of corporate bonds as a means for companies to finance themselves has grown significantly over the last decade, as corporate bonds have been the main beneficiary of the reduction in bank funding after the financial crisis and the decrease in interest rates. In fact, NFCs substantially increased their net issuance of debt securities over the last few years. Compared to 2006, the number of corporate bond issuances by NFCs nearly doubled to 788 in 2016, representing a volume of €240 billion.

Corporate bond issuance by NFCs in EU-28



Source: Dealogic

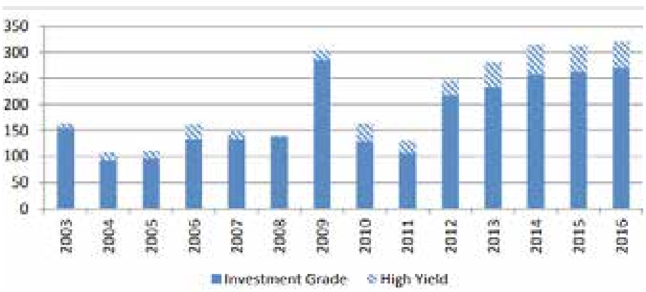
An efficient secondary market is a precondition for successful issuances of corporate bonds in primary markets.

However, bonds remain a marginal source of financing for NFCs in Europe, representing on average only 4.3% of their total liabilities. In the US, bonds represent 11% of NFCs' total liabilities. This suggests that corporate bonds have the potential to represent a significantly larger source of financing for European companies.

An efficient corporate bond market is also beneficial to investors, as corporate bonds can be valuable investment opportunities. They enable a diversified investment strategy and an optimisation of the risk/return profile of a portfolio. They are an effective additional tool to mitigate some risks and match some liabilities.

Lastly, corporate bonds reduce the over-reliance of the financial system on credit institutions and hence the susceptibility of the wider economy to bank deleveraging. The availability of an alternative source of funding for productive investment in the EU supports the wider economy, enables greater risk sharing and a more sustainable and smoother credit supply throughout the cycle.

Issuance in the euro-denominated corporate bond market (€ billion)



Source: Dealogic

Bond markets are not the same as equity markets

The Expert Group was keen to stress that, when designing frameworks and regulations for corporate bond markets, it is important to recall that bond markets are fundamentally different from stock markets. Equities and corporate bonds serve different purposes and undergo different valuation processes. They also represent fundamentally different investment propositions, which require different types of information to be properly priced. The sheer number of corporate bonds, their predominantly over-the-counter (OTC) trading and their limited liquidity compared to equities largely explains the limited information easily available on corporate bond markets, as compared to stock markets. As a result, the Expert Group urges policy makers to avoid attempts to reform bond markets drawing on analogies with the functioning and characteristics of stock markets. Such attempts risk leading to false and counterproductive conclusions.

Recommendations

The goal of the Expert Group is to optimise the functioning of corporate bond markets to the advantage of both issuers and investors which rely on corporate bond markets to secure funding and efficiently allocate their capital. As the role of intermediaries is essential to connect issuers and investors, and as the system functions as a whole, the Expert Group has looked at ways to make intermediation more efficient. The following recommendations therefore span issuers, investors as well as intermediaries.

The focus of the Expert Group has largely been on the functioning of the secondary market. This is due to the importance of the secondary market in itself, but also because an efficient secondary market is a precondition for successful issuances of corporate bonds in primary markets: when buying a new security, at the outset investors need to know that they will be able to sell it relatively easily and without triggering an adverse price movement if they so wish.

Lastly, while some recommendations from the Expert Group are specifically targeting corporate bonds, others have a broader reach, having an impact on other asset classes and/or financial instruments.

The recommendations start by making issuance easier for companies. This is followed by recommendations to promote a diverse, experienced and interested range of investors in corporate bonds. The next group of recommendations is targeted towards intermediaries and trading. They aim at supporting the traditional model of intermediation through market makers, but also take into account the growing importance of alternative forms of trading and of an efficient post-trade environment. Equally important is the role of information and transparency. Lastly, given its importance for the corporate bond markets, recommendations are tabled on the supervisory and policy framework. The recommendations are summarised in the box below.

Conclusion

Successful corporate bond markets are important for the funding of investment and the creation of jobs. They are a tried and tested source of finance for Non-Financial Corporations and reduce their dependence on bank funding. Efficient corporate bond markets also broaden investment opportunities for European investors, and represent a valuable asset class in a diversified investment strategy.

The recommendations put forward by the Expert Group should be seen as part of a comprehensive package which, if taken together, will make an important difference and ensure the continued success of corporate bonds in financing the European economy. The Expert Group calls on the Commission to engage with the recommendations and map out a clear way forward to bring about needed implementation. In this way, it will ensure that European corporate bond markets develop in line with the goals of Capital Markets Union.

Launch and next steps

The Expert Group reports were officially launched at a Public Hearing held in Brussels on 24 November. A study by Risk Control, *Drivers of Corporate Bond Market Liquidity in the European Union*, which was prepared for the European Commission as part of the same workstream was also launched at the event. (See the Secondary Market section of this Quarterly Report for an overview of the Risk Control study).

At the Hearing it was made clear that, while the Expert Group's findings and recommendations are welcomed and will help inform policy makers in their attempts to develop a deep and efficient pan-European corporate bond market, there is unlikely to be a wholesale rolling back of regulatory reforms, with financial stability and resilience remaining the priority. Furthermore, the Commission intends to launch a public consultation on the reports in early 2018, with a view to publishing its official comment later in the year.

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Successful corporate bond markets are important for the funding of investment and the creation of jobs.

The Expert Group Recommendations

Making issuance easier for companies

Corporate bonds are a tried and tested source of finance for NFCs. However, their potential to finance the economy is not fully exploited in Europe.

(1) The Market Abuse Regulation should be amended in order to alleviate the requirements regarding market soundings that could result in a disproportionate burden for companies.

(2) Regulators should work with market professionals to support transparent and fair allocation methods in the high yield market.

(3) National promotional banks should be given the necessary mandate to support SMEs to issue corporate bonds.

(4) To make it cheaper and simpler for small businesses to access corporate bond markets, the Expert Group requests enhancing the alleviations of the Growth Prospectus foreseen by the recently agreed Prospectus Regulation.

(5) The Commission should expedite its long-promised recommendation on private placements in order to extend good practices from lead Member States to other Member States.

Increasing access and options for investors

Efficient corporate bond markets are beneficial to investors, as corporate bonds represent a useful asset class in a diversified investment strategy.

(6) An efficient and straightforward insolvency framework is an important precondition for sustained investor interest in corporate bonds. The Expert Group strongly supports the Commission's proposal on restructuring and second chance. In addition, it recommends (i) EU harmonisation of ranking of creditors and the definition of insolvency triggers, and (ii) national measures to increase transparency regarding the position of investors in creditors' rankings.

(7) Coordinated action between regulators and market professionals should discourage any artificial inflation of primary orders from all investors in a primary allocation process.

(8) A recalibration or alleviation of capital requirements for corporate bonds with a long tenor in the forthcoming Solvency II review (2020).

(9) ESMA should conduct a mapping of existing practices in Member States with regard to internal crossing of orders. Building on this, it should promote convergence by setting out criteria with regard to how asset managers may internally cross buy and sell orders.

(10) The Pan-European Pension Product (PEPP) should be swiftly adopted and implemented. Its take-up should be encouraged by national and EU authorities, including through eligibility for special tax treatments.

(11) The Commission should review Member States' regulations and market practices to identify the obstacles that stand in the way of investors trading ETFs on exchange.

Ensuring the efficiency of intermediation and trading activities

The Expert Group supports the emphasis on safety and soundness of the financial system but also recognizes the need to ensure that market making is not disincentivised to the extent that the reduction in market liquidity raises the overall risk profile for the financial system and the economy as a whole.

EU authorities should review the capital and liquidity requirements, on the basis of a quantitative assessment of their impact on market-making and corporate bond liquidity. This review should notably:

(12) adjust the haircuts and inclusion amounts applied to corporate bonds in the Basel Liquidity Coverage Ratio (LCR), and distinguish between assets held on the trading book for market-making purposes from those held in the banking book;

(13) adjust the factors applied in the Net Stable Funding Ratio (NSFR) to corporate bonds and to inter-bank financing activities in repos and securities lending;

(14) amend the Leverage Ratio for the additional treatment of written credit derivatives to apply to contracts with a remaining term of less than one year.

The provision in CSDR for mandatory buy-ins is also identified by the Group as a significant (and unnecessary) threat to secondary market intermediation and liquidity:

(15) Implementation of CSDR mandatory buy-ins should be carefully managed to cushion its impact and provide space to review the provisions before they have unintended and potentially irreversible consequences.

Fostering the development of new forms of trading and improve the post-trade environment

(16) To support the development of a strong e-trading system, industry groups representing the buy side, the sell side and all trading venues, including FinTech firms, should issue guidance papers on good practices for electronic trading.

(17) No capital market is efficient without efficient post-trade processes. To encourage progress in this area, building on the European Post-Trade Forum, the European Commission should (i) report in 2018 on how barriers to greater fixed income clearing are being addressed, and (ii) identify best practices.

Ensuring an appropriate level of information and transparency

At EU level, pre- and post-trade transparency requirements are incorporated in MiFID II.

(18) A consolidated tape owned by ESMA should be created expeditiously to collect data on all eligible public and private corporate bonds. This should be accompanied by an "easy to use" interface accessible to all EU bond markets stakeholders at reasonable cost.

(19) To avoid fragmented liquidity across jurisdictions and limit regulatory arbitrage, ESMA should actively encourage NCAs to adopt similar deferral regimes across European jurisdictions in regard to post-trade transparency requirements.

(20) The Commission needs to explore different mechanisms that would enable smaller issuers to obtain reliable credit worthiness assessments. This would greatly enhance small issuers' ability to reach a critical investor base and make bond issuance meaningful.

(21) The Commission should monitor the impact of MiFID II rules on the availability of research in the corporate bond market. It should devote particular attention to small issuers, and take appropriate action swiftly should this impact be found to be negative.

Improving the supervisory and policy framework

Overlaps and inconsistencies between different EU capital market laws also hold back the development of European corporate bond markets.

(22) The European Commission and ESMA should:

- (i) assess the differences between EU legislation having an impact on corporate bond markets;
- (ii) streamline and consolidate overlapping and inconsistent rules and reporting requirements affecting corporate bond markets;
- (iii) set up a specialist industry group which would advise regulators on how to adapt the framework for corporate bonds, notably on a suitable methodology for ESMA's yearly assessment of corporate bond liquidity thresholds, and to support policy makers negotiating international standards at Basel; and
- (iv) upgrade capacity and knowledge of all competent authorities and ensure adequate training of supervisors and regulators in relation to corporate bonds.

The importance of SFTs to insurance companies

By Richard Hochreutiner

Introduction

Between 5% and 6%[1] of the size of the global market for securities financing transactions (SFTs, comprising securities lending and repos) is estimated to be attributable to the insurance industry. Since insurers choose different routes to market, ranging from direct market participation through to participation in bank securities lending and collateral management programmes, the actual participation level is probably higher.

Insurers use SFTs for a variety of purposes that benefit their clients and shareholders. These can be largely grouped into three categories: risk reduction, collateral transformation and yield enhancement. These three different categories are briefly described below. Their respective degrees of use vary from institution to institution.

Risk reduction

SFTs are an important cash management tool for insurers. Investing short-term cash into reverse repo agreements allows for the generation of returns without incurring unsecured bank risk – avoiding unsecured bank risk remains a focus for insurers despite the recent improvement of bank balance sheets and liquidity. Obtaining bankruptcy-remote collateral in exchange for cash investments in reverse repo transactions additionally allows insurers to invest cash with a broader credit spectrum of banks than they would otherwise be willing to do on an unsecured basis. This represents a better diversification opportunity.

From time to time, insurers need to borrow short-term cash as part of their cash management activities. Whilst the volume of such transactions is dwarfed by short-term cash investment, the ability to be able to access short-term liquidity when needed is of high importance. The likelihood that cash can be sourced is far higher on a secured than on an unsecured basis – especially during periods of name-specific stress. In addition, using repo as a tool to borrow cash in the SFT market significantly reduces the degree of dependence on specified individual banks to be ready to provide short-term cash when needed. In summary, repo enhances insurers' short-term funding resilience.

The SFT market is a welcome liquid and highly efficient market place for insurers' short-term cash management. Insurers particularly appreciate the robust legal framework under which repo and reverse repo can be transacted.[2]

There are concerns that recently the market has been changing and that the market is at risk of becoming less reliable, in the sense that banks struggle to be able to quote the size necessary for insurers to get their business done – especially around key reporting period end-dates. The consequence of a less reliable or less liquid SFT market – in the context of insurers' risk-reducing activities in the SFT market – would be the need for insurers to hold increased short-term cash balances, to reduce exposures to volatile SFT markets. This would on the one hand increase bank counterparty risk as the idle balances would *inter alia* need to be held on bank accounts and on the other hand will decrease investment returns (with consequences for clients and insurers alike) caused by a higher asset allocation to cash.

Collateral transformation

Insurers use the SFT markets in the area of collateral transformation for two reasons: first, to convert securities into cash or visa-versa; and, second, to convert one type of security into another.

1. Source: ISLA biannual survey, and assuming the participation of insurers in repo is comparable to the participation in securities lending.

2. Global Master Repurchase Agreements (GMRA) issued by ICMA, or its US equivalent MRA, issued by SIFMA.

As part of Dodd-Frank and EMIR, market participants must centrally clear certain derivatives. This entails posting initial margin and variation margin to a central counterparty, either directly or via a clearing broker. For example, as part of their interest rate risk management activities, insurers can be sizable players in the interest rate swap market. Interest rate movements can lead to sizable variation margin calls. Variation margin is posted in cash.

SFTs – in this case repos – are a highly efficient way to convert securities into cash temporarily in order to fund the posting of variation margin. Likewise, the receipt of variation margin requires the short-term flexible investment of sizable cash balances – in that case reverse repos.

Insurers need to post collateral in a broad spectrum of insurance structures, thus requiring the insurer to be invested in suitable assets that fit the requirements of the collateral receiver. Using collateral transformation transactions allows insurers to convert securities, for example denominated in one currency into securities denominated in another currency, in order to fulfil posting obligations, while at the same time keeping their investment portfolio as close to the optimum asset allocation and desired asset and liability management (ALM) position as possible.

SFTs – in this case securities lending/borrowing – are a highly efficient way to temporarily convert securities into other securities, without incurring significant changes in asset allocation and the related transaction costs.

Should the SFT market no longer allow for efficient collateral transformation, insurers would be forced to adapt the way they invest – thus, assuming deviations from the optimal asset allocation and desired ALM position, the impact of which will be a reduced return on investment for client and insurer alike.

Yield enhancement

Insurers own and manage a significant portion of the global securities inventory. The majority of these assets back life and savings products. As part of their investment activities, insurers participate, either directly or via bank lending programs in the SFT market by lending out otherwise dormant securities, on a fully collateralized basis to SFT market participants, in exchange for a fee that serves to enhance the yield of the overall portfolio. This additional yield, generated at marginal additional risk, is particularly welcome on savings products with their long-term investment horizon. In this context, insurers particularly appreciate the robust legal framework under which securities lending and borrowing can be transacted.[3]

SFTs – in this case collateralized securities lending – are a highly efficient low-risk manner to add vital basis points to long-term oriented portfolio returns.

Should the risk/reward profile and cost/income ratio for SFTs deteriorate, insurers would be forced to re-evaluate their role in the market. The absence of additional yield would have most impact on long-term saving products.

Conclusion

Insurance companies use SFTs in many ways. The SFT market benefits from insurers and insurers benefit from the SFT market.

Insurers are watching the developments in the SFT market closely and strongly welcome all efforts that benefit market depth, collateral fluidity and liquidity, and that benefit banks' ability to serve the needs of the insurance industry.

Richard Hochreutiner *is Director, Head Global Collateral, Swiss Re.*

The SFT market benefits from insurers and insurers benefit from the SFT market.

3. Global Master Securities Lending Agreement (GMSLA) issued by ISLA.

Summary of practical initiatives by ICMA

The practical initiatives on which ICMA has been engaged over the past quarter with, and on behalf of, members, include the following:

Primary markets

1 *Public sector issuers:* The Public Sector Issuer Forum (PSIF) met at the World Bank in Washington on 12 October to discuss, in particular: LIBOR replacement, introduced by David Bowman, Special Adviser to the US Federal Reserve Board, and Donald Sinclair, Head of Asset Liability Management at the World Bank; and cybersecurity, introduced by Tom Harrington, Chief Information Security Officer at Citi, and Clay Lin, Chief Information Security Office at the World Bank.

2 *MiFID II/R implementation in primary markets:* In the run-up to the implementation of MiFID II/R and PRIIPs at the beginning of 2018, ICMA continued to work intensively with the ICMA Primary Market Practices Committee and the Legal & Documentation Committee on the implications for the primary markets of the MiFID II/R regime for product governance (eg in relation to "target markets"), justification for allocations, and inducements, and the PRIIPs regime.

3 *Future of LIBOR:* On 29 November, the Bank of England and the FCA announced the next phase of work with market participants on LIBOR transition. From January 2018, the market-led Working Group on Sterling Risk-Free Rates will have an extended mandate and broader participation. Two new sub-groups will be formed to focus on benchmark transition in the loan market, chaired by LMA, and the bond market, chaired by ICMA.

4 *Benchmark Regulation:* ICMA has prepared and circulated standard language for prospectuses reflecting Article 29(2) of the Benchmark Regulation.

5 *Prospectus Regulation:* With the support of the ICMA Legal & Documentation Committee and leading international law firms, ICMA responded to the ESMA consultation paper on Level 2 measures on the Prospectus Regulation by the 28 September deadline.

6 *STC short-term securitisations:* On 5 October, ICMA responded, jointly with the ASF, GFMA and IIF, to the BCBS/IOSCO's consultative documents on criteria for and capital treatment of simple, transparent and comparable short-term securitisations.

7 *Omnibus III:* With the support of its primary market constituency and leading international law firms, ICMA has provided feedback to the European Commission on the proposals to centralise certain prospectus approvals with ESMA.

8 *FMSB Risk Management Standard:* ICMA submitted a response to the FICC Markets Standards Board (FMSB) on its transparency draft of the *Risk Management Transactions for New Issuance Standard* ahead of the deadline on 20 December.

9 *Primary Market Forum:* The 11th annual Primary Market Forum was held at JP Morgan in London on 8 November. There were 150 participants.

10 *Corporate Issuer Forum:* A marketing brochure has been prepared for the Corporate Issuer Forum. This is available on the ICMA website.

Secondary markets

11 *European Commission Expert Group on Corporate Bond Market Liquidity:* The report and recommendations of the European Commission High-Level Expert Group on Corporate Bond Markets, on which Andy Hill represented ICMA, was published on 20 November ahead of a launch on 24 November in Brussels. ICMA's Chair, Martin Egan, was a keynote speaker at the launch.

12 *IOSCO:* ICMA responded to the IOSCO consultation on corporate bond market transparency by the deadline of 16 October, and is in contact with the IOSCO Secretariat in Madrid about ICMA's research on corporate bond market liquidity (or lack of liquidity) in stressed market conditions.

13 *MiFID II/R regional workshops:* Led by Liz Callaghan, ICMA held a series of workshops for members in the autumn of 2017 in Stockholm, Brussels, Luxembourg, Paris, Frankfurt, Madrid, Milan, Dublin, Lisbon and Zurich as well as London, following earlier workshops in Hong Kong and Singapore. The workshops focused on the implications of MiFID II/R for fixed income trading. ICMA organised a separate session in London on 7 December with the FCA on outstanding MiFID II/R questions.

14 *Other MiFID II/R briefings for members:* ICMA provided members with monthly briefings on preparations for MiFID II/R, ahead of implementation on 3 January 2018, including an FAQ on the implications for non-EU members of ICMA.

15 *ICMA Secondary Market Rules & Recommendations:* ICMA is reviewing the impact of MiFID II/R and other proposed new EU regulations on the ICMA Secondary Market Rules & Recommendations.

16 *CSDR mandatory buy-ins:* Led by Andy Hill, ICMA has continued to explain to the authorities the potentially damaging impact of mandatory buy-ins on secondary markets.

17 *Single name CDS study:* Jointly with ISDA, ICMA is conducting a study into the state and evolution of the European single name credit default swap market.

18 *European investment grade bond market data:* Historical data on bond market trading activity, split between financials and non-financials, in both euro and sterling, have been made available on the ICMA website. The data are updated on a monthly basis.

19 *Asian corporate bond liquidity study:* ICMA has been researching the state and evolution of the Asian corporate bond markets, as an extension of its work on the European markets, with plans for a separate report to be published in early 2018.

Repo and collateral markets

20 *Repo and the real economy:* The ICMA European Repo and Collateral Council (ERCC), chaired by Godfried De Vidts, held its latest biannual General Meeting in Brussels on 14 November, with over 200 participants. The meeting highlighted the importance of repo for the real economy. Speakers included Benoit Coeuré from the Executive Board of the ECB, Mahmood Pradhan from the IMF, Peter Grasmann from the European Commission and Steffen Kern from ESMA.

21 *MiFID II/R and the repo market:* Following ICMA's intervention, the authorities clarified that pre- and post-trade transparency, most transaction reporting and some of the critical best execution requirements under RTS 27 do not apply to securities financing transactions.

22 *SFTR implementation:* ICMA is continuing to help members to implement the Securities Financing Transaction Regulation (SFTR), and is in ongoing contact with ESMA regarding a number of detailed points.

23 *Post-trade:* With the support of its ERCC Committee and its Operations Group, ICMA responded by the deadline of 15 November to the European Commission consultation on post-trade. The consultation reflects the conclusions of the European Post-Trade Forum, in which the ERCC was represented.

24 *ECB AMI-SeCo:* The ERCC is represented on the ECB's recently formed Advisory Group on Market Infrastructure for Securities and Collateral (AMI-SeCo). Among other things, this group is taking forward work on collateral management harmonisation which was initiated in the forerunner COGESI group. ICMA is actively involved.

25 *European repo market survey:* On 17 October, ICMA released the results of its 33rd semi-annual survey of the European repo market, which calculates the amount of repo business outstanding on 7 June.

26 *ERCC guide to repo best practice:* ICMA has published an updated version of the *ICMA ERCC Guide to Best Practice in the European Repo Market.* The amendments were prepared by the ERCC Guide Working Group, which continues to review and update the Guide to reflect latest market developments.

27 *FinTech mapping:* With the support of its FinTech Working Group, ICMA has posted on its website a FinTech mapping directory, which includes around 100 technology solutions for collateral management and ancillary services. ICMA's work on FinTech mapping has been led by Gabriel Callsen and Alex Westphal.

Asset management

28 *AMIC Council:* The biannual ICMA Asset Management and Investors Council (AMIC), chaired by Bob Parker, was held at Schroders in London on 8 November with 110 participants. Themes for discussion included: the future of the asset management industry; systemic risk in investment management; and research unbundling under MiFID II/R.

29 *MiFID II/R research unbundling survey:* AMIC has surveyed its members to discover firms' current intentions and their progress in implementing MiFID II/R research unbundling, with a specific focus on FICC research only. The survey was organised by Bogdan Pop. The results were unveiled at the AMIC Council on 8 November.

30 *ESDM: research unbundling:* At the request of Anne Leclercq, the Chair of the EFC's Sub-Committee on EU Sovereign Debt Markets (ESDM), Andy Hill made a presentation and answered questions on research unbundling at an ESDM Committee meeting in Brussels on 8 November.

31 *Leverage and asset management:* The joint AMIC/EFAMA report on fund leverage has been presented by René Karsenti at the ESMA Securities and Markets Stakeholder Group, and discussed by ICMA and EFAMA with a number of national regulators. The report analyses how leverage is used and how the European legislative framework regulates leverage, and makes recommendations to improve the monitoring and analysis of leverage risk.

32 *ETFs:* The AMIC responded to the Central Bank of Ireland consultation on exchange-traded funds (ETFs), and focused on the potential for systemic risk from ETFs and the impact of ETFs on corporate bond market liquidity.

33 *Bail-in:* The Bail-In Working Group held a workshop in Zurich on 16 November, led by Tim Skeet.

34 *Infrastructure finance:* On behalf of ICMA, Katie Kelly delivered a lecture on infrastructure finance, public-private partnerships and the state of infrastructure in Europe to a delegation from Jinan City in China.

Green, social and sustainable bond markets

35 *European Commission Expert Group on Sustainable Finance:* ICMA is represented by Nicholas Pfaff as an observer on the European Commission High Level Expert Group on Sustainable Finance.

36 *Tokyo Green Bond Conference:* On 2 November, ICMA held an innovative and successful green/social bond event focused on Asia/Japan. The event was co-hosted by ICMA and the Japan Securities Dealers Association in Tokyo. This was the first large-scale ICMA event on GBP/SBP outside Europe – with 400 participants and 36 speakers – including major official sector names (the Governor of Tokyo, Japan Ministry of Environment, ASEAN Capital Markets Forum etc.) and senior private sector speakers (including several ICMA Board member firms).

37 *Green finance in Asia:* ICMA and the GBP Executive Committee have provided comments to the ASEAN Capital Markets Forum on south-east Asian securities regulation related to ASEAN green bond standards.

38 *France's Green Evaluation Council:* ICMA has been nominated as an observer on the Evaluation Council of France's green sovereign bond and will be represented by Nicholas Pfaff. The Evaluation Council will define the specifications and schedule for evaluation reports on the environmental impact of France's green sovereign bond.

Other meetings with central banks and regulators

39 *Brexit:* ICMA has continued to keep in contact on Brexit with the UK, the euro area and the EU authorities, and to discuss with members – both in the UK and the EU27 – through ICMA Market Practice and Regulatory Policy Committees how it can best help the international capital markets to prepare.

40 *ECB:* On 20 November, ICMA held a series of meetings at the ECB in Frankfurt with Ulrich Bindseil, Director General of Market Operations and his team, Vitor Constancio, Vice-President of the ECB, and Korbinian Ibel, Director General of Microprudential Supervision IV.

41 *DG FISMA:* On 22 November, ICMA held a meeting in Brussels with Olivier Guersent, Director General of DG FISMA, on progress on Capital Markets Union and related issues.

42 *ESM:* On 8 December, Paul Richards made a presentation on Capital Markets Union and Brexit at the European Stability Mechanism in Luxembourg during a seminar on capital flows and Capital Markets Union.

43 *Official groups:* 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 ECB Macroprudential Policies and Financial Stability Contact Group, and on the Consultative Working Group to ESMA's Secondary Markets Standing Committee.

Primary Markets

by Ruari Ewing and Charlotte Bellamy

MiFID II/R and PRIIPs: implementation in primary markets

Professional investors (PRIIPs/product governance): Regarding the professional investors' intended target market (all bonds) outlined in some detail in the Fourth Quarter 2017 edition of this Quarterly Report, ICMA has circulated that rationale and related draft forms of language for consideration by transaction syndicates. This includes some of the more salient options available for consideration in terms of measures that might be put in place on issue that could, in varying combinations according to the circumstances, be reasonably expected to result in a target market encompassing sales being made to professional investors only. (Furthermore in this respect, manufacturers should not then be characterised as "making available" to retail investors in the EEA any "packaged" securities for PRIIPs purposes.) It also includes some examples of a written agreement between co-manufacturers that seems likely to be included in subscription agreements. Such an agreement seems likely to acknowledge the product governance regime and to cover the product approval process (and notably the professional investors target market approach) and distribution channels.

Retail investors (PRIIPs/product governance): Regarding a retail investors' intended target market, ICMA has continued to consider various potential approaches (as briefly noted in the Fourth Quarter 2017 edition of this Quarterly Report). Though the product governance regime envisages simple products being compatible with mass retail investors, one initial approach focuses on what one might simplistically summarise as bonds that are simple and listed. More specifically it relates to low-denomination bonds admitted to trading ("listed") on an EEA regulated market, and so within the contemplation of the EU's related initial and ongoing transparency regimes (or analogously subject to similar transparency). In relation to this approach, ICMA has circulated a draft rationale (outlined below) and related draft forms of language for consideration by transaction syndicates. The approach does not address the PRIIPs regime, which needs to be separately satisfied in terms of any KID requirement.

MiFID II/R regulates EEA regulated markets. There are no restrictions on the type of issuer or credit that can be admitted, and suspension is only triggered by non-compliance with periodic and *ad hoc* transparency obligations. Further, bonds other than ESMA complex bonds can be bought by retail investors on an execution-only basis outside the appropriateness regime. So, the regulatory infrastructure contemplates that retail investors can freely buy non-complex bonds provided the transparency obligations are met. It is thus proportionate that a product manufacturer's target market assessment should not be affected by fluctuations in an issuer's credit, provided that the bonds concerned continue to be admitted to the regulated market. In this respect, manufacturer target market reviews of the bond markets would logically conclude that no target market changes are warranted (and any distributor feedback would be expected to be without impact).

Whilst ESMA complex bonds cannot be bought by retail investors on an execution-only basis outside the appropriateness regime, certain ESMA complex bonds do not include terms that would affect the return expected from the product (the contractual right to return of principal consistent with, or more than, the original amount invested and, if applicable, a contractual right to regular payments of interest that are not deferrable). So, whilst technically ESMA complex, there are no additional risks that are difficult to understand. It is thus proportionate that such bond manufacturer's product governance responsibilities should also be based on admission to a regulated market, the disclosure obligations consequent on it and a similarly enduring target market – albeit not outside the appropriateness regime.

The EU has as a matter of public policy exempted from its initial and periodic transparency regimes bonds issued by an EEA Member State or by related official bodies. It has been noted that Member States publish abundant information on their financial situation which is, in general, available in the public domain. Given the connection with Member States of their related official bodies, it follows that such information in their respect should not need to be provided in the prospectus either. It is therefore proportionate that such bond manufacturer's product governance responsibilities (being otherwise the bonds discussed in the preceding two paragraphs) should again also be based on admission to a regulated market, the disclosure obligations consequent on it and a similarly enduring target market.

A negative target market is unlikely for these bonds given diversification/portfolio considerations and absent the exercise of regulatory intervention powers. However, any such negative target market will be subject to consideration in the specific circumstances.

Other aspects: ICMA members have further discussed various alternative ways of complying with MiFID II's allocation justification recording, inducements (and costs and charges) and trade and transaction reporting regimes. There seems to be sufficient understanding of the dynamics of the various alternatives for decisions to be made ahead of 2018's bond syndications.

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ICMA language for new bond issues

MiFID II/R and PRIIPs: As outlined above, ICMA has circulated substantially final draft suggested language for inclusion in new bond issues to address the PRIIPs Regulation and MiFID II/R product governance regimes.

Benchmark Regulation: ICMA has also circulated informally suggested language for prospectuses to address the requirements of Article 29(2) of the Benchmark Regulation.

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> **ICMA has circulated that rationale and related draft forms of language for consideration by transaction syndicates.**

Prospectus-related developments

Status and expected developments for the Prospectus Regulation: As reported on page 30 of the last ICMA Quarterly Report, ICMA submitted its responses to ESMA's Level 2 consultation papers on *Format and Content of the Prospectus* and *Scrutiny and Approval of the Prospectus* on 28 September 2017. Delivery of technical advice following these consultations is expected in the first quarter of 2018.

Separately, ESMA published a consultation paper on draft RTS under the Prospectus Regulation on 15 December 2017. This consultation covers key financial information for the summary, data and machine readability, advertisements, supplements and publication. The deadline for responses is 9 March 2018. ICMA will be considering a response to this consultation paper with the ICMA Prospectus Regulation Working Group.

The majority of provisions under the Prospectus Regulation will apply from 21 July 2019 (although certain provisions are already in application or will apply from 21 July 2018).

ESAs review (Omnibus III) – ICMA response: The ICMA primary market constituency submitted feedback to the European Commission on its proposal to centralise approval of certain prospectuses with ESMA pursuant to the ESAs review on 4 December 2017. The feedback was in line with the article on this topic on page 29 of the last edition of the ICMA Quarterly Report.

Updated ESMA Q&A on Prospectuses: ESMA has deleted Q27 and updated Q29, Q31, Q32 and Q44 in its Q&A on Prospectuses. The changes appear to be uncontroversial and consequential to the entry into application of certain parts of the Prospectus Regulation in July 2017 (two years in advance of the date for entry into application of the majority of provisions, as noted above).

Updated ESMA Q&A on Alternative Performance Measures (APMs): The most recent additions to the *ESMA Q&A on APMs* relating to *ESMA Guidelines on APMs* also appear to be uncontroversial.

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Bank of Italy-related developments

Article 129 reporting platform: Market participants continue to face practical challenges in the light of the Bank of Italy requirements for post-transaction reporting under Article 129 of the Italian Banking Act, as reported in previous editions of this Quarterly Report (see, for example, the article on page 26 of the Third Quarter 2017 edition).

In particular, ICMA understands that the Article 129 reporting platform does not allow users to select a previous report and use it as the basis for a new report. If the Infostat platform were to be amended to allow for this, it would allow users to report information more easily and quickly for new issues with terms that are similar to a previous transaction. This would represent a significant time saving for market participants. In addition, the reporting platform does not currently allow users to see reports going back further than three months or automatically populate the reporting platform for several bonds using a Microsoft Excel or other document. Technical changes to the reporting platform to address these points would represent a significant improvement for users. ICMA has raised this with the Bank of Italy and will keep members informed of any developments.

Article 16 licences for bank issuers: ICMA is engaging with the Bank of Italy in relation to a historical interpretation of Article 16 of the Italian Banking Act which requires any bank issuer placing bonds in Italy to have a licence for collecting deposits recognised or granted in Italy. This historical, informal interpretation can slow down, or prevent altogether, bank issuance or placement into Italy. It is also arguably out-of-date and no longer necessary in light of current European regulation. As such, ICMA intends to engage with the Bank of Italy to discuss this historical interpretation of Article 16.

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ICMA responses to consultations in primary markets

UK FCA feedback statement on retail access to debt markets and UK MTF: Further to the UK FCA's discussion paper on *UK Primary Market Effectiveness*, the FCA has now published its feedback statement. On the debt side, the discussion paper covered (i) retail access to debt markets and (ii) a proposal for a new London MTF (separate from the London Stock Exchange's International Securities Market). It seems that there will not be any further immediate action by the FCA on either of those points. This is aligned with the ICMA response to the discussion paper.

UK Quoted Eurobond Exemption (QEE) extension to London MTF: ICMA responded to a UK consultation in June 2017 supporting the proposal to extend the QEE from withholding tax for interest on debt traded on MTFs such as the London Stock Exchange's new International Securities Market. ICMA understands that this proposal has been taken forward and an amendment to section 987 of the Income Tax Act 2007 has been put forward in the Finance Bill 2017-2019.

FICC Markets Standards Board Risk Management Transactions Transparency Standard: ICMA provided comments on the *FICC Market Standards Board Risk Management Transactions Transparency Standard* on 20 December 2017. In particular, ICMA flagged the importance of ensuring that the Standard does not prevent market soundings, as these are a useful tool in new bond issuance.

FCA consultation on Industry Codes of Conduct Relating to Unregulated Markets and Activities: ICMA intends to respond to the FCA *consultation paper on Industry-written Codes of Conduct Relating to Unregulated Markets and Activities*, which is about the FCA's approach to supervising adherence to proper standards of market conduct for unregulated markets and activities, including standards set out in industry codes of conduct. The FCA proposes to recognise particular industry codes that it considers set out proper standards of market conduct for unregulated markets and activities. This means that the FCA would review and assess industry codes against new criteria, and state publicly that it considers a particular code is a helpful explanation of the proper standards of market conduct for a particular market or activity.

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Private placements

By Katie Kelly

The Euro Corporate Private Placement Joint Committee (ECPP JC) met earlier in 2017 with a number of items on the agenda: to decide whether to update the ECPP Market Guide, which was last updated in October 2016: it was concluded that, given the lack of recent developments in the space, this was unnecessary; to assess the latest private placement 2016 transaction data; to introduce the ECPP JC to those responsible for writing a report commissioned by the European Commission on *Identifying Market and Regulatory Obstacles to the Development of Private Placement Debt in the European Union*; and to consider the applicability of the Market Abuse Regime (MAR) soundings regime to private placement.

Owing to a number of factors (such as insurance companies being allowed to invest in loans, a withholding tax exemption for private placements in the UK, the publication of the Market Guide and the availability of standard documentation), the private placement market has undoubtedly increased over the last few years, but more needs to be done to develop the market further.

However, data released by Standard & Poor's in 2017 showed a decline in nominal issuance volumes from 2015 to 2016, although issuance volumes remained healthy – largely due to the health and strong competition from more traditional financing solutions. That said, much of the decline related to the larger end of the market while demand for smaller transactions (under €50 million) increased, which may be a strong indicator that there is an increasing awareness of the use and benefits of private placement among the SME sector at whom this market is targeted. These intended users of private placement could be key drivers for further growth of private placement, with an enlarged issuer base helping to justify modifications to ease issuance infrastructure and promote helpful regulatory interventions (in areas such as tax, insolvency, accounting and investment regulations) and also helping to increase the pipeline for "good deals" – the larger the market, the greater the impetus to create supply and demand.

Work continues to examine national barriers, and to identify the jurisdictions which are lagging behind in terms of under-developed markets, incompatible regulation and a lack of best practice. Coupled with this is a dearth of information available on issuers in an unrated market, a lack of a liquid secondary market in a largely buy-to-hold product, and the differences in European insolvency laws.

Much can be achieved through market discipline, including further streamlining documentation, easing the issuance process and lowering costs, developing relationships between the parties and establishing a mechanism to monitor closely the credit quality of the issuer, both by the investor and the national authorities, sometimes based on existing central bank data.

Regulatory adjustments also have a role to play – an area where ICMA has been very active. The ECPP JC has previously made submissions to EIOPA regarding potential recalibration of the capital requirements under Solvency II for insurance companies holding private placements as an asset. Based on actual default data and investor behaviour (intention to hold to maturity) for long-term assets, this submission held that default (credit) risk is more appropriate than market volatility (spread risk), leading to the conclusion that current calibrations are disproportionate and therefore, could be a hurdle to investment. This work is continuing, with EIOPA having recently released a consultation paper seeking detailed and qualitative input on issues such as financial ratios and the associated threshold approach, yield criterion, approved internal banking or insurance models and internal processes of the insurer.

Elsewhere, the Commission has recently launched an open public consultation, *Building a Proportionate Regulatory Environment to Support SME Listing*. Although not directly falling under the remit of ICMA, there is an obvious nexus between certain of the questions in the consultation and the work of the ECPP JC, in particular when it comes to the applicability of the MAR soundings regime to private placements. In this regard, the position of the ECPP JC has previously been to encourage a regulatory understanding that, based on a checklist of characteristics, circumstances and processes, a private placement transaction would fall outside of the scope of MAR soundings regime. The consultation runs until 26 February 2018.

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Asset-Backed Commercial Paper

A recent Moody's research bulletin explains that "securitisation is a relevant source of funding for the European economy". It highlights that "securitisation is a longstanding financing technique, promoting funding diversification and expansion of liquidity sources"; and that "securitisation provides a large share of highly rated bonds and sound credit performance."

On the specific topic of Asset-Backed Commercial Paper (ABCP), the bulletin explains that "ABCP programmes complement term securitisation and provide revolving short-term liquidity, especially to corporates seeking working capital funding (ie for their stock of trade receivables)"; and that "ABCP programmes can also be used to finance warehousing of a wide array of consumer debt (ie mortgages, car loans and leases, consumer loans), in order to prepare subsequent term securitisation transactions." Furthermore, it clarifies that "in 2016, the last partially supported European ABCP conduit was converted to full support, meaning that European ABCP investors benefit from a covered bond like dual recourse. They are primarily exposed to the credit quality of the conduits' key counterparties (ie liquidity provider), with an additional claim over the securitised assets."

On 25 October 2017, the BCBS released final *Guidelines on Identification and Management of Step-In Risk*. Step-in risk refers to the risk that a bank provides financial support to an entity beyond, or in the absence of, its contractual obligations should the entity experience financial stress. These guidelines aim to mitigate significant step-in risk through a supervisory process built on reporting. Specifically, banks will be required to assess their step-in risk based on a wide range of indicators and a self-defined but transparent materiality policy. The guidelines do not prescribe any automatic Pillar 1 liquidity or capital charge, but rather rely on the application of existing prudential measures available to mitigate significant step-in risk. The guidelines are expected to be implemented in member jurisdictions by 2020.

The introductory segment of these guidelines includes a section on existing provisions, which among other things states that: "In December 2014, the Committee issued the revised securitisation framework, which addresses two of the main causes of step-in risk to securitisation entities, by: (i) specifying that significant risk transfer (SRT) cannot be recognised for structures securitising revolving credit facilities (such as credit card securitisations) with early amortisation features – where risks returning to the originator increase if early amortisation is triggered; and (ii) requiring that the undrawn portion of all liquidity facilities be converted at a credit conversion factor of 100%, thereby eliminating any preferential treatment for ABCP facilities." The illustrative entity categories listed in Annex 2 of the guidelines, which should be subject to the identification and assessment of step-in risk, nevertheless includes entities issuing ABCP, securities arbitrage conduits and structured investment vehicles.

As reported in this section of Issue no 46 of the ICMA Quarterly Report, on 24 May, ESMA launched a consultation inviting responses to specific questions on draft technical advice, implementing technical standards and guidelines under the EU MMF Regulation (MMFR). On 17 November, ESMA announced that it had duly published its final report, the key requirements in which relate to asset liquidity and credit quality – including with respect to ABCP, taking into account the issuer of the instrument and the characteristics of the instrument itself; the establishment of a reporting template; and stress test scenarios carried out by MMF managers. The technical advice and ITS have been submitted by ESMA to the European Commission, in the latter case for endorsement.

On 3 November, IOSCO published two update reports, *Update to the IOSCO Peer Review of Regulation of Money Market Funds* and *Update to the IOSCO Peer Review of Implementation of Incentive Alignment Recommendations for Securitisation*, which summarise IOSCO's ongoing efforts in monitoring implementation of reforms for MMFs and securitisation since its publication of two peer reviews in September 2015. The reports address progress by IOSCO members in FSB jurisdictions in adopting legislation, regulation and other policies in these two G20 priority reform areas.

ABCP programmes complement term securitisation and provide revolving short-term liquidity, especially to corporates seeking working capital funding.

More specifically, the MMF report covers three topics (valuation, liquidity management and MMFs that offer a stable NAV) and finds that most jurisdictions have implemented the fair value approach for the valuation of MMF portfolios, but progress in liquidity management is less advanced and less even; and the securitisation report covers two topics (incentive alignment arrangements and disclosure requirements) and finds that overall, progress remains mixed across participating jurisdictions in implementing the recommendations for incentive alignment for securitisation.

As reported in this section of Issue no 46 of the ICMA Quarterly Report, on 30 May the European Parliament, the Council and the Commission agreed on a package that sets out criteria for simple, transparent and standardised (STS) securitisation. Following further technical talks to finalise the texts, the European Parliament gave its final approval, on 26 October, and subsequently, on 20 November, the Council adopted these new rules, aimed at facilitating the development of a securitisation market in Europe. The agreed package comprises a Regulation on securitisation and on criteria for STS products, together with a Regulation on capital requirements for positions in securitisation – which allows that STS securitisations attract less onerous capital requirements.

In Recital 16 of the former, it is noted that "in order to allow for the different structural features of long-term securitisations and of short-term securitisations (namely ABCP programmes and ABCP transactions), there should be two types of STS requirements: one for long-term securitisations and one for short-term securitisations corresponding to those two differently functioning market segments." "In an ABCP transaction, securitisation could be achieved, *inter alia,* through agreement on a variable purchase-price discount on the pool of underlying exposures, or the issuance of senior and junior notes by an SSPE in a co-funding structure where the senior notes are then transferred to the purchasing entities of one or more ABCP programmes. However, ABCP transactions qualifying as STS should not include any re-securitisations. In addition, STS criteria should reflect the specific role of the sponsor providing liquidity support to the ABCP programme, in particular for fully supported ABCP programmes."

Section two of this Regulation details the requirements for STS ABCP securitisation. Following some general points in Article 23, Article 24 specifies transaction-level requirements; Article 25 governs the sponsor of an ABCP programme; and Article 26 specifies programme-level requirements. These two new Regulations will enter into force on the twentieth day after their publication in the EU's *Official Journal,* with most of their provisions to apply from 1 January 2019 (securitisations outstanding before that date will be grandfathered). The ESAs will meanwhile develop applicable technical standards, which will provide details on the legislation's implementation.

As such, on 15 December, the EBA launched a public consultation (for comment by 15 March 2018) on draft RTS specifying a set of criteria for the underlying exposures in securitisation to be deemed homogeneous, as part of the requirements under the new EU securitisation framework. The homogeneity requirement aims to facilitate the assessment of underlying risks by investors and to enable them to perform robust due diligence. Its application is, therefore, one of the prerequisites for a more risk-sensitive regulatory treatment of the securitisation. The RTS are applicable to both ABCP and non-ABCP securitisations. At the same time, the EBA also launched a public consultation (also for comment by 15 March) on its draft RTS specifying the requirements for originators, sponsors and original lenders related to risk retention as laid down in the new EU Securitisation Regulation.

Then, on 19 December, ESMA published three consultation papers (for comment by 19 March) on draft technical standards implementing the new EU Securitisation Regulation, seeking stakeholder views on:

- the contents and format of underlying exposures and investor report templates;
- the operational standards for providing these reports to securitisation repositories, and the operational standards and conditions for accessing this information from securitisation repositories;
- the contents and format of the notification to ESMA of a securitisation's STS status; and
- the application requirements for third party entities seeking to be authorised as providers of STS verification services.

Circulated on 15 December, AFME's Third Quarter 2017 *Securitisation Data Report* shows that European ABCP issuance was €67.2 billion in the third quarter of 2017. This is a further small decline of 1.8% versus the prior quarter and of a marked decline of 50.5% versus the prior year. Multi-seller conduits (97.5% of total), particularly from France (80.0% of total), continue to dominate as the largest issuance category in the ABCP market.

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Public Sector Issuer Forum

by Nicholas Pfaff and Valérie Guillaumin

 

The Public Sector Issuer Forum (PSIF) was set up with support from ICMA in 2012. The PSIF now brings together the majority of Sovereigns, Supranationals and Agencies (SSAs) active in the European capital markets. It includes 38 institutional members, including key European DMOs, the European Commission (as an issuer), major agencies such as Kreditanstalt für Wiederaufbau (KfW) and the leading multilateral development banks, including the Asian Development Bank, Asian International Infrastructure Bank, European Investment Bank, European Bank for Reconstruction and Development and the World Bank.

The Forum is coordinated by a Steering Committee consisting of three senior representatives representing each a key SSA constituency: Arunma Oteh (Vice President and Treasurer of the World Bank), Frank Czichowski (Senior VP & Treasurer, KfW) and Anne Leclercq (Director Treasury, Belgian Debt Agency).

The primary objective of the PSIF is to promote the sharing of information and experience amongst the participants on their capital markets activity, focusing both on market practice and on the impact of new financial regulation on their operations. The PSIF is characterised by its high-quality dialogue with regulatory and public authorities. Major market participants and stakeholders are also invited from time to time for discussions on key topics relating among other to regulation, financial innovation, market liquidity and financial stability. The PSIF held three formal meetings in 2017.

The first meeting took place in March 2017, hosted by the Deutsche Finanzagentur in Frankfurt. The European Central Bank (ECB) provided an update on the Implementation of the ECB's Asset Purchase Programme (APP) and an update on financial stability in the euro area. Presentations on sovereign green bond issuance were also provided by France and Poland.

The second PSIF meeting was organised in June in London, hosted by the UK DMO. Topics included a review on the high-level impacts of MIFID II/R on trading of SSA debt securities. This meeting also gave the opportunity for PSIF members to share respective experiences concerning bilateral and central clearing of derivatives.

The World Bank hosted in October 2017 in Washington the PSIF's third meeting. A key topic was the challenge of LIBOR replacement following an overview of the work of Alternative Reference Rates Committee (ARCC) in the US. Members subsequently shared insights on assessing and managing the transition from LIBOR to an alternative rate. As a second topic, the threat represented by cybercrime was discussed with the help of an external presentation. Identified risk areas were in cloud computing, mobile devices, payment systems (eg SWIFT) and outsourcing. Both external and internal threats to organisations were considered.

In between regular meetings, calls on specific technical and regulatory issues are organized with the benefit of ICMA staff input or a member firm providing a briefing. These are followed by a Q&A and a general discussion. In April, the ICMA ERCC study on the repo market was discussed in this format.

The next full PSIF meeting will take place in March 2018 in The Hague, hosted by BNG Bank.

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Secondary Markets

by Andy Hill, Elizabeth Callaghan and Gabriel Callsen

MiFID II/R implementation workshops: key takeaways

Throughout the autumn, ICMA carried out MiFID II/R implementation "in the weeds" workshops. These workshops targeted trading and research-related market participants from the buy side and sell side who have been immersed in preparations for MiFID II/R. The workshops were held in cities across Europe: London, Stockholm, Brussels, Luxembourg, Paris, Madrid, Frankfurt, Milan, Dublin, Lisbon and Zurich. They allowed bond trading and research participants to assess whether they were on the same track as their counterparts in other regions.

> **The workshops facilitated excellent discussion regarding local implementation challenges and interpretations as well as the sharing of information.**

The workshops facilitated excellent discussion regarding local implementation challenges and interpretations as well as the sharing of information. Panels featured international and local experts from the buy side and sell side covering: trading workflow, market structure and research distribution and consumption. The following are the key takeaways from the eleven workshops across Europe.

Trading workflow

We are currently experiencing an increase in electronic trading within bond trading workflow, largely driven by pre- and post-trade efficiencies, as well as the need to access alternative sources of market liquidity given the increasing capital constraints of traditional market makers. However, MiFID II/R is shifting gears and is significantly speeding up the evolution of electronification of fixed income trading.

MiFID II/R is changing trading models. Execution behaviour and language is due to change significantly as a result of MiFID II/R. Execution strategies will become much more complex. For instance, it will be more important to know which counterparties can or cannot assume trading risk.

The background to this is Article 4 of MiFID II which requires that Systematic Internalisers (SIs) should act in a risk-facing principal capacity for client orders, and should not be facilitating back-to-back trades between clients in a (riskless) "matched principal" capacity. The ability for SIs to operate a "hybrid" model of risk-facing and riskless trading will very much depend on the discretion of national regulators, and, in some situations, it may be that investment firms can either provide firm pricing or work an order, but not both.

In 2018, in the countries where the hybrid model is ending, many traders are considering not trading "orders". Buy sides may instead work on a relationship and indicative basis. Execution strategies may involve knowing which trader to "go to" for this style of trading. This and other factors will impact market makers' current mode of operation. Several in the MiFID II/R workshops commented: "market makers of today will not be the same market makers of tomorrow".

As MiFID II/R progresses through implementation, it is changing the aims of some of the definitions. SIs, originally thought to be about liquidity, are quickly becoming all about reporting capabilities. When executing with an SI, the SI has the responsibility to report in all circumstances. Execution with an SI does not guarantee best price, just the obligation for the SI to report.

Lastly, all workshop audiences and panels were asked what they thought would be the impact of MiFID II/R on liquidity. About 90% agreed that, in the beginning of MiFID II/R, there will be very low volumes, and there will also be disruption in the market. The volumes will then increase as time goes by. When things start to settle, and the data are being used (may be in two to three years), the view is that liquidity should increase due to better and more realistic pricing. Anonymous trading platforms will also become more effective, with the help of quality data to support more reliable price formation.

Market structure

Everyone in the MiFID II/R implementation workshops agreed that the greatest innovation and change will take place in bond trading market structure. Innovation is occurring in market structure today, but at the moment the focus is on compliance with MiFID II/R. Budgets are stifled for innovation, unless directly related to MiFID II/R implementation. True innovation will occur, but this is likely to be two to four years down the road. One of the key drivers for innovation will be the data that MiFID II/R will generate. The data will be used in the pre-trade and post-trade space, influencing the change of direction in trading workflow. It is believed that data and technology-led innovation will fall into four categories: new trading protocols; new routes to access liquidity; new market data products; and new trading patterns, which may emerge using Execution Management Systems (EMS) and FIX protocols.

Before data and technology-led innovation kicks in, MiFID II/R is expected to rule the direction of travel for the evolution of market structure. One of the areas of growth will be in MiFID II/R information. Knowing which investment firms can make firm prices (risk-facing) and which will only work orders (riskless principal) will only be one of many important considerations. Traders will need to know a matrix of pre-trade information in order to determine where and with whom to trade. For example, counterparties will need to know the post-trade reporting deferral regime of the counterparty they intend to trade with. The trader may also want to know whether or not the counterparty can accept "resting orders" (where the order is left and worked through the day). Finally, a counterparty will need to understand who has the reporting responsibilities. Whether a buy side is a MiFID II/R firm is also important as that could change the reporting obligations for counterparties involved.

The first evidence of MiFID II/R in 2018 is expected to be in platform trading. Platform trading is expected to increase exponentially due to the extensive reporting requirements and the nature of audit-driven regulation. The platforms or trading venues in 2018 will have an additional category: the Organised Trading Facility (OTF). There was much discussion in the MiFID II/R workshops about understanding the differences between MTFs, OTFs and agency brokers.

Regarding MTFs, all participants see the trades in a multilateral capacity: there is the ability to interact; there is no discretion; and there is a high level of technology involved. With both an MTF and an OTF, interests can be advertised on screen. However, an OTF has discretion and can choose a different counterparty to improve price, if required. By contrast, an agency broker interacts primarily on the phone or chat messaging and "finds the other side". The agency broker has similarities to bilateral trading. One panellist described an agency broker as "multi-bilateral". The key seems to be that an OTF has discretion with more sophisticated technology and operates more of a system (sometimes with streaming prices), while an agency broker is more voice-driven, but does also have discretion. A firm can operate an agency broker and an OTF. However, the firm must be able to evidence to its local regulator that the activities are separated. Any trading venue has the obligation to report its status to its regulator.

A significant change to the market structure landscape will be the increase in "move to venue" or "subject to venue" trading (sometimes called "processed" or "negotiated" trades). This allows for large or illiquid trades to be agreed (indicatively) bilaterally but executed and reported via a trading venue. Avoiding negative market impact is one of the key benefits. For example, a "subject to venue" trade allows for a bilateral discussion regarding a large trade, that would otherwise be market-moving if subject to on-venue pre-trade transparency, to be concluded on a venue for execution and reporting purposes. The benefits for the counterparties are two-fold, as the discussion is kept between two counterparties, avoiding negative information leakage, and the trade can also be transacted in a more favourable post-trade deferral regime. Other benefits of this "move to venue"/"subject to venue" (MTV/STV) trading is that it can assist private banks in keeping below SI thresholds, since on-venue trades do not contribute towards the SI threshold calculations. Lastly, for smaller firms it assists with overall "straight-through processing" (STP).

In a few panels there was robust discussion about third-country status and the conflict with privacy laws in some countries. Some market participants in third countries (ie non-EU countries) are unable or unwilling to provide the personal details required for transaction reporting by EU trading venues governed by MiFID II/R. As a result, trading venues (the operators of MiFID II/R MTFs and OTFs) have introduced innovative solutions which involve third-country firms transacting with EU counterparties on non-EU trading venues. The view is that this workflow may potentially solve this matter for third countries. However, there remains the personal data challenge (not wanting to release the privacy data) for third-country firms which transact with EU counterparties on EU trading venues. The full extent of extra-territoriality and personal data is, as yet, unknown and will be closely observed in the coming months.

Research consumption and distribution

As far as consumption is concerned, it appears that the best approach is a diversified approach that covers global, niche and local research. The challenge will be coverage for niche and local research. Many workshop participants commented on their concerns regarding reduced research teams. Many of the panellists believed small corporates may not be covered enough in the future, which is a potential issue for Capital Markets Union SME funding. However, some thought independent boutique investment firms may step in to cover small corporates as well as niche and local markets.

While independent boutique research firms may be able to step in and assist with niche, local and small corporate research, there remains a major concern in the market as to how small asset managers will be able to pay for research. The view from the panellists was that the lack of ability to pay for research could lead to an increase in consolidation in the market for small asset managers. This warrants further monitoring to see what transpires.

> **The first evidence of MiFID II/R in 2018 is expected to be in platform trading.**

Regarding research distribution, the overall model that seems to be emerging is one that bears a resemblance to "Cable TV". First, there is the free research (as a non-monetary benefit) that "Free TV" is being offered by some banks, all generic research/channels for free. Second, there is the annual or monthly fee for all research: one fee for all research, including specific analyst coverage. This is the same as one fee for all channels, including premium channels. Lastly, there is the "pay per view" model. Clients can access a portal and download research from various analysts and "pay as you view". This is the same as paying to view a specific sporting event on TV. However, in the case of research, one can pay to download and print specific individual research.

No one knows for sure how exactly the distribution models will develop. Nevertheless, the most likely outcome will be one of a flat fee. As MiFID II/R matures, the most likely outcome appears to be a combination of "flat fee" and "pay per view": one flat annual fee with a top up of "pay per view".

In the later part of the first quarter and early second, ICMA plans to hold MiFID II/R *post-mortem* discussions. We will watch with interest as MiFID II rolls out in January 2018 and beyond.

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ESMA guidance on the implementation of MiFID II/R

MiFID II/R entered into force on 3 January 2018. In the last quarter of 2017, the European Securities and Markets Authority (ESMA) provided further guidance on a number of key issues for fixed income markets.

The following briefing is designed to provide a non-exhaustive summary of selected guidance impacting market structure and fixed income trading, notably: (i) Legal Entity Identifier requirements; (ii) other new ESMA Q&As released on 18 December 2017; (iii) an overview of MiFID II deferral regimes in EU Member States; (iv) liquidity assessments of individual bonds for trade reporting; (v) a revised ESMA opinion providing guidance related to third-country trading venues for post-trade transparency; (vi) trade reporting and third-country scenarios; (vii) transparency requirements for partial execution and post-trade deferrals for OTC trades; and (viii) transparency questions related to hedging newly issued bonds.

In addition, ICMA has been sending monthly briefings to members: the most recent example is the MiFID II/R Members Update December 2017.

(i) Legal Entity Identifier (LEI) requirements

The Legal Entity Identifier (LEI) is a mandatory requirement under MiFID II/R for meeting reporting obligations. It is a 20-digit, alpha-numeric code that enables clear and unique identification of legal entities participating in financial transactions. An LEI can be obtained from LEI issuers, also known as Local Operating Units (LOUs). A list of LEI issuers is available on the Global LEI Foundation (GLEIF) website.

On 20 December, ESMA published new guidance on LEIs:

LEIs for clients that are legal persons

- ESMA's original "validation test" (before the ESMA announcement on 20 December) for LEIs was: if there is a missing LEI or the LEI issue date post-dates the trade date, the transaction report is rejected.
- Under the new regime, ESMA provides for a temporary period of six months whereby investment firms may provide a service triggering the obligation to submit a transaction report to the client, from which it did not previously obtain an LEI code, under the condition that before providing such service the investment firm obtains the necessary documentation from this client to apply for an LEI code on his behalf. The investment firm will need to apply immediately for the issuance of the LEI on behalf of the client. Once the relevant LEI has been obtained, the investment firm should submit its transaction report (as outlined in Article 26 of MiFIR).
- This will also require NCAs temporarily to amend a validation rule in their transaction reporting systems to

MiFID II/R

Overview of selected ESMA guidance in the fourth quarter of 2017:

22 December: Updated liquidity assessments for individual bonds by ISIN

20 December: New ESMA guidance on Legal Entity Identifiers (LEIs)

18 December: Q&As on MiFID II/R transparency topics

18 December: Q&As on MiFID II/R market structure topics

18 December: Q&As on MiFIR data reporting

18 December: Q&As on MiFID II/R investor protection and intermediaries topics

15 December: Revised opinion in relation to third-country trading venues for post-trade transparency

15 December: Overview of MiFID II deferral regimes in EU Member States

14 December: Q&As on post-trading topics

6 December: Liquidity assessments for individual bonds by ISIN

15 November: Q&As on transparency topics

15 November: Q&As on market structure topics

14 November: Q&As on MiFIR data reporting

10 November: Q&As on investor protection topics

9 October: Briefing on Legal Entity Identifiers (LEIs)

3 October: Q&As on transparency topics

3 October: Q&As on investor protection topics

Note: ESMA Q&As and guidance are continuously updated, as dates reflect.

allow for the acceptance of transaction reports where the LEI issuance date is after the transaction execution date. Investment firms are invited to contact directly their NCA for the specific details regarding these amendments.

- To streamline the issuance of LEIs, the GLEIF has introduced the concept of the Registration Agent. A Registration Agent helps legal entities to access the network of LEI issuing organisations responsible for performing LEI issuance and related services.
- ESMA and NCAs reiterate that investment firms are expected to ensure full compliance with the MiFIR requirement for the identification of clients that are legal persons using LEIs, given the relevance and importance of these data for regulatory supervision purposes.

LEIs for issuers

- ESMA previously stated that, starting from 3 January 2018, trading venues are expected to use the LEI codes pertaining to a given issuer when submitting reference data on financial instruments issued by EU issuers to support market abuse monitoring and market transparency through Financial Instruments Reference Data Systems (FIRDS). The correct LEI of an EU issuer is also required to determine the appropriate NCA for reporting purposes. Failure to submit an LEI of the EU issuer will be considered a breach of reporting requirements by the trading venue.
- ESMA equally expects trading venues to ensure that all non-EU issuers are identified through their respective LEI codes. However, understanding the additional difficulties in this case and to facilitate the introduction of the new reporting requirements, trading venues will be allowed on a temporary basis of six months to report their own LEI codes instead of LEI codes of the non-EU issuers while reaching out to the non-EU issuers.
- ESMA and NCAs will closely monitor the accuracy and completeness of the submitted reference data and pay particular attention to the frequency and the number of trading venues' own LEIs used instead of non-EU issuers' LEIs.

Previously, ESMA published on 9 October 2017 a Briefing on the LEI, reiterating to whom the requirements apply and how to obtain an LEI.

As highlighted in the ICMA MiFID II/R September Members Update, non-EU firms that do not have an LEI may find that EU counterparties are unable to transact with them, or that they are unable to transact on EU trading venues. Similarly, issuers of securities that are traded on EU venues (Regulated Markets, Multilateral Trading Facilities, Organised Trading Facilities, and Systematic Internalisers) need to provide an LEI.

(ii) Other new ESMA Q&As released on 18 December 2017

ESMA issued further Q&As on 18 December 2017 on the following topics:

- MiFID II/R investor protection and intermediaries. Key areas discussed include best execution, inducements, provision of investment services and activities by third-country firms and late transposition of MiFID II.
- MiFIR data reporting. Q&A updates encompass transaction reporting obligations for non-EU branches of EU investment firms, and the concept of underlying instruments.
- MiFID II/R market structure. Key areas discussed include the application of MiFID II after 3 January 2018, including issues of late transposition, in relation to authorisations of regulated markets and reporting services providers.
- MiFID II/R transparency. Updates include Q&As on non-equity transparency, and pre-trade transparency waivers.

(iii) Overview of MiFID II/R deferral regimes in EU Member States

On 15 December, ESMA published a table compiling the supplementary deferral regimes applicable in different Member States for trading in non-equity instruments under MiFIR.

Under Article 11 of MiFIR, national competent authorities (NCAs) are empowered to grant operators of trading venues a publication deferral of the details of transactions that meet either of the following characteristics: Large in Scale (LIS), deemed illiquid, or above the Size-Specific-To-Instrument (SSTI) threshold. In conjunction with a publication deferral, NCAs may grant a "supplementary deferral" which means that the level of granularity may vary, ie by:

(a) requiring the publication of additional information during the standard time period of deferral;

(b) allowing the omission of the publication of the volume of transactions for a time period of four weeks;

(c) allowing the aggregation of transactions for a time period of four weeks (non-equity instruments other than sovereign debt);

(d) allowing the aggregation of transactions for an indefinite period of time (sovereign debt instruments);

(e) allowing the combination of (b) and (d) for sovereign debt instruments.

Based on voluntary contributions by NCAs, the list provides an overview of the current status of implementation of the applicable MiFIR deferred publication regime per type of instruments in Belgium, Denmark, France, Germany, Italy, Malta, the Netherlands, Portugal, Spain, Sweden and the UK.

(iv) Liquidity assessments of individual bonds for trade reporting

On 6 December, ESMA published the transitional transparency calculations (TTC) for equity and bond instruments. ESMA subsequently updated the TTCs on 22 December. According to ESMA: "This updated version mainly reflects changes in the classification of the instruments and the related parameters and resubmission of data by some trading venues." However, the changes in the TTCs for bonds are relatively minor.

In total, 561 bonds or 0.9% out of 61,656 fixed income instruments have been classed as liquid according to the MiFIR criteria (excluding Exchange Traded Commodities and Exchange Traded Notes).

Corporate bonds constitute the largest category with almost 39,000 (out of 61,656) instruments, of which 0.4% are deemed liquid. In other words, 99.6% of corporate bonds are eligible for pre-trade transparency waivers and post-trade publication deferrals due to their illiquid trading status.

The calculations are subject to future amendments by ESMA if deemed necessary and are applicable from 3 January 2018 until 15 May 2018. The next version of the liquidity assessments for bonds will be published on 1 May 2018, applicable from 16 May 2018 to 15 August 2018. Subsequently, the liquidity assessments will be revised on a quarterly basis.

Latest updates of the FAQ document issued by ESMA in relation to the TTCs can be found here.

(v) Third-country trading venues for post-trade transparency

On 15 December, ESMA issued a revised opinion on post-trade transparency requirements in relation to third-country trading venues. It stated that "in order to contribute to the smooth implementation of MiFID II/ MiFIR as of 3 January 2018 and to maintain a level playing field between third-country trading venues, transactions [executed by EU investment firms] on third-country trading venues should *not* be required to be made post-trade transparent under Articles 20 and 21 of MiFIR", pending the publication of ESMA's assessment of third-country trading venues.

In a previous opinion published on 31 May, ESMA specified that, subject to third-country trading venues meeting a set of criteria, EU investment firms trading on those trading venues were not required to make transactions public in the EU via an Approved Publication Arrangement (APA). ESMA has since been asked to conduct assessments of more than 200 third-country trading venues. The results are expected to be published in the course of 2018 according to ESMA.

(vi) Trade reporting and third-country scenarios

ESMA provided on 15 November further guidance on trade reporting requirements for transactions executed by EU investment firms outside the EU, and trades by branches or subsidiaries of non-EU firms within the EU. The Q&A addresses 13 different scenarios including the implications for trade reporting and Systematic Internaliser (SI) calculations, and provides a number of clarifications and "general principles" [Section 9, Q&A 2]:

- The transparency requirements always apply to transactions concluded on EU trading venues.
- Transactions executed on third-country trading venues should be treated as OTC transactions and reported through an APA, unless these trading venues are deemed "comparable".

Note: According to the aforementioned ESMA opinion, this does not apply until ESMA has published the assessments of third-country trading venues.

- If one of the parties of an OTC-transaction is an investment firm authorised in the EU, the transaction is considered as executed within the EU.
- Subsidiaries are independent legal entities and subject to the regulatory regime of the third country in which they are established.
- Transactions by non-EU branches of EU investment firms are treated as transactions of the EU parent company and, therefore, have to be made transparent under the MiFIR rules.

(vii) Pre-trade waivers for partial execution and post-trade deferrals for OTC trades

ESMA provided further clarifications on pre-trade waivers, partial execution in order books, RFQ and voice trading systems (15 November), and post-trade deferrals for OTC trades (3 October).

For equities and similar instruments, but importantly also for non-equity instruments, ESMA stated that "the Large in Scale (LIS) waiver continues to apply in respect of an order that is LIS when entered into an order book but that, following partial execution, falls below the threshold applicable for that financial instrument, unless the price or other relevant conditions for the execution of an order are amended" [Section 5, Q&A 6]. In other words, a partially executed LIS order in bonds is subject to the same LIS waiver.

However, in RFQ and voice-trading systems, ESMA clarified that "each actionable indication of interest (A-IOI) must be above the relevant Size-Specific-To-Instrument (SSTI) threshold to be eligible for a pre-trade waiver. The waiver is not available for trading protocols other than request-for-quote and voice-trading systems, which exclude order books. If an A-IOI above the SSTI is partially executed, the remaining amount of the A-IOI should be considered a new A-IOI and so the relevant waiver checks should be carried out again for the SSTI waiver to apply" [Section 5, Q&A 6].

With respect to post-trade deferrals, ESMA clarified that "the deferral regime applicable to OTC trades is determined by the deferral regime applicable in the Member State where the investment firm [...] is established. The [EU] location of the APA through which a transaction is made public is not relevant. Where it is for an EU branch to make a transaction public, the deferral regime applicable in the Member State where that branch is located should apply" [Section 4, Q&A 2].

(viii) Transparency questions related to hedging newly issued bonds

Furthermore, ESMA addressed on 15 November transparency requirements for transactions involving the purchase of a newly issued bonds and the simultaneous sale of another bond.

Question: "Where an investment firm buys a newly issued bond in the primary market as the result of an allocation and funds its investment by selling another bond to the lead manager of the issuance, simultaneously with and contingent upon the investment in the new issue, would this qualify as a package order for the purpose of pre-trade transparency?"

ESMA's answer: "No. Since primary transactions are not subject to transparency (see General Q&A 4 on transparency issues), they should not be considered when assessing whether components executed together qualify as a package order" [Section 4, Q&A 4 i)].

Note: The wording of the above-mentioned question is nearly identical to the question ICMA submitted on behalf of its MiFID II Working Group except that it refers to pre-trade transparency and does not address the question related to hedging. Nonetheless, ESMA's reply seems to suggest that a newly issued bond and the hedge do not qualify as a package transaction and are thus not eligible for deferred publication.

Further briefings with more granular information on the above-mentioned ESMA Q&A updates can be found on ICMA's dedicated MiFID II landing page.

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Fundamental Review of the Trading Book and secondary bond markets

What is FRTB?

The Fundamental Review of the Trading Book (FRTB) is a comprehensive suite of capital rules developed by the Basel Committee on Banking Supervision (BCBS) as part of Basel III, intended to be applied to banks' wholesale trading activities. Finalised in January 2016 as the Minimum Capital Requirements for Market Risk, it aims to address a number of identified shortcomings in the existing Basel II.5 framework, in particular: (i) an insufficient trading book/banking book boundary; (ii) the weakness of the Value at Risk (VaR) measures (which do not include "tail risks" of extreme losses); (iii) the need for more coherent and comprehensive risk capture (including market liquidity under stressed conditions); and (iv) the need for the standardised approach (SA) to serve as a credible fallback for the internal models approach (IMA).

The revised framework is scheduled to be implemented as final rules under domestic legislation on 1 January 2019, with regulatory reporting under the framework becoming a requirement from 31 December 2019. In the EU, this will be implemented as the Revised Capital Requirements Regulation (CRR II), published in November 2016.

Why is FRTB important for fixed income market makers?

FRTB was never intended to increase the overall capital requirements of banks, which was largely achieved in the Basel II.5 framework. However, the results of cumulative quantitative impact studies (QIS) in the latest BCBS Basel III Monitoring Report, published in December 2017, based on December 2015 data provided by 248 banks,[1] suggest that the weighted average overall capital increase will be significant: 52.3% for Group 1 banks, 50.9% for global systemically important banks (GSIBs), and 52.2% for Group 2 banks.

While the QIS are not granular enough to measure the impact on individual bank businesses, industry analysis suggests that much of the capital increases arise from the FRTB requirements (in particular the application of the revised SA and a minimum capital floor of 72.5% for IMA) and will directly impact banks' intermediation services for bonds and other securities. An industry QIS[2] based on 2015 data from 28 globally or locally significant banks points to trading book capital increases ranging from x1.6 to x5.3, depending on the underlying product.

1. 96 large internationally active ("Group 1") banks and 152 other ("Group 2") banks.

2. ISDA/GFMA/IIF: FRTB QIS Analysis, November 2015

Among the main implementation challenges firms and trading desks will face, and which have the potential to increase capital costs significantly, are two critical aspects of the revised framework: the treatment of non-modellable risk factors; and the P&L attribution requirement.

Non-modellable risk factors

The non-modellable risk factor (NMRF) is a capital add-on (under the Expected Shortfall model)[3] that seeks to address the problem of risk modelling for instruments where there are not sufficient price observations to support robust modelling under the VaR framework. The FRTB framework requires 24 observable "real" prices per year, with a maximum gap of one month between consecutive observations.

The conditions for modellability are particularly punitive for less liquid instruments, such as corporate bonds or off-the-run peripheral sovereign and emerging markets. New issues by their very nature fail to meet the criteria. For many trading books, 50% to 70% of their risk factor population may be classified as non-modellable. A 2017 survey by Oliver Wyman[4] suggests that the NMRF ES charge is likely to account for 30% to 50% of banks' total IMA risk capital.

Industry recommendations focus on either amending the price observation requirements, such as relaxing the maximum one-month gap, or enhancing data availability, such as encouraging data-pooling solutions or allowing the use of prices applied in credit support annex (CSA) reconciliation. Otherwise, the NMRF provisions are likely to entrench further bifurcation between actively traded, liquid instruments and less frequently traded, illiquid products, as well as providing a deterrent to new issuers coming to the capital markets.

P&L attribution

FRTB introduces a new concept for the IMA: P&L Attribution (PLA). The PLA framework is applied at the individual trading desk level, and requires desks to monitor and report both their hypothetical P&L (HPL), produced by revaluing positions using daily mark-to-market, and their Risk Theoretical P&L (RTPL). This latter measure is an *ex-ante* P&L estimate based on the banks' internal risk model. The difference between the two is defined as "Unexplained P&L" (UPL). Desks must report the Mean Ratio (MR) and Variance Ratio (VR) of UPL against HPL on a monthly basis, with the expectation that they should remain within a 10% and 20% threshold respectively. If a desk violates the threshold of either metric more than three months out of 12, the internal model approval is lost, and the desk must revert to applying the SA risk model.

This is potentially the single biggest challenge of implementing FRTB. Large banks typically have between 50 and 100 separate trading desks, each of which must adhere to the PLA requirements. Furthermore, there are potential issues with data sourcing, given that the HPL is typically based on desks' daily "marks", while RTPL must be based on risk model data, which is usually sourced independently by banks' risk management divisions. Even a small difference in the prices used (which can arise from the use of different vendors, or applying different "close of business" times) can lead to large daily deviations that result in frequent violations of the thresholds.

Given the relatively significant gap between IMA and SA capital charges, the PLA requirements pose regulatory capital "cliff edge" risks for banks and trading desks, which would substantially increase the cost for banks providing market intermediation services. Industry recommendations include permitting the alignment of market data sourcing for HPL and RTPL, and applying the PLA as a reporting requirement but not as a binding constraint.

Conclusion

While FRTB was not intended to increase banks' capital costs beyond those imposed by Basel II.5, it is clear from both BCBS and industry analysis that banks will see significant increases in their cost of capital, in particular to support their trading activities. The provisions under CRR II that allow for a phased implementation will provide some comfort for European banks, at least initially, but the implementation challenges will remain, not least with respect to managing non-modellable risk factors and ensuring close correlation between reported trading desk level P&L and internal risk models. Furthermore, the additional costs of liquidity provision are likely to impact disproportionately less liquid instruments and markets.

Given the potential impacts for secondary bond market efficiency and liquidity, the final calibration and implementation of FRTB are key priorities of ICMA's Secondary Market Practices Committee (SMPC).

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3. The Expected Shortfall (ES), which replaces the Basel II.5 VaR model, is the expected value of all changes in the portfolio value in the tail of the P&L distribution that exceed the VaR measure.

4. IHS Markit/Oliver Wyman: FRTB Markit Modellability Model: Preliminary Results, May 2017

Drivers of corporate bond market liquidity in the EU

In November 2017, Risk Control[5] published the report, *Drivers of Corporate Bond Market Liquidity in the European Union*, which was prepared for the European Commission as part of its work on developing market-based financing for corporates in the European Union. The report aims to provide a thorough analysis of the factors that influence market liquidity in corporate bonds, both financial and non-financial. The analysis considers both cyclical factors that drive liquidity and changes under way in the European corporate bond market, including the development of new trading mechanisms.

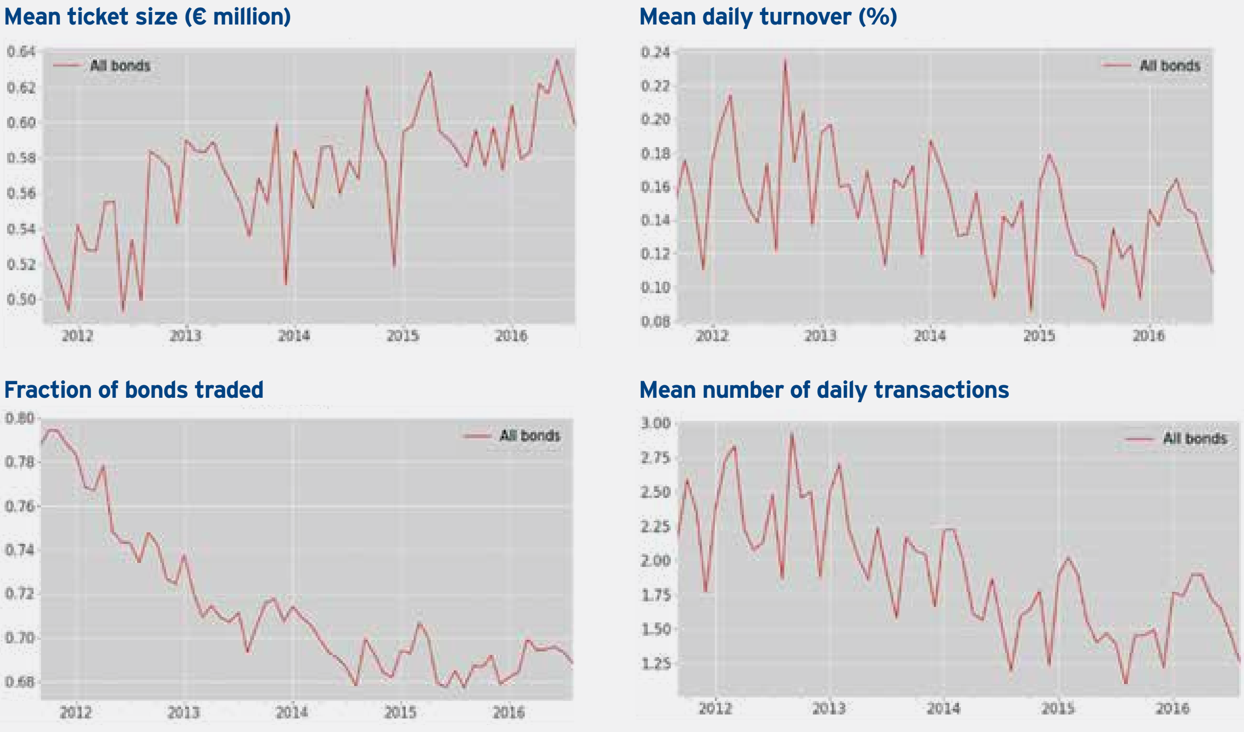
The report notes that the main empirical studies of bond market liquidity to date have not resolved the claims of market participants that liquidity remains difficult to obtain for many types of European corporate bonds. The primary limitation of existing studies is that analysis relies on unconditional time-series evidence of market liquidity indicators measured on an aggregative basis. This conflates the influences of risk and liquidity, masking the influence of other factors. Furthermore, existing studies have not allowed for the changing distribution of bonds by characteristics (such as High Yield versus Investment Grade or old versus young bonds) which may affect aggregate liquidity.

The research is unique in that it analyses datasets that investigate the issues neglected by past studies just described. Using Markets in Financial Instruments Directive (MiFID) data from the Financial Conduct Authority (FCA), clearing data from Euroclear, transactions data from a prominent Electronic Trading Platform (ETP), and quote and characteristic data from Bloomberg and Thomson Reuters, the study analyses activity-based and price-based indicators of European corporate bond liquidity in detail. The dataset examined here constitutes the most comprehensive yet constructed for analysing European corporate bonds' liquidity.

A slowdown in activity-based liquidity indicators

The analysis provides strong evidence of a slowdown in a variety of activity-based liquidity indicators. To illustrate, for non-financial bonds over the 2011-16 period for which FCA data is available, while the number of bonds increases, mean daily turnover rates for individual International Securities Identification Numbers (ISINs) fall by about a third. The fraction of bonds traded at least once a month declines from about 80% to 70%, while the mean number of daily transactions by ISIN drops from about 2.3 to about 1.3. A theme that appears in multiple aspects of the empirical findings is that, while new bonds continue to be traded, older bonds tend to a greater extent to be "siloed" in the portfolios of long-term investors, ceasing to trade unless they become information sensitive.

Activity trends for non-financials: FCA data



5. Risk Control Limited is a leading independent firm of quantitative risk specialists in Europe. Risk Control assists leading banks, asset managers, funds and public institutions around the world by advising on risk methodology and implementation and by supplying bespoke financial and operational risk software. For more information, visit www.riskcontrollimited.com

The analysis provides strong evidence of a slowdown in a variety of activity-based liquidity indicators.

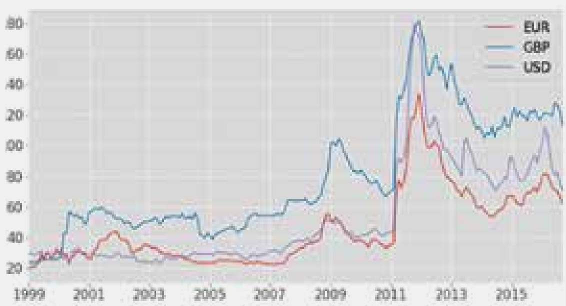
The study further shows, in line with previous studies, that price-based measures of liquidity (such as effective spreads, bid-ask spreads, round trip costs and market depth indicators such as Amihud ratios) decline following the 2011-12 crisis. In most cases, however, these measures exhibit a marked upward trend after 2014. This fact has been remarked by the most recent regulatory studies including FCA (2017) but is omitted from some influential official summaries of the state of bond market liquidity like International Organization of Securities Commissions (IOSCO) (2017). The Risk Control analysis shows that the recent upward trend holds for financial and non-financial issues, for young issues and seasoned issues, for big and small ticket trades, and for trades involving large issues and small issues.

The most obvious price-based measure is bid-ask spreads for individual bonds. Based on quotes, such spreads may be criticised as being non-executable expressions of trading interest. Nevertheless, they have the advantage that they are observable over long periods of time for a large fraction of the market.

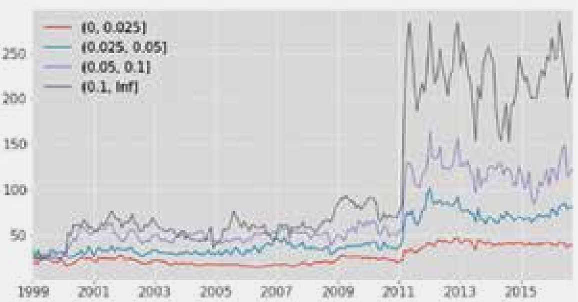
Especially, one may "condition" price-based measures of liquidity on risk by calculating trading costs for bonds with given levels of past return volatility. This provides a radically different view of how liquidity has evolved in recent years. One may see this in the lower left-hand plot in the figure below. It shows that trading costs for bonds of given volatility levels rose sharply in the crisis and have barely recovered since then. This observation suggests that trading costs may fail to be resilient in a possible future period of market stress.

Spreads for bonds of different issues size in bps

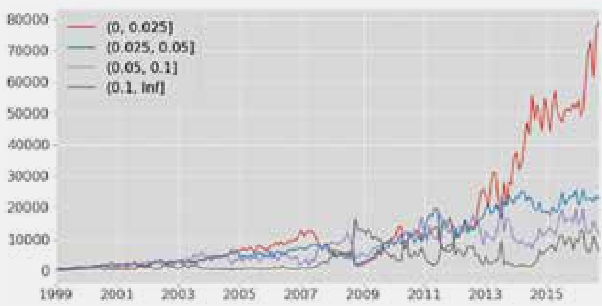
Spreads for bonds by currency in bps



Spreads for bonds in different volatility buckets in bps



Counts by month of bonds in price volatility buckets



The study also covers price impact measures, which include Amihud ratio measures (three versions), the Roll measure and Imputed Round-trip Costs measure. These measures were originally introduced for the analysis of trading costs in equity markets.

Drivers of market-maker profitability

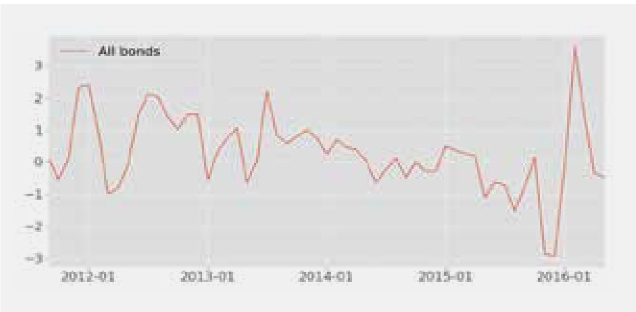
To assess drivers of market-making profitability in the European corporate bond market, the study analyses profitability indicators including dealer inventories, carry spreads (yields minus funding costs) and measures of round trip returns. The study relates these indicators to the evolution of potential drivers including capital costs and the implementation of Basel III liquidity rules.

Returns on round trips are calculated using data for purchase and sales of individual ISINs by single dealer banks. Following each individual bond purchase by a bank, subsequent sales are tracked so that actual returns can be calculated. If the bank makes a second purchase before the first block is completely sold, it is assumed that the second block remains in the bank's portfolio until the entire first block is disposed of.

The above described round trip return is expressed as a percentage of the initial purchase price. Funding cost and bond index return is subtracted from this "gross" round trip return subsequently to obtain a net adjusted round trip return measure.

Below, the plot suggests the net adjusted return trends down apart form a spike at the end. Upon inspection the sharp negative returns close to the end of the sample period are associated with the default of some Portuguese bonds whereas the very marked positive spike occurs when the ECB announces its corporate bond purchase programme.

Return on round trip (%, IR immunised, net of funding cost): FCA data



This study follows up by discussing factors that may affect dealer profitability. An obvious and important source of possible pressure on market-making profitability is regulatory change. Justified as a response to the financial crisis, regulatory change may have affected, in turn, dealer profitability, the availability of market-making services and ultimately market liquidity.

In the study, a sample portfolio representative of the bonds contained in the FCA dataset is generated. Its capital amount and profitability indicators, such as dealer inventories, carry spreads (yields minus funding costs) and measures of round trip returns are calculated. These profitability indicators are related to the evolution of potential drivers including capital costs and the implementation of Basel III liquidity rules. It appears that the periods of sharpest contraction in dealer inventories coincide with periods in which banks were struggling to become consistent with Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) rules. The following table summarises some of the findings in this study as regards timing.

Summary on dealer profitability

Conclusions

The Risk Control study provides evidence of reduced liquidity in the European corporate bond market, contradicting the findings of some regulatory studies. It shows that dealer profitability has been depressed limiting the extent to which market-making businesses could absorb the impact of regulatory changes.

Measuring the economic cost of illiquidity is challenging. Clearly, there is an impact on transactions costs for market participants. This in turn may increase the costs of borrowing for bond issuers. While advocating caution in interpreting the results, the study attempts to quantify this effect, showing that declines in dealer inventories, conditional on risk, are associated with rises in borrower yield spreads.

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ICE Data Services Corporate Bond Market Liquidity Tracker

ICE DATA SERVICES™

December 2017

Liquidity Tracker

ICE Liquidity Trackers are designed to reflect average liquidity across global markets. The ICE Liquidity Trackers are bounded from 0 to 100, with 0 reflecting a weighted-average liquidity cost estimate of 10% and 100 reflecting a liquidity cost estimate of 0%. The ICE Liquidity Trackers are directly relatable to each other, and therefore, the higher the level of the ICE Liquidity Tracker the higher the projected liquidity of that portfolio of securities at that point in time, as compared with a lower level. Statistical methods are employed to measure liquidity dynamics at the security level (including estimating projected trade volume capacity, projected volatility, projected time to liquidate and projected liquidation costs) which are then aggregated at the portfolio level to form the ICE Liquidity Trackers by asset class and sector. ICE Data Services incorporates a combination of publicly available data sets from trade repositories as well as proprietary and non-public sources of market colour and transactional data across global markets, along with evaluated pricing information and reference data to support statistical calibrations.

Corporate Bond Liquidity Tracker

Commentary

The trackers suggest that liquidity levels for IG corporate bonds have remained relatively stable over the last quarter for USD and EUR, while showing a slight improvement for GBP. In the HY space, however, EUR and GBP market liquidity has deteriorated over the quarter into year-end, while USD HY market liquidity has remained steady. Based on observations from 2016 year-end, it would seem likely to expect a seasonal drop in liquidity across all corporate bonds, although at the time of writing there is no expectation of the extreme funding shocks experienced over the 2016 "turn". Furthermore, it will be interesting to observe what impact, if any, the implementation of MiFID II/R will have on EUR and GBP corporate bond market liquidity over the next quarter.

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Repo and Collateral Markets

by David Hiscock and Alexander Westphal

European repo and collateral market developments

CCP Recovery and Resolution Directive

On 28 November 2016, the European Commission announced its proposed new EU rules for the recovery and resolution (R&R) of CCPs – in the form of a draft Regulation subject to approval and adoption by the European Parliament and the Council of the EU, whose work on this proposal remains ongoing. Within the debate to determine the tools to be provided for CCP R&R, consistent with our discussions on this topic, the ERCC has focussed on seeking to ensure that variation margin gains haircutting (VMGH) is clearly not to be applied to repo variation margins, as these concern changes in collateral value rather than economic gains or losses, and that initial margin (IM) is not subject to haircutting.

While work remains to be done as the applicable legislative process continues, it seems thus far that it is generally considered that VMGH is indeed specifically related to the haircutting of VM amounts which represent mark-to-market gains and therefore VMGH does indeed not apply to repo variation margins. Considering IM there has also been seemingly broad agreement that this should not be subject to haircutting.

Final Basel reforms

On 7 December, the BCBS's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), endorsed the outstanding Basel III post-crisis regulatory reforms, which includes a revised standardised approach for credit risk, revisions to the internal ratings-based approach for credit risk, revisions to the credit valuation adjustment (CVA) framework, a revised standardised approach for operational risk, revisions to the measurement of the leverage ratio and a leverage ratio buffer for global systemically important banks (G-SIBs), and an aggregate output floor. A short description of the agreed reforms is set out in a summary document accompanying the final standards' text detailing the reforms and the BCBS's assessment of their quantitative impact. The revised standards will take effect from 1 January 2022 and will be phased in over five years.

With respect to the Leverage Ratio there is specific acknowledgement of the need to continue to monitor its impact on SFT markets and market liquidity. There is also a passage which details concerns that authorities may need to act upon in case certain SFT type transactions and structures result in an inadequate capture of banks' sources of leverage. And, there is a limited discretion to exempt central bank reserves, akin to the approach being followed by the Bank of England. The detailed provisions for the treatment of SFTs appear to assimilate into the text the views already documented in published Q&A and otherwise continue to be as per the January 2014 BCBS leverage ratio.

The final standards' text also includes specific provisions regarding the treatment of SFTs in the standardised approach for credit risk (see paragraph 125 on page 34 and section 3. Collateralised transactions at pages 36-46);

and the internal ratings-based approach for credit risk (see particularly pages 67-74). Note also that CVA (see at page 109) reflects the adjustment of default risk-free prices of derivatives and SFTs.

Additionally, the BCBS has now completed its review of the regulatory treatment of sovereign exposures, mandated by the GHOS in January 2015, and, also on 7 December, published a discussion paper (for comment by 9 March) on this topic. The BCBS is of the view that the issues raised by its review and the potential ideas outlined in the discussion paper are important, and could benefit from a broader discussion. However, the BCBS has not reached a consensus on making any changes to the regulatory treatment of sovereign exposures at this stage, and has therefore decided not to consult on the ideas presented in the discussion paper.

From the ERCC's perspective, within this new BCBS discussion paper, the most directly pertinent question raised is number 10, which says: "What are current market practices related to haircuts for sovereign repo-style transactions? Do you believe that the current repo-style discretion to apply a haircut of zero should be removed from the credit risk mitigation framework?"

Net Stable Funding Ratio (NSFR)

In March 2017, the ERCC wrote to Peter Simon MEP, who is the European Parliament's *rapporteur* in respect of the Commission's proposals (of 23 November 2016) for updating of the CRR and the CRD to include, among other things, a binding Leverage Ratio and a binding NSFR. The European Council and Parliament are continuing to work on this proposal. From the EP side, Peter Simon's draft report, dated 22 November 2017, with 179 proposed amendments – it is now up to MEPs to propose additional amendments – has now been published.

While this publication is only one more step in the continuing process of finalising the EU's revision of the CRR, this draft report does include one very interesting amendment (number 106, on page 79) related to the NSFR which is in line with one of the ERCC's proposals for a better calibrated regime. This suggests that the starting point for calculating NSFR should be to first net out all repo transactions which "have the same explicit final settlement date", instead of the Commission's proposal which only allows for netting subject to a more familiar set of conditions (ie same counterparty and explicit final settlement date; legally enforceable; and intent to settle net).

Among other points within Peter Simon's report it is proposed that small and non-complex institutions, as defined in Amendment 22 (on pages 21-22) should be given the opportunity to use a distinct simplified NSFR, details of which are specified in Amendments 113-128 (on pages 84-103).

On 21 December, the BCBS published a proposed technical amendment (for comment by 5 February 2018), which is related to the treatment of extraordinary monetary policy operations in the NSFR. To provide greater flexibility in the treatment of extraordinary central bank liquidity-absorbing monetary policy operations, the technical amendment proposes to allow reduced required stable funding factors for central bank claims with maturity of more than six months.

EU large exposure limits

Among changes to the EU CRR, proposed late in 2016 by the Commission, there is a small change in the wording of the rules related to large exposures. To understand the detail regarding this large exposures topic, it is necessary to look at the CRR, where the large exposure section starts at page 229, and at the Commission's November 2016 proposed amendments, where the changes to the applicable articles start at page 193. In particular, it should be noted (i) that the new text to be inserted as Article 401(4) (at page 200 in the changes), says: "Where an institution reduces an exposure to a client due to an eligible credit risk mitigation technique in accordance with Article 399(1), it shall treat the part of the exposure by which the exposure to the client has been reduced as having been incurred to the protection provider rather than to the client."; and (ii) that the very next one of the changes provides for the first sentence of Article 403(1) to change from ending in the permissive word "may" to instead end in the prescriptive word "shall".

The effect of this thus appears to be that (if the new proposals are adopted), where collateral is being used to reduce a counterparty exposure when calculating exposures for the purposes of the CRR's large exposures requirements, there will be a substituted exposure to the issuer of the collateral which must be added into the reporting entity's other exposures (while today this is not obligatory). However, as most of the collateral being taken in the European repo market is high-quality government bonds, so long as the exposures to the issuers of this collateral do then come under the exemptions from the limits to large exposures afforded by CRR Article 400(1) (at page 234 of the CRR), this should be just a reporting point (rather than a concern about actual limits).

Nevertheless, it would be a significant challenge to accurately track collateral issuer exposures (alongside counterparty ones) for purposes of these rules and any repo or securities lending activities where the collateral is not government bonds will not benefit from the exemption and therefore large exposure limits will apply to applicable collateral issuer exposures. The ERCC has joined others in expressing concern about this point of detail and, while some progress seems to be made towards obtaining acknowledgement that this change in requirements should not be adopted, is continuing to monitor the applicable legislative debate.

Haircuts

Article 29.3 of the EU SFT Regulation (SFTR) requires the European Commission to submit, by 13 October 2017, "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", alongside any appropriate proposals.

On 19 October, the Commission duly published its final report under SFTR Article 29(3), taking into account a more detailed report previously prepared by ESMA, EBA and ESRB and issued in October 2016. The final Commission report includes a short general assessment of the functioning of SFT markets and on the impacts on leverage and options to tackle its build-up, before covering in turn the relevant FSB recommendations on SFTs and measures taken so far at EU level, ie (i) transparency of SFT markets (FSB recommendations 1-5), (ii) cash collateral reinvestment (FSB recommendation 6), (iii) re-hypothecation of client assets (FSB recommendations 7-8), (iv) collateral valuation and management (FSB recommendation 9), and most importantly (v) collateral haircuts, including qualitative standards for methodologies to calculate haircuts and numerical haircut floors (FSB recommendations 12-18).

Overall, the Commission followed the guidance from ESMA and concludes:

- To a large extent, the FSB recommendations on SFTs have been addressed in the EU through the adoption of SFTR and specific provisions in sectoral financial services legislation and guidelines. As such, there does not seem to be a need for further regulatory action at this stage.
- The Commission will continue to thoroughly monitor developments in SFT markets and the international regulatory space. The Commission will reassess the added value of qualitative standards and haircut floors on the basis of a report to be prepared by ESMA once comprehensive SFT data is available (ie once SFTR reporting is live – expected in 2019).

On numerical haircut floors more specifically, the Commission lists the following reasons why it believes that legislative action would be premature:

- lack of clarity on mutual relationship between haircuts and procyclicality;
- discussions between ESMA and market participants as well as data suggest that haircuts actually applied by market participants tend to be higher or at the level of the haircut floors recommended by the FSB;
- SFTs in scope of the FSB recommendation (bank to non-bank and non-bank to non-bank) represent a limited share of the overall market;
- incorporation of numerical haircut floors for bank to non-bank SFTs into the Basel III framework which was originally recommended by the FSB for the end of 2015 as a prerequisite for authorities introducing the haircut floors is still delayed; and
- other important jurisdictions (eg the US and Japan) are also in the early phases of their assessments and have not taken a decision on haircut floors yet.

Money Market Funds (MMFs)

As reported in this section of Issue no 46 of the ICMA Quarterly Report, on 24 May, ESMA launched a consultation inviting responses to specific questions on draft technical advice, implementing technical standards and guidelines under the EU MMF Regulation (MMFR). On 17 November, ESMA announced that it had duly published its final report, the key requirements in which relate to asset liquidity and credit quality – including with respect to assets received as part of a reverse repo agreement; the establishment of a reporting template; and stress test scenarios carried out by MMF managers. The technical advice and ITS have been submitted by ESMA to the European Commission, in the latter case for endorsement.

Repo and collateral-related research papers

On 19 October, the ECB published the results of the September 2017 survey on credit terms and conditions in euro-denominated securities financing and OTC derivatives markets (SESFOD), which showed little overall change in credit terms for secured funding. Regarding the provision of finance collateralised by euro-denominated securities, a small net percentage of respondents reported a decrease in the maximum amount and the maximum maturity of funding for many types of collateral, as well as a decrease in haircuts applied to government bonds and a decrease in financing rates when government and corporate bonds were used as collateral. On balance, respondents reported that the liquidity and functioning of markets for all types of underlying collateral covered by the survey remained basically unchanged. These results follow the deterioration reported since mid-2015 in liquidity and functioning of markets for many types of euro-denominated collateral.

Authored by ESMA staff, *Collateral Scarcity Premia in Euro Area Repo Markets* was published as ESRB working paper series No 55 on 20 October. Using bond-level data from both repo and securities lending markets, this paper introduces a new measure of collateral reuse and studies the drivers of the cost of obtaining high-quality collateral, ie the collateral scarcity premium, proxied by specialness of government bond repos. The authors find that the cost of obtaining high-quality collateral increases with demand pressures in the cash market (short-selling activities), even in calm financial market conditions. In bear market conditions – when good collateral is needed the most – this could lead to tensions in some asset market segments. Collateral reuse may alleviate some of these tensions by reducing the collateral scarcity premia. Finally, the authors find that the launch of the ECB QE programme has a statistically significant, albeit limited, impact on sovereign collateral scarcity premia, but this impact is offset by the beginning of the ECB securities lending programme.

The Leverage Ratio and Liquidity in the Gilt and Repo Markets is a Bank of England staff working paper, published on 3 November. Noting that market participants have argued that a significant unintended consequence of post-crisis regulatory leverage ratio requirements has been a reduction in the liquidity of fixed income markets, the authors assess this claim in the context of the Gilt and Gilt repo markets. They find that gilt repo liquidity worsened during the period when UK leverage ratio policy was announced, and that gilt liquidity worsened conditional on factors such as funding costs and inventory risk. They also find evidence that gilt repo liquidity has become less resilient. However, they conclude that evidence from heterogeneity in dealer behaviour is inconclusive regarding a causal link between leverage ratio requirements and the reduction in market liquidity.

On Collateral: Implications for Financial Stability and Monetary Policy is an ECB staff discussion paper, published on 7 November. In this paper the authors first review what drives the demand and supply for both real and financial collateral assets. Then they examine financial stability issues and the case for regulating the use of collateral; and they discuss the role and design of market infrastructures such as CCPs. Finally, the authors examine the interaction of standard and non-standard monetary policy and the functioning of private collateralised markets. They show that the use of collateral is neither a sufficient nor a necessary condition for financial stability. To ensure the stability of collateralised markets a mix of micro- and macro-prudential regulation, as well as a sufficient supply of safe public assets that can be used as collateral, are needed.

On 29 November, the ECB published its latest semi-annual *Financial Stability Review*. This includes a special feature on *Recent Developments in Euro Area Repo Markets, Regulatory Reforms and Their Impact on Repo Market Functioning*. The conclusions section of this feature starts by stating: "Overall, the analysis presented in this special feature supports the notion of an overall functioning repo market in the euro area and the view that regulatory reforms have not had a material unintended effect on the amount of euro area banks' outstanding repo transactions." Following some further points the conclusions end by stating that "further analysis is warranted to establish whether some regulatory and other metrics could be calculated based on averaging rather than the balance sheet on a single date. This could help reduce the volatility observed and contribute to a smoother functioning of markets around these dates."

The latest BIS Quarterly Review, published on 3 December, includes a box, *Can CCPs Reduce Repo Market Inefficiencies?*. This considers a rule change by The Depository Trust and Clearing Corporation (DTCC), approved by the US SEC in May, which allows DTCC's subsidiary, the Fixed Income Clearing Corporation, to expand the availability of clearing in the repo market to a broader set of institutional investors. Through this rule change, MMFs can provide cash or securities in the DvP markets through a dealer sponsor. The initial response to this rule change by the MMFs that clear repos through the Fixed Income Clearing Corporation suggests that central clearing could potentially reduce market segmentation.

Published on 6 December 2017, the ECB staff research bulletin, *Collateral, Central Clearing Counterparties and Regulation*, summarises research on why regulation of collateral and CCPs promotes financial stability. It concludes that some effects of using collateral and CCPs are already well understood, for example how CCPs and collateral can help avoid losses when default occurs. However, their effects on incentives to avoid default in the first place are less well understood; but these incentives are key to financial stability. To fully restore incentives for costly risk management, regulation is needed to prevent a fire-sale externality sparking a vicious circle of falling asset prices and the excessive use of variation margins.

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ICMA ERCC Guide to Best Practice in the European Repo Market

On 18 December, the ICMA ERCC published a further set of revisions to its Guide to Best Practice in the European Repo Market (Guide). Written on the basis of detailed input from experienced, current market practitioners, the Guide's purpose is to help foster a fair and efficient European repo market by recommending practices which market experience suggests can help avoid uncertainty or disagreement about transactions, and consequent delay or disruption to repo trading and settlement. With the same purpose in mind, the Guide also codifies market conventions, where this has been thought to be helpful, usually in response to queries from market participants.

Whilst tidying up some further minor details, this latest version of the Guide also introduces some elements of new, extended and refined best practice guidance. Examples include elements of best practice in notifying the termination of open repos; agreeing interest rates for late payments, including in the case of negative rate repos; confirming transactions and instructing settlement; valuing collateral; and making margin calls. In addition, this latest version includes a new annex which outlines what open, evergreen and extendible repos are. The Guide will continue to be refreshed as market practice evolves and responsive to applicable questions or comments. It is clearly understood that the practices set out in the Guide are general recommendations only and, as such, parties to repos are free to agree other terms, where they see fit. Nevertheless, the ICMA ERCC hopes that all market participants will strive towards the best practices elaborated in the Guide, or at the very least benefit from better appreciating the need to carefully manage the risks in transacting repos.

The effective date of this latest version of the ICMA ERCC Guide to best practice in the European Repo Market is 18 December 2017.

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MiFID II/R and SFTs

In its updated Q&A on MiFID II/MiFIR investor protection and intermediaries (10 November 2017), ESMA confirmed that SFTs are inside the scope of the MiFID II record keeping requirements, as outlined in Article 16(6) of the Regulation.

4. Record keeping

Question 2

Are securities financing transactions (SFTs) in scope of the MiFID II requirements for order record keeping, as outlined in Article 16(6) of MiFID II and further specified in Section 8 of the MiFID II Delegated Regulation?

Answer 2

Yes. Article 16(6) of MiFID II states that firms "shall arrange for records to be kept of all services, activities and transactions undertaken by it which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions under this Directive, Regulation (EU) No 600/2014, Directive 2014/57/EU and Regulation (EU) No 596/2014 […]". Article 16(6) has a general application and does not provide for exclusions of particular types of transactions. SFTs are therefore inside the scope of the MiFID II record keeping requirements.

More details on this and the broader scope of MiFID II/R for repo and SFT markets can be found in the updated ICMA FAQs available on the ICMA website.

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SFTR implementation

The crucial SFTR Regulatory Technical Standards (RTS), which contain the details of the upcoming reporting requirements for securities financing transactions (SFTs), continue to be under review by the European Commission. It is expected that these should be published in the course of the next few weeks, with subsequent time for the European Parliament and Council to review and approve the rules. As currently expected, the rules should enter into force in 2Q 2018, one year before the reporting goes live for most market participants, including banks, ie around mid-2019.

While waiting for the rules to be finalised, the ICMA ERCC SFTR Task Force continues to work towards their implementation. The bilateral SFTR reconciliation exercise for repo and buy/sell-back trades launched by the group in June 2017 continues to be on the agenda and is hoped to help identify the key problem areas and reporting fields as a basis for further industry work. However, another important part of the implementation effort will be to ensure close collaboration with the relevant service providers who are developing solutions to help firms comply with the SFTR reporting challenges. Service providers, ranging from traditional vendors and matching engines to authorised Trade Repositories (TRs) will play a key role in the implementation process, as many firms are expected to rely heavily on such vendor solutions.

The ERCC SFTR Task Force has thus decided to take collaboration with the relevant providers to the next level. As a first step, a sub-group of the Task Force reached out to all identified relevant vendors and prospective TRs in the space to set up an initial bilateral discussion with each of them. These sessions were held in December, enabling the Task Force to learn more about the different solutions that are being developed specifically for repo and to discuss how to involve the relevant firms more effectively in the Task Force.

As a result of the fruitful discussions, it was decided to invite all the ten service providers that participated in the bilateral sessions to join the ERCC SFTR Task Force. To have the service providers on board will add value to the Task Force discussions and might also be an opportunity to advance discussions between the different providers on common conventions and standards which would in turn facilitate seamless interaction and interoperability between the different solutions once the SFTR reporting goes live. The Task Force remains of course open to add further relevant providers that may not have been contacted so far.

At the same time, ICMA also continues to be in close contact with the relevant authorities, in particular ESMA, to clarify any outstanding questions in relation to the SFTR rules and their implementation. As part of this process, on 15 November the ERCC SFTR Task Force submitted feedback to ESMA on a set of draft validation rules for trade repositories which they had shared with selected industry bodies for review.

Overall, 2018 is expected to be a pivotal year for implementation, which will determine the success of SFTR. While the actual reporting is expected to go live only in 2019, 2018 will be the year where firms will have to take the crucial decisions and make the necessary system developments in order to be ready to go live, irrespective of whether they plan to rely mostly on their internal systems or on one of the comprehensive vendor solutions. As resources gradually shift from MiFID II/R to SFTR, discussions in the ERCC SFTR Task Force will thus no doubt intensify.

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2018 is expected to be a pivotal year for implementation, which will determine the success of SFTR.

SFTR: extra-territorial features

By Caroline Dawson and Miles Binney

Introduction

The EU Securities Financing Transactions Regulation (SFTR) came into force on 12 January 2016, although many of its requirements are subject to transitional provisions. The SFTR is integral to the European Commission's strategy to reduce perceived "shadow banking" risks in the securities financing markets and forms part of the EU's response to the Financial Stability Board's August 2013 policy proposals on securities lending and repos. This article outlines the key extra-territorial features of the SFTR and discusses some of the issues for the global market as it prepares for implementation.

New information and execution conditions on the reuse of securities collateral

Article 15 of the SFTR, which came into effect on 13 July 2016, lays down new requirements for the reuse of securities and other financial instruments provided as collateral under all security and title transfer collateral arrangements. As a result, the scope of Article 15 extends beyond SFTs to cover, for instance, financial instruments collateral provided in respect of derivatives transactions. The definitions of "security collateral arrangements" and "title transfer collateral arrangements" follow those in the Financial Collateral Directive, but apply regardless of the nature of the obligation secured.

Article 15 applies to a broad range of counterparties – defined to cover any "undertaking" established in the EU – that receives collateral with a right of reuse. This potentially includes even situations where a counterparty receives collateral from individuals that do not qualify as an "undertaking". It applies to counterparties established in the EU, even if they are acting through a branch outside the EU.

Article 15 also applies extra-territorially – ie to non-EU counterparties – although only if these counterparties are receiving collateral from counterparties established in the EU, or where a non-EU counterparty is acting through a branch in the EU.

There are limited exceptions to this rule, and counterparties receiving collateral from exempt entities must still comply with the reuse requirements.

Article 15 stipulates that all counterparties – not just financial intermediaries – will have the right to reuse financial instruments received as collateral under a security or title transfer collateral arrangement only if the following conditions are fulfilled:

- *Disclosure of risks and consequences:* the providing counterparty must be duly informed in writing by the receiving counterparty of the "risks and consequences" that may be involved in (i) giving consent to a right of reuse under a security collateral arrangement or (ii) concluding a title transfer collateral arrangement; and
- *Prior express consent:* the providing counterparty must have (i) "granted its prior express consent, as evidenced by a signature in writing or in a

> legally equivalent manner to a security collateral arrangement which provides a right of use of collateral", or (ii) "expressly agreed" to provide collateral by way of a title transfer collateral arrangement.[1]

Additionally, the SFTR stipulates that the exercise of any right of reuse must be undertaken in accordance with the terms of the collateral arrangement and financial instruments received under a collateral arrangement must be transferred from the account of the providing counterparty. There is still some uncertainty around how to satisfy this requirement. However, at least where the receiving counterparty acts as custodian for the providing counterparty, it seems likely that the client's account should indicate that securities have been transferred from that account if and when they are reused or are the subject of title transfer collateral arrangements. The SFTR alternatively provides for reuse to be evidenced by "other appropriate means" if third country counterparties are involved in the transaction and are subject to the laws of that third country.

New requirements to report SFTs to a trade repository by T+1

The reporting regime under the SFTR applies to counterparties established in the EU, including their non-EU branches, and to the EU branches of non-EU counterparties. Even if not covered by these requirements, many non-EU counterparties will nevertheless be impacted when they transact SFTs with counterparties who are covered. This is because the reporting entities will require to obtain certain information in order to fulfil their reporting obligations, including the LEI of their counterparty.

The reporting regime follows the model for derivatives reporting under EMIR, and stipulates that both parties to a trade must report new, modified or terminated SFTs to a registered EU or recognised non-EU trade repository by T+1, and must maintain records of SFTs for at least five years following the termination of the transaction. Additionally, counterparties must report the associated collateral to the trade repository, either by T+1, or on value date + 1, according to the method of collateralisation adopted.

The reporting obligation is phased in by counterparty type. The European Securities and Markets Authority is required to produce regulatory technical standards (RTS) setting out further detail on the reporting obligation. Once those RTS come into force, banks and investment firms will have a 12-month grace period until the reporting obligations apply; meanwhile, central securities depositories and central counterparties will have a 15-month transitional period; other financial counterparties (including UCITS and AIFs), an 18-month period; and, finally, non-financial counterparties, a 21-month period.

However, where implementing legislation was previously expected to come into force by the first quarter of 2018, the final RTS is still awaiting approval by the European Commission and the European Parliament, and is presently expected to enter into force during the second quarter of 2018 instead. As a result, we do not currently expect the reporting obligation to start until 2019.

Preparing for implementation

The SFTR is the latest in a series of wide-sweeping regulatory initiatives affecting securities financing markets and collateral, both within and outside of the EU. Although less extensive than other recent regulatory reforms, most notably MiFID II/R, the SFTR nonetheless presents significant compliance challenges. At the core will be identifying in-scope entities and transactions, which may require systems build and establishing internal processes, eg to capture all new in-scope collateral arrangements. Market participants will need to integrate their implementation project for the SFTR, and monitor developments, as the full implementation of the SFTR draws closer.

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1. In April 2016, ICMA, jointly with four other trade associations, issued a standard SFTR information statement to help firms comply with the later requirement regarding title transfer collateral arrangements.

Time to move forward

Personal view by Godfried De Vidts

After the significant process of necessary financial regulatory reforms, there seems to be a growing consensus that we now need to clear up loose ends, with a number of official efforts under way which seek to assess the impact of these reforms. Unsurprisingly, various unintended consequences have emerged and, in an effort to adapt to the reformed environment, industry participants, despite being accused of wanting to reverse the regulatory reform, have engaged in a number of market improvement initiatives. This sounds familiar from long experience, but pushing responsibility for adaptive market change solely onto the private sector is not a sufficient way forward.

Considering one particular aspect of European markets, alongside many other private market participants, I have been involved for years in efforts to improve the EU's post-trade environment, working on the two Giovannini report groups, the CESAME (I and II), the MOG, the COGESI group (now transformed into AMI-SeCo), the European Post Trade Group (EPTG) and Forum (EPTF); and witnessed plenty of other expert groups, such as that which has just reported on the European Corporate Bond Market. The list of all these groups gets longer and longer. Many of these initiatives end up in a call for evidence from the European Commission, followed by a consultation where stakeholders can provide feedback as to what in their mind needs to happen. Unfortunately, consequent commitment to public-sector reform proceeds at a snail's pace, while concrete pragmatic actions taken at the prerogative of the market are never able to deliver a complete reform – which necessitates complementary public-sector actions.

A good example of how this process is continuing can be seen in relation to the recent EPTF report, in which various European associations delivered refreshed and actionable feedback to improve Europe's back office. In question 5 of the ensuing consultation respondents are asked what the EU post trade should look like in the next 5 and 10 years' time. Yet the focus ought to be on actions highlighted in the EPTF report, importantly including the number of practical issues which have been pushed into a "watch list". These issues need intensified action, together with all the other identified issues, from the regulatory authorities at large, in order to overcome national restrictions and properly develop the EU's Single Market. Also, at the November hearing for the European Corporate Bond Market Report, some of the Expert Group's recommendations have been described as "too challenging to implement from a regulatory perspective", again showing the difficulty of finding the political will to act to boost markets.

To my frustration, and that of many of my peers, one of the things which we continue to see is evidence of a silo mentality when looking at the sort of structural measures needed to give Europe the necessary impetus to tackle long-known problems. Thinking in periods tied to legislative terms (5 or 10 years) is also not helpful, when facing complex challenges in need of consistent long-term efforts to deliver reform. While many recent reforms can be ticked as "done", which will increase the safety and robustness of financial markets, what have we actually achieved that serves to increase or improve market liquidity – which is an essential component for the provision of usable products that serve the real economy?

With more transparency, data and reporting in place, better insight should be obtained, but will this achieve the ultimate goal of delivering better markets? Can regulators get ahead of the curve? Do officials take a wide enough "helicopter" view and appreciate the linkages between various financial market products, which are so necessary if they are indeed to avoid the next financial crisis? Natural disasters usually see officials taking a helicopter to look at the damage, so why can we not take such action to look at what the regulatory tsunami has done?

In my experience there are strong, important cross-market linkages to be considered. For instance, well-functioning repo markets enhance the robustness of both the bilateral OTC derivatives market and the recently encouraged centralised clearing facilities. Also, government and corporate bond markets need liquid secured financing markets (mainly repo or securities lending); and the central bank community has pushed the market to secured lending since the late 1990s. Meanwhile, moving to complement a largely bank-funded economy with the financing capacity which a Capital Market Union can deliver seems a worthwhile goal. As part of this, the non-banking sector needs to be able efficiently to mobilise cash and collateral used by different types of investors, to broaden their liquidity and risk management and investment strategies. Furthermore, post-financial crisis regulatory reforms have focused on encouraging or requiring more market participants to collateralise more of the risks they take. It is the repo markets which play a critical role in helping to ensure collateral can move effectively and efficiently around the financial system. In addition to their vital role in transmitting monetary policy, the proper functioning of repo markets should be of utmost importance for policy makers globally.

At some point there will be another crisis, as a senior policy maker told me a few months ago: a crisis that may be even worse than the one witnessed in 2008. And I agree with that view, unless we take further action now.

One way of protecting us has been identified: the use of collateral. Collateral is in effect the new cash, put to use through liquid and stable repo and securities lending transactions. Yet an excessive focus on simply piling up collateral as protection may not prove to be the right answer. All actors in financial markets should indeed reduce risk and increase their resilience using collateral, but this needs to be done in a suitably proportionate manner. Besides essential proposals for CCP recovery and resolution, Europe is already looking at the next version of EMIR. This should give us an opportunity to fine-tune collateral demand and usage, not only for the OTC derivatives markets but also for FX and other markets. MiFID II/R will increase reporting and SFTR will provide a better view for regulators on the use of repo and securities lending. Combining all these tools, while allowing innovative services to deliver tangible improvement in risk management and market infrastructure, and at the same time improving or reducing excessive collateral use, should help avoid a future financial Armageddon.

Godfried De Vidts *is Director of European Affairs, NEX, Member of the ICMA Board and Chair, ICMA European Repo and Collateral Council (ERCC) and Committee.*

FinTech mapping directory for repo and cash bond operations

ICMA's Ops FinTech Working Group (WG), a sub-group of the European Repo and Collateral Council (ERCC), has published a mapping directory of over 100 technology solutions available for repo and cash bond operations, including ancillary services. Over 12 months, the WG conducted a mapping exercise of existing FinTech solutions in the market. Initially, members of the WG gathered relevant details on the various technology solutions. ICMA subsequently reached out to each vendor firm to validate the information. At the same time, vendor firms were given the opportunity to add solutions that had not been included yet. The directory spans the following 10 categories:

(1) Collateral management (Lifecycle)

(2) Collateral management (Margin)

(3) Corporate actions

(4) Exposure agreement

(5) Intraday liquidity: monitoring and reporting

(6) KYC onboarding

(7) Matching, confirmation & allocation

(8) Reconciliation

(9) Static Data & Standard Settlement Instructions (SSI)

(10) Workflow & communication

The ICMA Ops FinTech mapping directory compares the capabilities of different providers and seeks to create greater transparency in a very dynamic and fluid market. It provides information on how each solution can be used, for example at which stage of the trade lifecycle, whether for cleared or uncleared transactions and where the solution sits within the IT infrastructure.

It focuses on providers and solutions that are used by working group members, and is intended to be a living document. It does not constitute an exhaustive list of providers in the market, and will be updated on a regular basis to include other existing or new solutions. The document can be accessed by ICMA member firms and the public on ICMA's website.

Relevant providers that are not yet covered by the mapping directory and wish to join are welcome to do so.

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Asset Management

by Patrik Karlsson and Bogdan Pop

MiFID II/R: FICC research unbundling survey results

In the last two weeks of October 2017, ICMA's Asset Management and Investors Council (AMIC) surveyed its members to discover firms' current intentions and progress regarding their implementation of MiFID II research unbundling with a specific focus on FICC research. This summary sets out the key elements of the survey results, which are also available here.

Thirty-three firms responded to the survey. In respect of types of firms, roughly two thirds of respondents were asset managers or investment funds and roughly one third were private banks. By geographical location, the respondent firms represent a good mix of 15 mostly European countries with the biggest proportion being represented by France, Germany, Italy, the Netherlands, Switzerland and the UK.

The vast majority of firms, 96%, said they are aware of the application of the new rules and the ESMA guidance on FICC research. Some firms, 37%, said they are already compliant with the new rules, while the others were actively working on becoming compliant. Not surprisingly, most firms, 89%, expected to be compliant by the 3 January 2018 deadline. The 11% who did not, may be from countries who may not have the same implementation deadline for MiFID II, such as Switzerland. Half the firms responded that they had not received guidance from their national regulator about the implementation of research unbundling for FICC research.

In line with market developments, most asset managers intend to pay for research themselves. 67% of firms said they intend to pay for FICC research using their P&L, 17% are still undecided, 8% do not intend to pay for external research, 4% intend to use a research payment account (RPA) funded by a charge to clients and 4% intend to use a combination of the options. At the time of the survey, up to 46% of respondents said that they had not yet been approached by a significant majority (75%) of their existing FICC research providers.

Most respondents (58%) expect FICC research spend to increase. The remainder are equally split (21%) between FICC research spend staying the same and FICC research spend decreasing. Most respondents (83%) agree that they will use a smaller number of research providers once the new rules come into effect. Most respondents (65%) agree that the demand for FICC research is going down, while a minority (35%) say it will not change. 61% of respondents said they will not change their consumption from independent research providers, while 22% said they

Most asset managers intend to pay for research themselves.

will consume more. In respect of broker research, 22% of respondents said they will not change their consumption, while 78% said they will consume less. So, overall, independent research providers are expected to get a larger slice out of the shrinking pie.

A slim majority of respondents (54%) believe the quality of research will not change following the implementation of MiFID II. However, 32% believe research will get worse, while 14% believe it will get better. Most asset managers are confident that the reduction in the number of FICC research providers will not have a negative impact on their funds' performance. 86% of respondents said they are not concerned about this scenario, showing a potential oversupply of research. Most respondents (68%) said that they do not intend to or have not increased their in-house FICC research capacity because of the new rules.

Finally, with regard to the impact outside the EU, the majority of asset managers with global activities plan to unbundle fees globally. 61% said they plan to unbundle fees globally, 31% plan to pay for research in non-EU jurisdiction only for EU clients and only 8% plan to segregate the EU and non-EU businesses.

AMIC promoted the survey among its members and stakeholders by launching it at the AMIC Conference in London on 8 November 2017. Depending on the appetite from members, AMIC may re-run the survey in late 2018 to assess the impact of the unbundling rules after they have been in force for a few months.

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STS securitisation

The simple, transparent, standardised (STS) Securitisation Regulation was approved by the European Parliament on 26 October and by the EU Council on 20 November. The text has now been published in the *Official Journal*. The Regulation must be applied as of 1 January 2019.

Previously, the industry had expressed concern about the provisionally agreed text, which contained a ban on self-certified loans for non-STS securitisations, while industry had only expected the ban to apply for STS securitisations. This would have had serious consequences for legacy issues that need re-financing. The final text in Article 9(2) specifies that the ban on self-certified loans only apply to loans originated after the entry into force of the EU Mortgage Credit Directive (Directive 2014/17/EU), which was 20 March 2014. This would exclude most of the legacy issues from the ban.

The EBA has started work on the significant number of technical standards that it is empowered to draft under the Regulation. It has held a hearing and commenced the work of creating homogeneity standards for loans in STS securitisation. On 19 December, the EBA issued consultations on risk retention and homogeneity of underlying exposures in securitisation, both with a deadline for response on 15 March 2018. On the same day, ESMA also launched three consultations on technical standards for STS securitisation, seeking views on investor reporting to securitisation repositories, the STS notification to ESMA and on requirements for third party entities verifying STS status.

The European Commission is also working separately on a set of amendments to the Delegated Act of Solvency II to amend the capital calibrations of requirements for STS securitisations. The Commission consulted Member States during the summer. Non-STS securitisation will likely not see any benefit in the proposal, which will likely be limited to STS only. This will make the STS criteria in the Level 2 process of the STS Securitisation Regulation more important for the securitisation market in Europe.

Finally, the proposal to review the European Market Infrastructure Regulation (EMIR) was published earlier in 2017 and proposed to designate Securitisation Special Purpose Entities (SSPEs) as financial counterparties for the purpose of EMIR and so bring SSPEs into scope for derivatives clearing and margin exchange. This could have a debilitating effect on securitisation markets in Europe.

The industry has raised this issue with the Council and European Parliament. The Council Presidency issued a Presidency proposal to maintain the *status quo* and not classify SSPEs as financial counterparties. The debate in the European Parliament continues.

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Variation margin for forward FX

Article 11(3) of the European Market Infrastructure Regulation (EMIR) requires financial counterparties (FCs) and non-financial counterparties who exceed certain thresholds (NFC+s) to exchange collateral for uncleared OTC derivatives. Entities in those categories will be required to collect margin from one another, subject to the phase-in thresholds for initial margin. However, the requirement to exchange Variation Margin (VM) took place in two stages. If both parties have, or belong to groups each of which has, an average notional amount of non-cleared OTC derivatives over a VM Notional Amount Threshold of €3 trillion, they were required to exchange Variation Margin from 4 February 2017, and all other counterparties were required to exchange Variation Margin from 1 March 2017.

As the industry told both US and EU regulators prior to 1 March 2017 that systems were not ready for implementation of VM, especially to the large group of FX derivative users, both the US and the EU delayed implementation, the US by a no-action letter and the EU through a statement from ESMA.

The EMIR RTS further provide for a delayed application of the requirement to exchange Variation Margin for physically settled FX forwards, until the earlier of (i) the date of entry into force of the Delegated Act under MiFID II, which was expected to enter into force on 3 January 2018 (and expected to define these contracts) or, if later, the date the Variation Margin exchange requirements first apply, and (ii) 31 December 2018.

Of these, 3 January 2018 was the date that would apply in the EU. This represented a lack of sequencing with the US, as the US announced that it intended to delay implementation of margin exchange for FX forwards even further. If the EU pressed ahead with implementation of the 3 January 2018 deadline, it would have placed EU entities at a serious disadvantage and the burden would fall disproportionately on the asset management industry because funds frequently use FX forwards for currency hedging purposes.

Following engagement from a number of buy-side trade associations alongside AMIC, the Joint Committee of European Supervisory Authorities (ESAs) issued a statement on 24 November 2017 about the application of variation margin to forward FX derivatives. The ESAs noted that the call for a narrower scope of application was correct and were working on amendments to the relevant RTS in EMIR to reflect this. However, the ESAs noted that this will take some time, so between the implementation of new standards and 3 January 2018 when the original RTS are applied, the ESAs ask the National Competent Authorities (NCAs) generally to apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a "proportionate manner".

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AMIC Council

The latest AMIC Council took place on 8 November 2017 in London, hosted by Schroder Investment Management. The AMIC Council holds two plenary sessions annually to advise the Executive Committee of AMIC on priorities and to discuss current issues at biannual conferences. These meetings also provide excellent networking opportunities for the AMIC community.

AMIC Chairman Robert Parker provided the attendees with his assessment of the challenges and opportunities for the asset management sector. We then heard insights from Amlan Roy, Global Chief Retirement Strategist at State Street Global Advisors, into the effects and importance of demographics on the future of asset management and how the industry needs to work together with pension funds to create products that address imbalances caused by demographics.

This was followed by a panel on the future of the asset management industry which debated the implications of regulation, more specifically the impact of MiFID II, on the fixed income trading environment and on the various products as well as potential innovations required by the industry to adapt.

The second panel of the day discussed systemic risk in asset managers, with a focus on fund liquidity, leverage risk in funds, exchanged views on whether ETFs pose systemic risks and on new developments in the US which may have implications for asset managers globally.

The third panel focused on the intricacies of the new MiFID II research unbundling rules and discussed their effects on asset managers, independent research providers and also on FinTech solutions developed to fill gaps in the developing market for research.

AMIC Secretary, Patrik Karlsson, presented the findings of the AMIC FICC Research Unbundling survey and spoke about the activities and working groups of AMIC. The next AMIC Council will take place on 6 March 2018 in Brussels.

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ICMA bail-in event in Zurich

By Katie Kelly

Following the success of the bail-in seminar held by ICMA in April 2017, a follow-on event was held in Zurich in November. Based on the premise that it is becoming more difficult for investors to be able to evaluate the risks they now run when investing in bank paper, especially in light of recent bank failures and how the regulators have dealt with them, the event brought together some 60 Swiss-based professionals from the buy side, the capital structuring side and the legal community for a substantive, interactive and animated debate.

Investors need to view the new system as being predictable and fair, but a lack of clarity and consistency in the application of the bail-in framework brings with it some political and regulatory risk, not helped by recent and contrasting interventions in Spain and Italy. One complication is that the holders of senior debt have been spared, mainly it seems because a large, but indeterminate part of the outstanding issues were held by retail investors with political clout. This may lead banks in future to only raise wholesale funds from sophisticated investors who are able to measure and bear the risk, and requiring investors to ask themselves just how far political judgement further complicates an already complex and delicate set of calculations.

Investors need assurances that the actions, valuations and write-downs applied in a bail-in scenario are fair and untainted by political considerations or opaque methodologies. This part of the equation is missing, suggesting that investors will find it challenging to correctly fine-tune their pricing and appetite for bank risk in future.

One further lesson to note is that banks may go straight to resolution once confidence starts to fail, meaning that, as soon as any capital triggers are reached, intermediary steps may be bypassed, leading to investors having to re-examine risk-return and yield on bail-in instruments.

Now that there have been a handful of resolution interventions, it is important that consistency begins to emerge, which ICMA hopes to be able to track in similar seminars throughout 2018.

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Green, Social and Sustainable Bond Markets

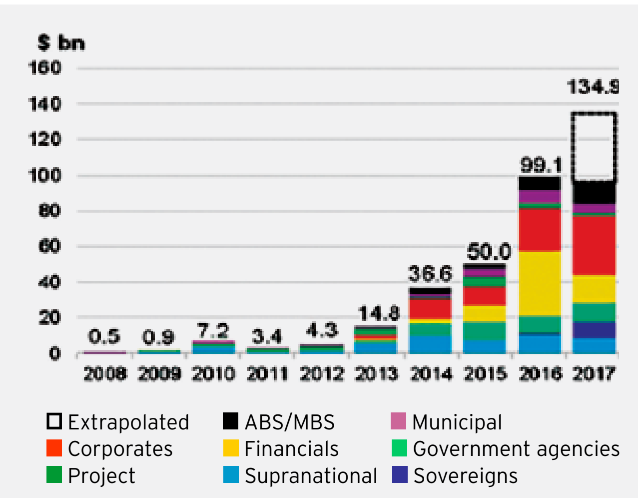
by Nicholas Pfaff, Valérie Guillaumin and Peter Munro

Green and social bond market developments

The last quarter of 2017 was another eventful period for the green bond market in terms of growth and diversification, policy and regulatory developments and Green Bond Principles (GBP) related events.

Market developments

Annual green bond issuance by issuer type



Source: Bloomberg New Energy Finance

In the last quarter of 2017, international green bond issuance exceeded the symbolic threshold of $100 billion. With the total in late December surpassing $117 billion, the market had already significantly exceeded last year's total. Overall in 2017 green bond volume was fast approaching the range of $120-130 billion, thus meeting market expectations. To underline continued momentum, October and November ($17 billion) both set new monthly records for issuance. Less discussed is the fact that total outstanding green bonds are now as a result in the order of $300 billion, underlining the meaningful scale and investability of this market.

In terms of market structure, European issuers represent more than half of the market, with France being the leading issuer within that group, notably through the contribution of its sovereign green bond that represents almost €10 billion after the second tap in December 2017. China has been the leading source of volume, alongside France, closely followed by the US. It is important to underline the continuing internationalisation of the market, with issuers from around 40 countries in a growing range of currencies.

Two key developments concerning issuer diversification are the progress with corporates, representing more than a third of issuers in 2017, and the entry of sovereign issuers, that are just under 10% of total issuance. Other than the landmark sovereign issue from France, there were very symbolic sovereign deals with the first sovereign issues from developing nations represented by Fiji and Nigeria. Financial sector issuance continued to diversify, with new bank issuers and the first issue by a life insurer, Manulife.

Regulatory recognition and initiatives

The GBP continue to represent the indispensable reference for policy makers and regulators, when they consider

The GBP continue to represent the indispensable reference for policy makers and regulators.

Launch of the ASEAN Green Bond Standards with (right to left) Attorney Teresita Herbosa, Co-Chair of the ACMF Green Finance Working Group, Tan Sri Dato' Seri Ranjit Ajit Singh, Chair of ASEAN Capital Markets Forum (ACMF) and Chairman of Securities Commission Malaysia, Khun Rapee Sucharitakul, Vice Chair of the ACMF, Mushtaq Kapasi, Chief Representative Asia Pacific ICMA.

potential guidance or regulatory initiatives on a national or regional level in the green bond space. When requested, the GBP Executive Committee (GBP Excom), with the support of the ICMA Secretariat, provides feedback on the content and potential implications of such initiatives. This is done with the objective of promoting compatibility with the GBP and practices in the international green bond market.

The GBP Excom thus gave detailed input into the ASEAN Green Bond Standards (GBS) that were published in November 2017 by the ASEAN Capital Markets Forum (ACMF), a forum which comprises capital market regulators from 10 ASEAN jurisdictions, namely Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. The ASEAN GBS are aligned with and guided by the four core components of the GBP, and also include the following key additional features:

- Eligible Issuers must have a geographical or economic connection to the region.
- Fossil fuel power generation projects are explicitly excluded from the ASEAN GBS.
- There are requirements for public and online availability of information on use of proceeds, project evaluation and selection, and management of proceeds.
- External reviewers' credentials and scope of review conducted must be made publicly accessible.
- More frequent reporting from issuers is encouraged.

In the EU, ICMA is providing, as a significant observer, input into the work of the High-Level Expert Group (HLEG) on Sustainable Finance advising the European Commission. This is particularly the case for the workstreams concerning a possible EU Green Bond Standard and a future EU Sustainability Taxonomy, and also to a lesser degree on the discussions concerning "investor duties" (currently the subject of an ongoing consultation). ICMA is supportive of the taxonomy work, but is also arguing for the proposals for the green bond market to be closely related and compatible with the GBP. Generally, ICMA is recommending that the Commission should aim, as much as possible, to achieve its policy goals by working with successful market initiatives rather than through potentially unwieldy regulation in the area of sustainable finance.

During the One Planet Summit organised in Paris in December 2017, to mark the second anniversary of the Paris Agreement, European Commissioner Valdis Dombrovskis identified in his speech on *Greening Finance for Sustainable Business* some early priorities following input from the HLEG, as well as the Commission's own reflections on the topic. These are that the Commission (i) "integrate sustainability factors into investment mandates ", (ii) develop an "EU taxonomy for sustainable finance", (iii) "define EU standards and labels for green bonds and green investment funds" and (iv) "amend capital charges for banks to boost green investments and loans by introducing a so-called green supporting factor".

The first three priorities were consistent with expectations and the HLEG's interim report. The last recommendation on a green supporting factor should be underlined. It relates to a potential policy proposal from the Commission that raises technical issues (eg in terms of defining eligible green assets), and would also impact banking and insurance regulation in a manner for which there is no current consensus among the prudential authorities. (See the recent paper from UNEP Enquiry on the *Role of Central Banks in Enhancing Green Finance*).

Finally, ICMA has joined the effort initiated by the International Organization for Standardization (ISO) to develop an international standard for green bonds with a focus on environmental performance. This future standard is formally referred to as *ISO/NP 14030 Green Bonds – Environmental Performance of Nominated Projects and Assets*. Its development is currently scheduled to take up to 36 months and involves market participants and wider stakeholders. ICMA's focus will be once again to ensure compatibility with the GBP and practices in the international green bond market

Supporting best practice

ICMA has been nominated as an observer on the Evaluation Council of France's green sovereign bond. The French Government is committed to publishing reports on the *ex-post* environmental impact of eligible green expenditure at appropriate intervals. This commitment is also intended to contribute to setting high standards in the market. The Evaluation Council will define the specifications and schedule for evaluation reports on the environmental impact of Eligible Green Expenditure financed by France's green sovereign bond. It will also give its opinion on the quality of the evaluation reports and the impact and relevance of the findings. The Green OAT Evaluation Council is chaired by Manuel Pulgar-Vidal, former Minister for the Environment in Peru, president of UNFCCC COP20 and WWF Global Climate and Energy Practice Leader. Its members are seven independent experts, as well as two observers. These are:

- Mats Andersson, Vice-Chairman of the Global Challenges Foundation, Chairman of PDC and former CEO of AP4, Sweden's fourth national pension fund;
- Nathalie Girouard, Head of the Environmental Performance and Information Division of the Environment Directorate at the OECD;
- Ma Jun, Director of the Center for Finance and Development and Special Adviser to the Governor of the People's Bank of China;
- Karin Kemper, Senior Director for the Environment and Natural Resources Global Practice at the World Bank;
- Sean Kidney, co-founder and CEO of the Climate Bond Initiative (as observer);
- Nicholas Pfaff, Senior Director and Secretary to the Green Bond Principles, ICMA (as observer);
- Thomas Sterner, Professor of Environmental Economics at the University of Gothenburg;
- Eric Usher, Head of the Secretariat of the United Nations Environment Program Finance Initiative.

The members of France's Green OAT Evaluation Council with Brune Poirson, France's Secretary of State to the Minister for the Ecological and Inclusive Transition, and Anthony Requin, CEO of Agence France Trésor.

Promoting the green and social bond market

On 2 November, ICMA held an innovative and successful green and social bond event focused on Asia and Japan. It was co-hosted with the Japan Securities Dealers Association in Tokyo. It is the first large scale ICMA event on the GBP & SBP outside Europe. The conference was over-subscribed, with 400 participants. There were 36 speakers, including several from the official sector at a high level (Governor of Tokyo, Japan Ministry of Environment, ASEAN Capital Markets Forum etc.) and many senior private sector speakers. The sponsorship of the conference was also wide (JSDA, BNP Paribas, EIB, Daiwa, Mizuho, Nomura, Moody's), indicative of the appeal of the event. Given the highly favourable outcome, the event will be repeated in autumn 2018.

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Sustainable finance

Personal view by René Karsenti

Regarding the market for sustainable finance, the following trends seem worth watching:

Further mainstreaming through growth and internationalisation:

- I note especially the uptake in market interest in Asia. It is no longer only in China, but also in Japan and the ASEAN countries.
- Key sustainability initiatives are coming from Europe, and are likely to have global repercussions. These include the anticipated release of an EU Sustainability Taxonomy, starting with a focus on climate mitigation.
- The mainstreaming of climate change and ESG considerations through disclosure and investor duties.
- And standards spreading across asset classes, beginning with Green Loans integrating the architecture of the Green Bond Principles (GBP).

On the *regulatory front*, attention to sustainability continues to grow: European Supervisory Authorities were called upon to integrate sustainability in their remit. I can see ESMA responding to this: I feel that it may be timely and, as a member of ESMA's Securities and Markets Stakeholders' Group, I welcome it and will be contributing to it.

There are also some powerful undercurrents propelling these developments:

The political response: With the Paris Agreement and positive potential for green and social finance, it is no accident that President Macron convened a range of influential leaders to discuss the role of finance during the One Planet Summit. From my vantage point also as a contributor to the Social Impact Taskforce of the G7, I can see further evidence of how social considerations in the broader sense, and how finance can contribute, are important features of leaders' agendas.

Broadening the market: Another driving force that I see prominently is the diversification of market participants and products in the sustainability space. As the sustainability concept overall goes mainstream on the buy side, with ESG integration a pervasive trend, the market is also harbouring a range of new and innovative segments. These include green securitisations such as MBS, social venture capital and impact investing.

ICMA's proactive role: ICMA is sensitive to the wider trends towards sustainability in the markets. Building on the practical value of the GBP and Social Bond Principles, it has led to the establishment of the Global Green Finance Council, an assembly composed mainly of trade associations, offering a one-stop shop for cross-fertilizing best practice across asset classes. Green Loan Principles are likely to be an early product of this effort. We hope to make sustainability an effective part of the market's DNA.

The transformational impact of generational change: Millennials and other younger demographics are thinking differently about finance. As we hear through our ICMA Future Leaders Council, motivations for entering the finance industry are increasingly influenced by sustainability. Financial return combined with social return. We should be grateful to these younger generations who are bringing us back to the fundamentals of finance which were mostly forgotten and had led us to the financial crisis.

Indeed, green and sustainable finance is the future of finance. All of us should feel privileged to contribute in particular to a vital low carbon transformation of the economy and other social impacts.

This future of finance is when finance favours long term solutions; when finance through innovation and new technologies, connects to the real economy; when finance is mindful of its environmental and social impacts, when finance invests in the future; when finance save lives. "The world does not belong to us, it is lent to us by our children." Together we are responsible to achieve it.

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International Regulatory Digest


by David Hiscock and Alexander Westphal

G20 financial regulatory reforms

On 6 October 2017, the FSB Plenary met in Berlin. The FSB reviewed its workplan for the remainder of 2017 and 2018; and Argentina's Plenary members briefed the meeting on the potential themes for the finance track of the Argentine G20 Presidency in 2018. Work coordinated by the FSB to agree the international post-crisis policy reform agenda is nearly complete, but, in some cases, important policies have yet to be fully operationalised – so monitoring and publicly reporting on member jurisdictions' implementation of agreed reforms remains a priority. Meanwhile, in a number of areas post-implementation evaluation of the effects of the reforms is becoming possible, which can inform adjustments where needed. The FSB is also monitoring, and addressing where needed, new and emerging risks; and, as such, the Plenary assessed potential vulnerabilities in the financial system and discussed a number of specific items.

The Plenary agreed that the FSB, in coordination with the relevant standard-setting bodies, should undertake an evaluation of the effects of reforms on financial intermediation, to be carried out as part of the FSB's framework for post-implementation evaluation of the effects of the G20 financial regulatory reforms. The evaluation of effects will comprise (i) in advance of the 2018 Argentine G20 Summit, examination of trends in the financing of infrastructure investment; and (ii) examination of intermediation trends by broad financing source (including bank financing and market-based financing), across types of borrowers and across countries. A separate evaluation, to review the incentives for central clearing of OTC derivatives, began in July and will conclude in late 2018.

The Plenary also:

- discussed the progress of the annual reviews of the lists of G-SIBs and G-SIIs; and received an update on the work by the BCBS and the IAIS to assess any cross-sectoral inconsistencies in the assessment methodologies for G-SIBs and G-SIIs;
- reviewed the results of a stocktake of existing publicly available regulations

The FSB, in coordination with the relevant standard-setting bodies, should undertake an evaluation of the effects of reforms on financial intermediation.

and supervisory practices with respect to cyber-security in the financial sector, as well as existing international guidance; and discussed key themes raised in a public-private sector workshop held in September;

- discussed progress in the development of a toolkit to strengthen governance frameworks to mitigate misconduct risks, which is planned to be published in April 2018; and approved for publication shortly a progress report on reforms to major interest rate benchmarks; and
- received updates on the annual global shadow banking monitoring exercise, the results of which will be published by end-2017, and the operationalisation, by IOSCO, of relevant FSB policy recommendations to address structural vulnerabilities from asset management activities; and approved the operational arrangements to initiate data collection and aggregation of global SFTs, beginning with end-2018 data – the detailed reporting guidelines will be published later this year.

FSB members asked the FSB Chair, Mark Carney, whose second term would have come to an end on 4 November 2017, to serve for a further period until 1 December 2018; and the Plenary agreed the appointment of Dietrich Domanski to succeed its current Secretary General, Svein Andresen, who is leaving the position in January 2018.

The Annual Meetings of the Boards of Governors of the World Bank Group and the IMF took place in Washington, DC, on 9-15 October. Submitted versions of statements and videos relating to these Annual Meetings have been published. One of the meetings held during this period was the 36th meeting of the International Monetary and Financial Committee (IMFC), on 14 October, chaired by Agustín Carstens, Governor of the Bank of Mexico. The *communiqué* of this meeting includes a paragraph regarding safeguarding financial stability, which says: "We will continue to strengthen the resilience of the financial sector to support growth and development, including addressing legacy issues in some advanced economies and vulnerabilities in some emerging market economies, as well as monitoring potential financial risks associated with prolonged low interest rates and continued accommodative monetary policy. Effective financial supervision and macroprudential frameworks are key to guard against financial stability risks. We stress the importance of timely, full and consistent implementation of the agreed financial sector reform agenda, as well as finalizing remaining elements of the regulatory framework as soon as possible." Statements given on the occasion of this meeting have been published.

On 18 October, the BCBS published an updated progress report on adoption of the Basel regulatory framework, providing a high-level view of BCBS members' progress in adopting Basel III standards as of end-September 2017. The report focuses on the status of adoption of all the Basel III standards (which will become effective by 2019) to ensure that the Basel standards are transformed into national law or regulation according to the internationally agreed timeframes; and is based on information provided by individual members as part of the BCBS's Regulatory Consistency Assessment Programme. The report includes the status of adoption of the Basel III risk-based capital standards, the LCR, the NSFR, the standards for G- and D-SIBs, the Leverage Ratio, the large exposure framework, the interest rate risk in the banking book, and the disclosure requirements.

Since 2010, the FSB has conducted an annual Implementation Monitoring Network (IMN) survey on implementation of agreed G20/FSB recommendations. Dated 3 November, the FSB's report, *Implementation of G20/FSB Financial Reforms in Other Areas*, provides a summary of key findings based on the 2017 FSB IMN survey. This FSB report covers the following areas: (1) hedge funds; (2) securitisation; (3) enhancing supervision; (4) building and implementing macroprudential frameworks and tools; (5) improving oversight of CRAs; (6) enhancing and aligning accounting standards; (7) enhancing risk management; (8) strengthening deposit insurance; (9) safeguarding the integrity and efficiency of financial markets; and (10) enhancing financial consumer protection.

On 8 November, the Board of IOSCO published a report on the implementation of the G20/FSB post-crisis recommendations aimed at strengthening securities markets. This report has been prepared by IOSCO's Assessment Committee and is designed to provide further clarity on the recommendations and the role of securities market regulators in overseeing how these recommendations are implemented. For this report IOSCO coordinated with the FSB to analyse the responses to the FSB's 2017 IMN survey. IOSCO's report finds that most responding jurisdictions have taken steps to implement the G20/FSB recommendations and IOSCO guidance in each of the designated areas. Similar to last year, implementation is most advanced with respect to hedge funds, structured products and securitisation, and the oversight of CRAs. In the area of safeguarding the integrity and efficiency of markets, where progress in implementation has lagged, jurisdictions reported that they have undertaken some work to harmonise and strengthen their rules.

On 21 November, the FSB published the 2017 list of G-SIBs, using end-2016 data and an assessment methodology designed by the BCBS. The list comprises 30 banks. One bank (Royal Bank of Canada) has been added to the list of G-SIBs identified in 2016 and one bank (Groupe BPCE) has been removed, and therefore the total number of G-SIBs remains the same. In connection with this, the BCBS released further information related to the 2017 G-SIB assessment. At the same time, the FSB announced that, in consultation with the International Association of Insurance Supervisors (IAIS) and national authorities, it had decided not to publish a new list of global systemically important insurers (G-SIIs) for 2017. In November 2018 the FSB will review the situation based on the then progress made by the IAIS in developing the activities-based approach.

On 30 November, the FSB issued for consultation (for comment by 2 February 2018) two proposals for guidance on the implementation of particular aspects of its *Key Attributes of Effective Resolution Regimes* for G-SIBs, thereby supporting the application of the overall policy framework to end "too-big-to-fail". The first, *Principles on Bail-in Execution*, proposes a set of principles to assist authorities as they make G-SIB bail-in resolution strategies operational. And, the second, *Funding Strategy Elements of an Implementable Resolution Plan*, sets out proposed guidance on the development of a plan for funding in resolution.

As from 1 December, Argentina assumed the Presidency of the G20 and will conclude its term with a G20 Leaders' Summit in Buenos Aires, on 30 November-1 December 2018. The Presidency's proposed agenda focuses on three themes: the future of work and what this means for education, infrastructure for development, and food security for a sustainable future. The more detailed overview of Argentina's G20 Presidency 2018 includes a section on continuing work towards a strong and sustainable financial system. This says: "The G20's programme of financial sector reforms has made the system resilient. Substantial progress has been made in making financial institutions more resilient, ending the problem of "too-big-to-fail", transforming shadow banking into sounder market-based finance and making derivatives markets safer. We will work toward the full completion of the financial reform package and its implementation, assess its initial effects on the economy, particularly on infrastructure, and continue to monitor any risks to financial stability." Kicking off the finance track, a first meeting of Finance and Central Bank Deputies was held on 30 November in Bariloche and a second such Deputies' meeting will immediately precede a first meeting of Finance Ministers and Central Bank Governors, scheduled for 19 March.

On 7 December, the BCBS's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), endorsed the outstanding Basel III post-crisis regulatory reforms, which include the following elements:

- a revised standardised approach for credit risk, which will improve the robustness and risk sensitivity of the existing approach;
- revisions to the internal ratings-based approach for credit risk, where the use of the most advanced internally modelled approaches for low-default portfolios will be limited;
- revisions to the credit valuation adjustment (CVA) framework, including the removal of the internally modelled approach and the introduction of a revised standardised approach;
- a revised standardised approach for operational risk, which will replace the existing standardised approaches and the advanced measurement approaches;
- revisions to the measurement of the Leverage Ratio and a leverage ratio buffer for global systemically important banks (G-SIBs), which will take the form of a Tier 1 capital buffer set at 50% of a G-SIB's risk-weighted capital buffer; and
- an aggregate output floor, which will ensure that banks' RWAs generated by internal models are no lower than 72.5% of RWAs as calculated by the Basel III framework's standardised approaches – banks will also be required to disclose their RWAs based on these standardised approaches.

A short description of the agreed reforms is set out in a summary document accompanying the final standards' text detailing the reforms and the BCBS's assessment of their quantitative impact. The revised standards will take effect from 1 January 2022 and will be phased in over five years. The BCBS has established a programme to evaluate its post-crisis reforms and will actively participate in the FSB's efforts to evaluate the effects of reforms. GHOS members acknowledged ongoing challenges related to implementing certain bank capital reforms, in particular the most complex standards; and therefore endorsed the BCBS's proposal to extend the implementation date of the revised minimum capital requirements for market risk, which were originally set to be implemented in 2019, to 1 January 2022 – thus aligning implementation of the revised market risk framework with the now finalised Basel III revisions for credit risk and operational risk. This will allow banks additional time to develop the systems infrastructure needed to apply the framework and for the BCBS to address certain specific issues related to the market risk framework, including a review of the calibrations of the standardised and internal model approaches to ensure consistency with the BCBS's original expectations.

GHOS members also reaffirmed their expectation of full, timely and consistent implementation of all elements of this package, including the minimum capital requirements for market risk. The standards agreed by GHOS constitute minimum standards and, as such, jurisdictions may elect to adopt more conservative

GHOS members acknowledged ongoing challenges related to implementing certain bank capital reforms.

standards. Moreover, jurisdictions will be considered compliant with the Basel framework if they do not implement any of the internally modelled approaches and instead implement the standardised approaches.

Additionally, the BCBS has now completed its review of the regulatory treatment of sovereign exposures, mandated by the GHOS in January 2015, and, also on 7 December, published a discussion paper (for comment by 9 March 2018) on this topic. The BCBS is of the view that the issues raised by its review and the potential ideas outlined in the discussion paper are important, and could benefit from a broader discussion. However, the BCBS has not reached a consensus on making any changes to the regulatory treatment of sovereign exposures at this stage, and has therefore decided not to consult on the ideas presented in the discussion paper.

On 20 December, the BCBS released a *Consultative Document on Stress Testing Principles* (for comment by 23 March) and a *Range of Practices Report on Supervisory and Bank Stress Testing*. The latter describes and compares supervisory and bank stress-testing practices and highlights areas of evolution, finding that, in recent years, both banks and authorities have made significant advances in stress-testing methodologies and infrastructure. A stress-testing taxonomy is included with a common set of definitions for stress-testing terms to aid the dialogue between banks and supervisors. Given the rapid evolution in stress-testing practices, the BCBS also reviewed its current set of stress-testing principles, as published in May 2009, and the consultative document sets out a proposal to replace this set with a new streamlined version. The proposed new version states the principles at a high enough level to be applicable across many banks and jurisdictions.

At its meeting in December 2017, the BCBS established a procedure for issuing technical amendments, defined as changes to standards that are not substantial in nature but that cannot be unambiguously resolved based on the current text, to its standards. Technical amendments, which are expected to be published for public comment for 45 calendar days, differ from responses to FAQs, which clarify the intention and interpretation of the standards but do not require any change to the standards and are therefore published without public consultation.

On 21 December, the BCBS published its first proposed technical amendment (for comment by 5 February 2018), which is related to the treatment of extraordinary monetary policy operations in the NSFR. To provide greater flexibility in the treatment of extraordinary central bank liquidity-absorbing monetary policy operations, the technical amendment proposes to allow reduced required stable funding factors for central bank claims with maturity of more than six months.

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Chinese policy developments

by Ricco Zhang

Chinese Ministry of Finance: On 10 November 2017, the Chinese Ministry of Finance announced new measures to further open up the financial sector in China to foreign investors.

- For securities companies, mutual fund management companies and futures companies regulated by the China Securities Regulatory Commission (CSRC), foreign ownership limits, whether held directly or indirectly, on a single entity or aggregated basis, will be increased from 49% to 51%. Furthermore, three years after the above measures have been implemented, any remaining limits on foreign ownership will be removed.
- For domestic commercial banks and financial asset management companies regulated by the China Bank Regulatory Commission (CBRC), the foreign ownership limit of 20% on a single entity basis and 25% on an aggregated basis will be removed, and foreigners will be subject to the same requirements on equity ownership as Chinese nationals.
- For insurance companies regulated by the China Insurance Regulatory Commission (CIRC), in three-year time the foreign ownership limit on insurance companies engaged in personal insurance business will increase to 51%, whether on a single entity or aggregated basis. Over the next five years, the foreign ownership limit will be removed altogether.

The CSRC, CBRC and CIRC are expected to amend their rules accordingly in order to implement the changes.

Communist Party Congress: Also, more generally, the 19th Communist Party Congress (CPC) took place in October 2017. The Chinese Government announced its policy priorities for the next five years. The priorities in the financial sector most relevant to the international capital market are summarized below.

- President Xi Jinping emphasised in his speeches at the 19th CPC to uphold Deng Xiaoping's policy of "opening up and reform". RMB liberalisation and the opening of domestic financial markets are likely to continue, especially since cross-border flows and RMB valuations have stabilised in 2017. One aspect of this policy will be to attract more international institutions to participate into the Chinese market through such initiatives as Bond Connect.
- China will focus on anti-pollution controls, which is expected to have positive implications for sustainable finance and green bonds.
- The Belt and Road initiative will remain a priority. ICMA expects that the Government will welcome panda bond issuance from Belt and Road countries.
- Further policy tightening is expected to stabilise the onshore securities markets and housing markets.

UK-China Economic and Financial Dialogue: ICMA continues to work closely with Chinese policy makers to promote research and cooperation on bond market opening and development. In particular, pursuant to the 9th UK-China Economic and Financial Dialogue, ICMA has established an international working group with China's National Association of Financial Market Institutional Investors (NAFMII) and the City of London to facilitate foreign investment and issuance into the Chinese domestic bond market.

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Together with the CMU, a complete Banking Union will promote a stable and integrated financial system in the EU.

European financial regulatory reforms

On 29 September 2017, EIOPA published its 2018 Work Programme (WP), highlighting and specifying its activities and tasks for the coming year, within the framework of a multiannual work programme 2017-2019. InsurTech is on the rise and it is expected to further expand in importance and dimension for the insurance and pension industries and the authorities that supervise them, so EIOPA has made InsurTech a cross-cutting theme of its annual WP. Further details within EIOPA's WP are presented to show how the work fits against four strategic objectives:

(i) to strengthen the protection of consumers;

(ii) to improve the functioning of the EU internal market in the field of pensions and insurance;

(iii) to strengthen the financial stability of the insurance and occupational pensions sectors; and

(iv) EIOPA to be a responsible, competent and professional organisation.

Then, on 5 October, ESMA published its 2018 WP, which sets out its priorities and areas of focus for 2018 in support of its mission to enhance investor protection and promote stable and orderly financial markets. The 2018 WP takes into account ESMA's Strategic Orientation 2016-2020 and reflects the shift in focus of ESMA's work, from building the single rulebook, towards two key activities: supervisory convergence and assessing risks. In addition, the possible changes proposed under the ESAs' and CCPs' reviews and ongoing planning for the UK's exit from the EU present a changing environment for ESMA, which will require it to be prepared to adapt and reprioritise the 2018 WP as needed.

For 2018, the key areas of focus under ESMA's activities of supervisory convergence, assessing risks, single rulebook and direct supervision will be:

(i) providing guidance and promoting the consistent application of MiFID II and MiFIR by market participants and NCAs;

(ii) ensuring the quality, integration, usability and transparency of the data that ESMA collects;

(iii) contributing to the development of Level 2 measures in relation to the revised prospectus regime; and

(iv) enhancing the effectiveness and lasting impact of supervisory activities at individual CRA and trade repository levels.

Also on 5 October, the EBA published its detailed annual WP for 2018, describing its specific activities and tasks for the coming year, as well as a multiannual work programme, highlighting the key strategic areas of work from 2018 to 2021. In 2018, the EBA will focus on:

(i) the CRR/CRD and BRRD developments, and review of the consequences of the BCBS's revision of the trading book;

(ii) implementing the data infrastructure and data analysis project to enhance the EBA's role as a data hub for banks in the EU through the expansion of its data infrastructure and analytical capabilities;

(iii) monitoring and evaluating the impact of the UK leaving the EU to protect the public interest;

(iv) evaluating and contributing to the FinTech regulatory perimeter;

(v) fostering proportionality in relation to policy developments; and

(vi) contributing to the European Council's action plan to tackle NPLs in Europe.

On 11 October, the European Commission published a call for the completion of all parts of the Banking Union by 2018. Building on the significant progress already achieved, the Commission's new Communication sets out an ambitious yet, in its view, realistic path to ensure agreement on all the outstanding elements of the Banking Union, based on existing commitments by the Council. This came ahead of the December Euro Summit, in an inclusive format, where completion of the Banking Union was part of discussions on further deepening the EMU. The vision is that, together with the CMU, a complete Banking Union will promote a stable and integrated financial system in the EU. Key features of the Communication encompass:

- quick agreement on the November 2016 package of proposals to reduce risks and strengthen the resilience of EU banks;
- progress on the European Deposit Insurance Scheme, using first a more limited reinsurance phase and then coinsurance, conditional on progress achieved in reducing risks;
- a fiscal backstop to the Banking Union, where a common backstop for the Single Resolution Fund is contemplated on the basis of a credit line from the ESM – this workstream will need to be articulated with the Commission's forthcoming package of proposals for the deepening of Europe's EMU, which will include a proposal to transform the ESM into a European Monetary Fund, within the framework of Union law;
- reducing non-performing loans, where the Commission is already working on a comprehensive package of measures which is due to be adopted in spring 2018 (moreover, in the review report of the SSM, also published on 11 October, the Commission is clarifying the powers of supervisors to adjust banks' provisioning levels with regard to NPLs for supervisory purposes);
- possible measures for sovereign bond-backed securities (SBBS), where the Commission will consider the outcome of the ESRB's work on SBBS with a view to putting forward in 2018 a proposal to enable the development of SBBS; and
- continuing to ensure high-quality supervision, where, as mentioned in the CMU Mid-Term Review, the Commission would also propose in December 2017 that large investment firms carrying out bank-like activities be considered credit institutions and be subject to bank supervision.

On 12 October, the EBA published an *Opinion on Brexit* to ensure the consistent application of EU legislation to businesses seeking to establish or enhance their EU27 presence in order to retain access to the EU Single Market. The Opinion aims at providing greater certainty to firms and ultimately at ensuring a level playing field. In the Opinion, the EBA addresses a number of relevant policy topics relating to authorisations, the prudential regulation and supervision of investment firms, internal models, outsourcing, internal governance, risk transfers via back-to-back and intragroup operations, and resolution and deposit guarantee scheme issues. The EBA will monitor how the Opinion will be applied in practice by authorities and will continue its policy and risk analysis work in relation to the challenges posed by Brexit.

On 17 October, ESMA hosted its first conference, entitled *The State of European Financial Markets*, with over 350 participants from across the European financial sector. Steven Maijoor, ESMA Chair, provided introductory remarks, following which Valdis Dombrovskis, Vice-President of the European Commission, delivered the keynote address. Panel debates addressed the topics of (1) trading and market infrastructures; (2) Brexit; (3) investors and innovation; and (4) the regulatory agenda post-2017. Other keynote speakers were Xavier Rolet, CEO, London Stock Exchange; Roberto Gualtieri MEP, Chair of ECON; and Ashley Alder, Chairman, IOSCO. The speeches have been published and a video playback of the event is available.

On 18 October, the ECB hosted a conference on structural reforms in the euro area. Following some welcome remarks, the conference started with a speech given by the ECB President, Mario Draghi. The conference then comprised three panel sessions: (1) reforms, productivity, resilience and long-term well-being; (2) political economy of reforms; and (3) reforms and governance in the EMU. The text of the opening speech and presentations given by the panellists have been published.

On 23 October, the ECB published a *Report on Financial Structures*, which shows ongoing consolidation in the banking sector. The number of credit institutions declined further in 2016, bringing the cumulative decline since 2008 to 25%. Alongside of this, euro area banks' median CET1 ratio rose to 15.4 % in 2016, from 14.4 % in 2015; the financial sector expanded in 2016, reflecting growth in both banks' and non-banks' assets; and assets in the investment fund sector grew by 7% in 2016.

Following on from the announcements made in President Juncker's 2017 State of the Union Address, on 24 October, the European Commission presented its 2018 Work Programme. The focus of the 26 new initiatives in this Work Programme is two-fold. First, there are targeted legislative actions to complete work in priority policy areas, which will all be tabled by May 2018 to allow the European Parliament and Council to complete the legislative work before the European elections of June 2019.

Second, there are ambitious actions and initiatives that have a more forward-looking perspective, as the new Union of 27 shapes its own future for 2025 and beyond. From a financial markets standpoint, the most immediately relevant segments of the work programme are "a deeper and fairer Internal Market with a strengthened industrial base" (page 5) and "a deeper and fairer Economic and Monetary Union" (page 6). Related to these segments, page 4 of Annex I (new initiatives) includes line items for completing CMU, EMU and Banking Union; and on pages 7-10 in Annex III (priority pending proposals) there are line items for, among others, PEPP, amendments to EMIR, CRR, BRRD, CCP R&R and EDIS. Also of note, on page 2 of Annex IV (withdrawals) it is reported that, as there is no foreseeable agreement, the Commission plans to withdraw its proposal for bank ring-fencing.

On 25 October, the Commission welcomed political agreement to fast-track selected parts of the 2016 EU Banking Reform package, tripartite agreement having been reached on elements of the review of the BRRD and of the CRR/CRD. The agreement on the BRRD creates a new category of unsecured debt in bank creditors' insolvency ranking, establishing an EU harmonised approach on the priority ranking of bank bondholders in insolvency and in resolution. The agreement on the CRR/CRD implements the new IFRS 9 and will help mitigate the impact of the IFRS 9 standards on EU banks' capital and ability to lend. It will also avoid potential disruptions in government bond markets that would result from rules limiting large exposures to a single counterparty.

On 26 October, a technical report, by the staff of the European Commission, was published, which outlines the policy actions taken by EU countries in the financial sector between 2008 and 2015 in response to the global financial crisis. The report looks at reforms both at European and national level and shows that decisive action in the aftermath of the crisis paid off: credit growth to the private sector has been expanding, although the situation remains uneven across the EU. Confidence has returned to the financial sector, with a lower reliance on central bank borrowing; and banks are stronger thanks to higher capital buffers. Still, work is continuing to address vulnerabilities, such as the high level of NPLs and yield spreads.

In context of its work on convergence, on 30 October, the EBA published an update of all the information disclosed by EU Competent Authorities according to its ITS on supervisory disclosure, which were published in the EU *Official Journal* on 4 June 2014. This information, published in an aggregated format, provides an overview of the implementation and transposition of the CRD IV and CRR across the EU. It also provides a detailed picture of the use of options and national discretions by each Competent Authority as well as information on the general criteria and methodologies used for the purpose of the supervisory review and evaluation process. The information disclosed on the implementation and transposition of the CRD IV package covers all EU jurisdictions and includes, for the first time, information provided by the SSM.

On 15 November, the Joint Committee of the ESAs published its Work Programme for 2018. In 2018, under ESMA's chairmanship, the three ESAs will, in particular, focus on: (i) microprudential analysis of cross-sectoral developments; (ii) assessment of risks and vulnerabilities for financial stability; (iii) consumer protection issues relating to retail investment products; (iv) supervisory cooperation for anti-money laundering supervision; (v) coordination of financial conglomerate matters; and (vi) accounting and auditing issues. In addition, the Joint Committee will continue to serve as an important forum for addressing other developments with cross-sectoral impact, such as Brexit and the ongoing legislative changes so as to enhance the operation of the ESAs.

Acting swiftly following an agreement reached, on 20 November, by the governments of the EU27, on 29 November, the European Commission made a legislative proposal to amend the founding Regulation of the EBA. This proposal is strictly limited to confirming the new seat of the EBA, which as a direct consequence of Brexit is being relocated from London to Paris. Under the ordinary legislative procedure, the European Parliament and the Council are expected to give priority to the handling of this proposal.

On 30 September 2015, the European Commission launched a Call for Evidence on the EU regulatory framework for financial services and, in November 2016, the Commission then adopted a Communication on the follow-up to the Call for Evidence. The Commission concluded that, whilst the financial services framework in the EU was generally working well, targeted follow-up measures were justified in four areas. Many of these follow-up measures fed into reviews of individual pieces of legislation; the implementation of ongoing policy work; the calibration of Level 2 technical standards and upcoming Level 1 texts; and the EU's input in global fora.

One year on from the adoption of that Communication, a 1 December progress report published by the Commission provides a fresh update on the follow-up to the Call for Evidence. There are two main messages emphasised by the Commission in this context: (1) the Commission has been active in tackling the issues identified by stakeholders in the Call for Evidence process and continues to do so to ensure that EU legislation remains fit for purpose; and (2) the Commission is working to ensure that the regulatory compliance framework is fit for the digital age, where possible through automation and standardisation – which should ultimately lead to reducing the burden for industry and result in better financial supervision.

On 6 December, building on the vision set out in the Five Presidents' Report of June 2015 and the Reflection Papers on the *Deepening of the Economic and Monetary Union (EMU)* and *the Future of EU Finances* of spring 2017, the European Commission set out a *Roadmap for Deepening the EMU*, including concrete steps to be taken over the next 18 months. The overall aim is to enhance the unity, efficiency and democratic accountability of Europe's EMU by 2025. Deepening the EMU is considered as a means to an end: more jobs, growth, investment, social fairness and macroeconomic stability; and this Roadmap reflects remaining challenges and sets out a way ahead.

In addition to the Roadmap, the Commission's new package includes four main initiatives:

- a proposal to establish a European Monetary Fund (EMF), anchored within the EU's legal framework and built on the well-established structure of the ESM;
- a proposal to integrate the substance of the Treaty on Stability, Coordination and Governance into the Union legal framework, taking into account the appropriate flexibility built into the Stability and Growth Pact and identified by the Commission since January 2015;
- a Communication on new budgetary instruments for a stable euro area within the Union framework setting out a vision of how certain budgetary functions essential for the euro area and the EU as a whole can be developed within the framework of the EU's public finances of today and tomorrow;
- a Communication spelling out the possible functions of a European Minister of Economy and Finance who could serve as Vice-President of the Commission and chair the Eurogroup, as is possible under the current EU Treaties.

On 7 December, the EBA welcomed the agreement reached on the finalisation of the Basel III framework by the BCBS and published a summary of the results, showing the impact of the agreed reforms on the EU banking sector. The EBA supports the aim of the global agreement to restore credibility and comparability of regulatory capital metrics. In this respect, the EBA has been fully engaged in reducing excessive variability of risk-weighted assets through a regulatory roadmap aimed at effectively harmonising definitions and parameters of internal models. Subsequently, on 20 December, the EBA published its full assessment quantifying the impact of the reform package. Overall, the results, based on data as of 31 December 2015, show that European banks' minimum Tier 1 capital requirement would increase by 12.9% at the full implementation date. To comply with the new framework, EU banks would need €17.5 billion of additional CET1 capital, and the total capital shortfall would be €39.7 billion.

On 18 December, the EBA published its Fourth Impact Assessment Report for the liquidity coverage ratio (LCR), which shows that EU banks have continued to improve their LCR since 2011. At the reporting date of 31 December 2016, EU banks' average LCR was significantly above the 100% minimum requirement, which is to be fully implemented by 1 January 2018. In addition, a more in-depth analysis suggests that the LCR regulation, together with capital standards and stable funding, have helped banks increase their lending to real economy. The report is based on liquidity data and wider bank balance sheet statistics from 157 EU banks across 16 Member States.

As discussions on the UK's future relationship with the EU continue, on 20 December, the Bank of England announced a consultation (for comment by 27 February 2018) on an updated approach to authorising and supervising international banks and insurers, and its issuance of guidance on its approach to international CCPs. The foundation of the Bank of England's approach is the presumption that there will continue to be a high degree of supervisory cooperation between the UK and the EU. On this basis, EEA banks and insurers may (if they are not conducting material retail business) apply for authorisation to operate as a branch in the UK. There are expected to be no implications of the proposed policy for the current operations of banks and insurers from non-EEA countries such as the US, Switzerland and Japan.

Alongside this, the UK FCA published a statement on EU withdrawal and the UK Chancellor issued a written statement. The latter reports that, as requested by the Bank and the FCA, the Government will, if necessary, bring forward legislation which will:

- enable EEA firms and funds operating in the UK to obtain a "temporary permission" to continue their activities in the UK for a limited period after withdrawal;
- ensure that contractual obligations, such as insurance contracts, which are not covered by the temporary permissions regime, can continue to be met;
- ensure that UK authorities are able to carry out functions currently undertaken by EU authorities, with the Bank of England to be given functions and powers in relation to non-UK CCPs and CSDs; and provide for a temporary regime to enable the Bank to permit these firms to continue to operate in the UK for a limited period after exit; and
- provide the FCA with functions and powers in relation to UK and non-UK CRAs and Trade Repositories and any powers necessary to manage the transition post-exit.

On 20 December, the European Commission proposed a two-track overhaul to make life simpler for smaller investment firms, while bringing the largest, systemic ones under the same regime as European banks. The new rules split non-systemic investment firms into two groups. The capital requirements for the smallest and least risky investment firms will be set in a simpler way. The rules will be comprehensive and robust enough to capture the risks of investment firms, yet flexible enough to cater to various business models and ensure that these firms can remain commercially-viable. These firms would not be subject to any additional requirements on corporate governance or remuneration.

For larger firms, the rules introduce a new way of measuring their risks based on their business models. For firms which trade financial instruments, these will be combined with a simplified version of existing rules. The proposal further defines as credit institutions those systemic investment firms which carry out certain bank-like activities (ie underwriting and dealing on own account) and have assets over €30 billion. These systemic firms will be fully subject to the same treatment as banks. As announced in the Commission's review of the ESAs, this means that their operations in Member States participating in the Banking Union are subject to direct supervision by the ECB in the SSM.

As from 1 January 2018, a decade after its accession to the EU, Bulgaria has taken over the rotating Presidency of the Council of the EU for the first time. Considering that the EU is at the doorstep of key reforms aimed at making it stronger, more united and more democratic, Bulgaria's Presidency has identified four priority areas, which reflect these reforms: (i) the future of Europe and the young people – economic growth and social cohesion; (ii) European perspective and connectivity of the Western Balkans; (iii) security and stability in a strong and united Europe; and (iv) digital economy and skills of the future. Bulgaria is part of a trio, with Estonia preceding it and Austria succeeding it.

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Financial benchmarks

On 10 October, the FSB published a progress report on implementation of its 2014 recommendations to reform major interest rate benchmarks such as key interbank offered rates (IBORs). In brief, the progress report concludes that IBOR administrators have continued to take important steps to implement the FSB's recommendations, including steps to adjust methodologies used to calculate benchmark rates. However, in the case of some IBORs, such as LIBOR and EURIBOR, underlying reference transactions in some currency-tenor combinations are scarce and submissions therefore necessarily remain based on a mixture of factors including transactions and judgement by submitters. Regulators have taken a number of steps to address these issues, including developing powers to require mandatory contributions to benchmarks, but it remains challenging to ensure the integrity and robustness of benchmarks and it is uncertain whether submitting banks will continue to make submissions over the medium to long term.

Limited progress has been made to date on migration from major IBORs to RFRs even where they are already available.

Regulators in some FSB jurisdictions have made good progress in supporting workstreams focused on identifying new or existing RFRs that could be used instead of IBORs in a range of contracts, in particular derivatives. However, limited progress has been made to date on migration from major IBORs to RFRs even where they are already available. The official sector has also actively engaged with ISDA to tackle the risks associated with permanent discontinuation of widely used IBORs. It is also important that work on contract robustness is extended to other non-derivative markets where contracts reference IBORs such as mortgages, loans, floating rate notes and futures contracts. The FSB will publish another progress report in 2018.

As reported in this section of Issue 47 of the ICMA Quarterly Report, the Bank of England and the UK FCA are guiding the market to consider how to transition from LIBOR, now that SONIA had been chosen as the preferred near risk-free interest rate (RFR) benchmark for use in sterling derivatives and relevant financial contracts. In this context, on 29 November, the Bank of England and the UK FCA announced the next phase of work with market participants on LIBOR transition in the sterling market, including that ICMA will Chair a new sub-group which will be formed to focus on benchmark transition issues in bond markets. The Quarterly Assessment within this issue of ICMA Quarterly Report provides a more detailed description of work regarding *The Transition From LIBOR*.

Furthermore, as reported in this section of Issue 47 of the ICMA Quarterly Report, on 21 September, the Financial Services and Markets

Authority (FSMA – the Belgian financial regulatory agency), ESMA, the ECB and the European Commission announced the launch of a new working group tasked with the identification and adoption of a risk-free overnight rate which can serve as a basis for an alternative to current benchmarks used in a variety of financial instruments and contracts in the euro area. Consequently, also on 29 November, the FSMA, ESMA the ECB and the European Commission published a formal call for expressions of interest (by 12 January 2018) in participating in this Working Group on Euro Risk-Free Rates. This call is primarily aimed at credit institutions, which will constitute the voting members of the working group and are expected to take the lead in the reform process. Other, non-banking institutions or associations may also flag their interest in contributing to the activities of the working group and its future substructures, and ICMA will be doing so.

As also reported in this section of Issue 47 of the ICMA Quarterly Report, on 5 July 2017, ESMA published its Q&A on practical questions regarding the implementation of the EU Benchmarks Regulation (BMR). On 8 November, ESMA published an updated version of this BMR Q&A, including two new answers. These concern the application of the BMR outside the EU; and transitional provisions applicable to third country benchmarks. Then, on 14 December, ESMA published a further updated version, adding two more new answers. These concern the obligations applicable to administrators in context of authorisation and registration; and requirements for users, regarding the written plans to be produced by supervised entities.

On 19 December, ESMA issued an announcement that it would, as from 3 January 2018 (ESMA's first working day of 2018), begin publishing a register of administrators and third country benchmarks, in accordance with Article 36 of the EU Benchmarks Regulation. ESMA is currently still working on a new technical release of this register, therefore until the new register release is fully available as an IT functionality on its website (in 3Q 2018), ESMA will provide an interim solution which involves it publishing, on a daily basis (ESMA working days), the latest registers' information in a comma-separated values (CSV) file format, available for download.

On 28 December, Commission Implementing Regulation (EU) 2017/2446 amending the BMR was published in the *Official Journal*. With effect from 29 December, this adds LIBOR, administered by ICE Benchmark Administration, to the list of critical benchmarks pursuant to BMR Article 20(1).

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Credit rating agencies

On 11 October 2017, the Board of IOSCO published a report titled *Other CRA Products* (OCPs), which provides market participants with a better understanding of certain non-traditional products and services offered by credit rating agencies (CRAs). These non-traditional products may include, for example, private ratings, confidential ratings, expected ratings, indicative ratings, prospective ratings, provisional ratings, preliminary ratings, one-time ratings, regional ratings, national ratings, point-in-time ratings, scoring, credit default swap spreads, bond indexes, portfolio assessment tools, credit assessments, rating assessments, assessments, fund ratings, data feeds, research or other tools.

This report on OCPs describes six groups of OCPs and their current status, as well as business practices and trends within the CRA industry. It concludes that OCPs should be responsive to the spirit of the four high-level objectives set forth in the IOSCO *Principles Regarding the Activities of CRAs* and which relate to the quality and integrity of the rating process; independence and conflicts of Interest; transparency and timeliness of ratings disclosure; and confidential information. Secondly, it observes that the legal and/or corporate organizational structures chosen by CRAs to engage in an activity or offer a service or product are not indicative of whether they are subject to the Code of Conduct.

ESMA announced the registration of Kroll Bond Rating Agency Europe Limited, based in Ireland, as a CRA under the EU's CRA Regulation, with effect from 13 November 2017. This registration brings the total number of CRAs registered in the EU to 26. Amongst these 26 registered CRAs, three operate under a group structure, totaling 17 legal entities in the EU, which means that the total number of CRA entities registered in the EU is 40.

On 17 November, ESMA published its final report updating its *Guidelines on the Application of the Endorsement Regime* under the EU CRA Regulation. This final report details a number of changes and clarifications to the existing guidelines focusing on the obligations of the endorsing CRA, the conduct of the third-country CRA, and the third-country legal and supervisory framework. It also clarifies ESMA's supervisory powers over endorsed credit ratings and the notion of objective reasons. These guidelines will take effect on 1 January 2019, in order to give CRAs sufficient time to adapt policies and procedures to take into account ESMA's additional guidance on the requirements which are as stringent as EU requirements (which will be developed by ESMA in 2018).

At the same time, ESMA also published its final report on *Technical Advice on CRA Regulatory Equivalence*

These nine countries under assessment continue to meet the requirements for endorsement taking into account the new CRA 3 requirements.

– *CRA 3 Update*. The EU's latest iteration of its CRA Regulation, CRA 3, will enter into force on 1 June 2018 for the purposes of endorsement and equivalence. This technical advice to the European Commission assesses the legal and supervisory framework of the nine jurisdictions (Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore and the US), which until now have been eligible for equivalence and endorsement.

ESMA deems that these nine countries under assessment continue to meet the requirements for endorsement taking into account the new CRA 3 requirements; and ESMA's decision on this is final and not subject to approval. Concerning equivalence, there are currently four certified CRAs located in three non-EU jurisdictions (Japan, Mexico and the US) which rely on this regime. ESMA has concluded that the local legal and supervisory frameworks of these three jurisdictions, as well as of Canada and Hong Kong, meet the objectives of the additional CRA 3 requirements for the purposes of equivalence; but the final determination of equivalence is the exclusive prerogative of the Commission. As the four other jurisdictions' legal frameworks are equivalent to CRA 1 and 2 and parts of CRA 3, ESMA has invited the Commission to explore the possibility to consider granting a transitional period to allow the relevant authorities to further develop their regulatory regimes.

On 20 November, ESMA published an update to its Q&A on the application of the EU CRA Regulation, adding a new section on organisational requirements. This new section addresses the rotation periods applicable to analysts and persons involved in the approval of ratings.

As reported in this section of Issue 47 of the ICMA Quarterly Report, on 18 July, the Joint Committee of the ESAs launched a public consultation to amend the ITS on the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk. Following from this, on 7 December, the Joint Committee of the ESAs duly published two amended ITS on these mappings. The amendments reflect the recognition of five new CRAs and the deregistration of one CRA, while mappings for the other 25 ECAIs covered in the ITS remain unchanged.

On 20 December, ESMA published its annual market share calculation for EU-registered CRAs. The purpose of the market share calculation is to facilitate issuers and related third parties in their evaluation of a CRA with no more than 10% total market share in the EU. This is necessary as the EU CRA Regulation, under Article 8d, says that issuers or related third parties are required to consider appointing a CRA with no more than 10% total market share whenever they intend to appoint one or more CRAs to rate an issuance or entity. This market share calculation is valid for use from its date of publication and applicable until the date of publication of the next Market Share Calculation in 2018.

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OTC (derivatives) regulatory developments

At its meeting on 4-5 October 2017, the BCBS discussed the NSFR standard and agreed to allow national discretion for the NSFR's treatment of derivative liabilities. This is intended to facilitate the implementation of the NSFR, which is expected to begin on 1 January 2018. The NSFR assigns a 20% "required stable funding" factor to derivative liabilities, but the BCBS has agreed that, at national discretion, jurisdictions may lower the value of this factor, with a floor of 5%. The BCBS is considering whether any further revisions to the treatment of derivative liabilities are warranted, and if so, will undertake a public consultation on any proposed changes.

On 13 October, the European Commission announced that it has determined the US to be equivalent to EMIR, in terms of the legal, supervisory and enforcement arrangements for non-centrally cleared OTC derivatives transactions. This decision alleviates regulatory burden for EU and US companies, by allowing market participants to comply with only one set of rules and to avoid duplicative or conflicting rules. In particular, the decision concludes that CFTC rules on risk monitoring and mitigation for OTC derivative contracts not cleared by a CCP are equivalent to EMIR. It also determines that US rules on obligations on the exchange of collateral (margins) between counterparties are equivalent to EU rules. This decision takes the form of an implementing act, and enters into force on the twentieth day following its publication in the *Official Journal* of the EU.

Also on 13 October, the European Commission and the US CFTC announced a common approach for the mutual recognition of EU and US derivatives trading venues. Under this approach, both EU and US companies will be able to trade certain derivatives on their respective trading venues while complying with their trading obligations. Both the European Commission and the CFTC are working towards shortly adopting the legal acts that put this approach into action.

On 19 October, ESMA published, for the first time, data on the size of the interest rate, credit, equity, commodity and foreign exchange derivatives markets in the EU, based on the weekly data it receives from trade repositories. According to ESMA's initial analysis, which was performed on the data available on 24 February 2017, the size of the EU's derivatives markets across all asset classes was estimated as having a notional value of about €453 trillion and around 33 million transactions.

In terms of number of transactions, the equity derivatives market is the largest (48% of the total number of transactions reported), followed by foreign exchange products (19%), interest rate derivatives (15%), commodity derivatives (14%) and credit derivatives (4%). However, in terms of market size as measured by the value of gross notional amount outstanding, the picture looks different. Interest rate derivatives constitute the largest market (€282 trillion), followed by foreign exchange derivatives (€112 trillion). Equity, credit and commodity derivatives markets are much smaller (€36 trillion, €14 trillion and €9 trillion respectively). Finally, the type of transaction varies significantly across asset classes, reflecting different degrees of contract standardisation. OTC transactions are predominant on FX, credit and interest rate derivatives markets, whereas there is a slight majority of exchange traded transactions on equity and commodity derivatives markets.

On 14 December, the FSB, BCBS, CPMI and IOSCO launched surveys as part of their joint work to review the effects on incentives to centrally clear OTC derivatives trades following the implementation of the G20 regulatory reforms. Financial and non-financial firms that are participants in derivatives markets are encouraged to complete the surveys. The work will be undertaken by the FSB-BCBS-CPMI-IOSCO Derivatives Assessment Team (DAT) and the BCBS. The DAT study began in July 2017 and the final report is expected to be completed in late 2018. The newly launched survey covers areas such as the effects of G20 reforms on derivatives markets, client clearing service provision, and other market structure issues and observations. The survey results will also be used by the BCBS to inform its own review of the impact the Basel III Leverage Ratio on banks' provision of clearing services and any consequent impact on the resilience of central clearing.

The Demand for Central Clearing: To Clear or Not to Clear, That is the Question is an ESRB working paper, published on 15 December, which analyses whether the post-crisis regulatory reforms developed by global standard-setting bodies have created appropriate incentives for different types of market participants to centrally clear OTC derivative contracts. Beyond documenting the observed facts, the authors analyse four main drivers for the decision to clear. Using confidential European trade repository data on single-name sovereign CDS transactions, they show that for all the transactions reported in 2016 on Italian, German and French sovereign CDS 48% were centrally cleared, 42% were not cleared despite being eligible for central clearing, while 9% of the contracts were not clearable because they did not satisfy certain CCP clearing criteria. However, there is a large difference between CCP clearing members that clear about 53% of their transactions and non-clearing members, even those that are subject to counterparty risk capital requirements, that almost never clear their trades. Moreover, the authors find that diverse factors explain clearing members' decision to clear different CDS contracts.

On 18 December, the Joint Committee of the ESAs published its jointly developed draft RTS, amending the framework of EMIR with regard to physically settled FX forwards. These amendments aim at aligning the treatment of variation margin for physically-settled FX forwards with the supervisory guidance applicable in other key jurisdictions. In particular, this would imply that the requirement to exchange variation margin for physically-settled FX forwards should target only transactions between institutions (credit institutions and investment firms).

On 21 December, ESMA issued the results of a peer review it conducted into how national competent authorities (NCAs) ensure that CCPs comply with requirements under EMIR. ESMA's peer review covered the supervision by NCAs of CCPs' default management procedures (DMP), including how they simulate the default of a clearing member (fire drills). Overall, ESMA found that NCAs supervise DMPs adequately and that most EU CCPs have performed fire drills. However, the report also highlights the areas where divergences emerged; where supervisory convergence could be further enhanced; and existing good practices. A possible case of non-compliance with EMIR was also identified in the area of the frequency of fire drills, which will require further follow-up.

ESMA's list of CCPs authorised to offer services and activities in the EU, in accordance with EMIR, was last updated on 11 December, and its list of third-country CCPs recognised to offer services and activities in the EU was last updated on 9 October. ESMA's *Public Register for the Clearing Obligation* under EMIR was last updated on 6 December; whilst its (non-exhaustive) list of CCPs established in non-EEA countries which have applied for recognition has not been updated since 18 April.

In view of ESMA's statutory role to build a common supervisory culture by promoting common supervisory approaches and practices, ESMA has established a process for adopting Q&A documents which relate to the consistent application of EMIR. The first version of ESMA's EMIR Q&A document was published on 20 March 2013, with the most recent update having been published on 14 December.

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Market infrastructure

ECB: Advisory groups on market infrastructure

Members of the ECB's AMI-SeCo, among which Nicholas Hamilton, as Co-Chair of the ERCC Ops Group, held their latest regular two-day meeting on 6-7 December 2017. A key focus of the meeting was on the different ongoing infrastructure initiatives pursued by the Eurosystem and the complementary work on collateral management harmonisation (all covered more in detail below). In addition, AMI-SeCo members also reviewed and endorsed the latest T2S Harmonisation Progress Report (in its 8th edition) which will be published by the end of January 2018. As usual, the group also received updates from the various sub-groups such as XMAP and the Task Force on Distributed Ledger Technology as well as T2S governance bodies, including CSD Steering Group, Change Review Group, Directly Connected Parties Group and CSDR Task Force. All the related meeting documents, including the official conclusions from the meeting have been published on the ECB website.

The AMI-SeCo meeting was preceded by a joint meeting with AMI-Pay, the corresponding advisory group focused on payments infrastructure. This joint session was held on 6 December and focused mainly on topics related to TARGET2 (T2) and T2S operations, but also covered at a higher level some of the Eurosystem's infrastructure initiatives. On the same day, AMI-Pay also met separately in its usual composition. During the two-hour session just ahead of the joint meeting, AMI-Pay members discussed different outstanding issues mainly linked to T2 and the ongoing work on instant payments (TIPS). All documents from this meeting as well as the joint AMI-SeCo/AMI-Pay meeting, including agenda and outcome of both meetings, are available on the ECB website.

ECB: Other market contact groups

The Bond Market Contact Group (BMCG) last met on 10 October in Frankfurt. Unsurprisingly, a big focus of the meeting was on the imminent implementation of MiFID II/R and the potential implications for the functioning and the structure of bond markets in Europe. This discussion was introduced by presentations by Barclays, Deutsche Asset Management and Commerzbank. The latter focused on the MiFID II rules on research specifically. In addition, besides the usual general discussion on the bond market outlook, members also discussed sovereign risk concentration and the state of primary dealership, with presentations by Nomura (on sovereign risk concentration) and HSBC (on primary dealers). The next quarterly meeting of the BMCG is scheduled for 6 February 2018.

Members of the Money Market Contact Group (MMCG) had their latest meeting on 4 December in Frankfurt. No documents from that meeting have been published yet, but all the documents from the previous session held on 26 September 2017 are now available on the ECB website. This includes a number of presentations on the various topics covered at the meeting, including intraday liquidity management, the impacts of the Net Stable Funding Ratio (NSFR), in particular its unintended consequences for FX swaps and repo markets, as well as ongoing benchmark reforms.

The ECMS project will require an extensive harmonisation effort in relation to collateral management processes before it can be implemented.

ECB: Ongoing initiatives related to market infrastructure

As mentioned above and reported in previous editions of the ICMA Quarterly Report, the ECB is working on several significant market infrastructure-related initiatives, in close coordination with its two market infrastructure advisory groups, AMI-SeCo and AMI-Pay.

On 6 December, two of these projects have officially received the green light from the ECB's Governing Council, namely (i) the consolidation of TARGET2 and T2S and (ii) the development of a Eurosystem Collateral Management System (ECMS). The consolidated T2/T2S system is expected to be launched in November 2021, while the ECMS is expected to replace the currently fragmented collateral frameworks of the 19 national central banks by November 2022. The ECMS project in particular will require an extensive harmonisation effort in relation to collateral management processes before it can be implemented. This work has been initiated in March 2017 at the inaugural meeting of AMI-SeCo where it was decided to ask the Harmonisation Steering Group (HSG) to take the lead. HSG members in turn agreed to set up a dedicated Task Force, the CMH-TF, to identify and develop a list of key activities in the field of collateral management that could merit harmonisation, following a similar approach as the extensive T2S harmonisation agenda. Industry experts, including from the ICMA ERCC and ISLA, in conjunction with ECB staff, have since then made remarkable progress, in line with a very ambitious timeline. A first detailed report prepared by the CMH-TF was approved by the AMI-SeCo at its meeting on 7 December. The report concludes the first phase of the project. It lists and describes 76 harmonisation needs across 10 broader collateral harmonisation activities, thereby setting the agenda for further work to be undertaken by the Group in 2018 and beyond.

The third major infrastructure initiative undertaken by the Eurosystem is the TIPS project in relation to instant payments. This initiative is the most advanced. The final decision to go ahead with the project was taken by the Governing Council in June, with a view to start operating the service in November 2018.

ECB: TARGET2-Securities (T2S)

Following on from the successful roll-out of the T2S migration, with the fifth and last wave having been concluded in September 2017, the Eurosystem and T2S users alike are getting to grips with the new settlement environment, its opportunities and challenges, and starting to reflect on next steps. A short ECB series of interviews with market participants provides some interesting insights in this context: the most recent interviews present the views of Alex Dockx, Executive Director at JP Morgan and Alain Pochet, Head of Client Delivery at BNPP. These follow up on previous editions with Stephen Lomas (Deutsche Bank) and Marcello Topa (Citi).

In the meantime, T2S now processes on average over 500,000 transactions a day, with an average daily value of €600 billion (in October). Settlement efficiency rates have been consistently high over the course of the last year at an average of 98%. More detailed T2S figures are included in a set of slides presented to AMI-SeCo in December.

In 2017 TARGET2, the Eurosystem's real-time gross settlement (RTGS) system, celebrated its 10th anniversary. On this occasion, the ECB published an in-depth account of the first ten years of T2 operations with some interesting statistics and thoughts on its perspectives for the future.

European Commission

On 23 August 2017, the European Commission published a consultation paper on *Post-trade in a Capital Markets Union: Dismantling Barriers and Strategy for the Future*, following up on the conclusions of the European Post-Trade Forum (EPTF). Having been an active member in the EPTF, the ICMA ERCC also submitted a response to this consultation which is available on the ICMA website. While avoiding unnecessary duplication with the comprehensive EPTF report, the response was a good opportunity to highlight some of the crucial issues from a collateral and repo-specific perspective. One of the key messages for the ERCC has been to reiterate the importance of those topics that are covered in the so-called watchlist section of the EPTF Report, eg on the lack of collateral mobility, which in the ERCC's view was not sufficiently reflected in the Commission's consultation.

On 1 December, the Commission published a consultation related to supervisory reporting regimes in the EU. This follows up on the September 2015 Call for Evidence which sought to gather feedback on the benefits, unintended effects, consistency, and coherence of the EU regulatory framework for financial services. As supervisory reporting was highlighted as one of the key challenges in the responses to that consultation, the Commission is now following up this point specifically. The focus of the current consultation is thereby on reporting regimes already in place by end 2016. ICMA is currently considering whether to respond to the consultation by the deadline on 28 February 2018.

ESMA: Post-trading

An important part of ESMA's mandate is to clarify implementation questions in relation to legislation that is or is due to come into force through Q&A documents, an essential part of the so-called Level 3 process. ESMA maintains extensive Q&A documents on all the major post-trade laws, including EMIR, CSDR and the relevant post-trade aspects of MiFID II/R. The Q&A documents are being updated regularly, most recently on 14 December when additional questions have been included in all three documents mentioned above.

In the context of EMIR, ESMA has been mandated as single supervisor of all European Trade Repositories (TRs), responsible to receive transaction reports under that law. On 24 November, ESMA authorised NEX Abide TR AB as a new TR under EMIR, bringing the total number of authorised derivatives TRs to eight. Many of the TRs are also expected to offer similar services under the upcoming SFTR, but will have to go through a separate authorisation process with ESMA for that purpose.

On 17 November, ESMA published for public consultation (for comment by 15 January 2018) future guidelines on the calculation of derivative positions by TRs authorised in the EU under EMIR. In 2017 all TRs combined have received on average around 400 million reports relating to derivatives each week. As single supervisor, ESMA monitors the way TRs make data available to public authorities and that data should be of sufficient quality to enable those authorities to monitor risk in derivatives markets. ESMA has observed divergent and inconsistent approaches to position calculations by TRs and accordingly is seeking to ensure future consistency.

Global Legal Entity Identifier System (GLEIS)

The growth of LEI issuance by Local Operating Units (LOUs) has picked up significantly in the third and particularly fourth quarter of 2017. The total number of LEIs issued globally exceeded one million in early January 2018. The significant increase in new issues is reflected in the most recent LEI statistics as well as the latest Quarterly GLEIS Business Report for the third quarter of 2017 published on 14 November.

> **Despite these challenges in the short term, the longer-term benefits of globally harmonised unique identifiers such as the LEI are widely recognised.**

Despite this positive trend, serious concerns remain particularly in Europe in view of the MiFID II/R implementation on 3 January 2018, due to MiFID's strict "No LEI, no trade" approach. This is expected to lead to problems given that many relevant counterparties and issuers outside of the EU have not yet obtained an LEI. Most recently this challenge has also been acknowledged by ESMA in its latest statement on LEIs issued on 20 December. For more details on this issue, please see ICMA's latest MiFID II/R update as well as the detailed MiFID II/R update in the secondary markets section of this Quarterly Report.

Despite these challenges in the short term, the longer-term benefits of globally harmonised unique identifiers such as the LEI are widely recognised. Recent research undertaken by McKinsey & Company for the GLEIF underpins these positive expectations. Its White Paper, *The Legal Entity Identifier: The Value of the Unique Counterparty ID*, estimates that broader, global adoption of Legal Entity Identifiers (LEIs) could yield annual savings of over $150 million within the investment banking industry and up to $500 million for banks in the issuance of letters of credit.

The full LEI database continues to be freely accessible on the GLEIF website through the LEI search tool.

BIS: Committee on Payments and Market Infrastructures (CPMI)

On 15 December, CPMI published its annual statistics on payment, clearing and settlement systems in the CPMI member countries. The report includes the final figures for 2016, represented in tables for each individual country as well as a number of comparative tables.

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Macroprudential risk

Published on 3 October 2017, the IMF's latest *Global Financial Stability Report* finds that the global financial system continues to strengthen in response to extraordinary policy support, regulatory enhancements, and the cyclical upturn in growth. Global bank balance sheets are stronger because of improved capital and liquidity buffers, amid tighter regulation and heightened market scrutiny. However, some banks are still grappling with legacy issues and business model challenges, where progress has been uneven. The environment of continuing monetary accommodation may lead to a continued search for yield where there is too much money chasing too few yielding assets, pushing investors beyond their traditional habitats.

As the search for yield intensifies, vulnerabilities are shifting to the non-bank sector and market risks are rising.

As the search for yield intensifies, vulnerabilities are shifting to the non-bank sector and market risks are rising. This may lead to a further compression of risk compensation in markets and higher leverage in the non-financial sector, so policy makers at both the national and global level will have to strengthen the financial and macroeconomic policy mix.

On 5 October, the EBA published a periodical update of its *Risk Dashboard*, summarising the main risks and vulnerabilities in the EU banking sector through a set of risk indicators in 2Q 2017. EBA sees that progress is positive, but risks remain heightened on asset quality and sustainable profitability. Highlights include that:

- in the second quarter of 2017, the CET1 ratio reached a new peak since 4Q 2014, increasing from 14.1% in 1Q 2017 to 14.3% in 2Q 2017, with all EU countries experiencing an average ratio above 10% – however, this outcome was driven by a reduction of the denominator, with banks decreasing their risk exposure amounts (by €195 billion), particularly for credit risk, also in connection with the liquidation or restructuring of some intermediaries;
- the quality of banks' loans portfolios continued improving, although the slow progress and wider dispersion among countries remained a concern;
- the average RoE showed a slight increase from 6.9% (1Q 2017) to 7.0% in 2Q 2017, while the average RoE increased by 1.3 p.p. from 5.7% in 2Q 2016;
- net interest income continued to decrease its share of EU banks' total operating income in 2Q 2017 compared to the previous year (55.4% in 2Q 2017 vs 57.0% in 2Q 2016); and
- the loan-to-deposit ratio for households and NFCs confirmed a downward trend.

The Peterson Institute held a conference, the fourth in a series, on *Rethinking Macroeconomic Policy*, coordinated by Olivier Blanchard and Lawrence Summers, on 12-13 October. Following an introductory session, the first day featured discussions on monetary policy; fiscal policy; and financial stability. Topics on the second day were inequality and political economy; and international economy issues. The associated papers, presentations and speeches have been published.

The Board of Supervisors of the EBA agreed, in its meeting held on 24-25 October, on the final timeline of the 2018 EU-wide stress test. The exercise is expected to be launched at the beginning of 2018 and the results to be published by 2 November 2018. Subsequently, on 17 November, the EBA published its final methodology for the 2018 EU-wide stress test, following a discussion with industry in summer 2017. The methodology covers all relevant risk areas and, for the first time, incorporates IFRS 9 accounting standards.

On 26 October, EIOPA published its updated *Risk Dashboard* based on the second quarter 2017 data. The results show that the risk exposure of the insurance sector in the EU remains overall stable with some slight improvements in the solvency ratios of groups and life solo undertakings. Profitability of the sector has shown some positive signs both for life and non-life. Despite some positive developments, the continuing low-yield environment and the observation that market fundamentals might not properly reflect the underlying credit risk, are still important concerns for the European insurance industry.

On 1 November, the ESRB published a working paper in which the author proposes *A Macro Approach to International Bank Resolution*, which should consider: (i) the contagion effects of bail-in; and (ii) the continuing need for a fiscal backstop to the financial system. For bail-in to work, it is important that bail-inable bank bonds are largely held outside the banking sector, which is currently not the case; but the use of stricter capital requirements could push them out of the banking system. The organisation of the fiscal backstop is crucial for the stability of the global banking system. Single-point-of-entry resolution of international banks is only possible for the very largest countries or for countries working together, including in terms of sharing the burden of a potential bank bailout. The euro area has adopted the latter approach in its Banking Union; whilst other countries have taken a stand-alone approach, which leads to multiple-point-of-entry resolution of international banks and contributes to fragmentation of the global banking system.

On 2-3 November, the IMF hosted a research conference themed *The Global Financial Cycle*. Following opening remarks given by the IMF's Managing Director, Christine Lagarde, there were panel sessions on (1) Financial, Real, and Commodity Cycles; (2) Global Financial Cycle: a Myth?; (3) Role of the Exchange Rate; (4) Transmission of Global Financial Shocks; (5) Real and Distributional Impacts; and (6) Taming the Global Financial Cycle. There were also remarks by Richard Berner, Director, Office of Financial Research, US Treasury and a closing forum, which discussed the Global Financial Cycle – Causes, Consequences, and Policy Responses. The remarks and all related papers have been published.

A Structural Model to Study the Bail-Out Process in a Bank and its Macroprudential Policy Implications is an ECB staff working paper, published on 13 November. In the authors' model, a government assumes the equity stake under unlimited liability upon abandonment of the original equity holders. The model determines an abandonment trigger such that if total income drops below this trigger, private shareholders abandon the bank. Given this trigger, the model also determines the bank rescue costs, the expected time to the bank rescue and the bank rescue probabilities. A static analysis of this model produces several empirically testable hypotheses. The empirical exercise presented highlights the importance of the assumptions made regarding the behaviour of the operational costs, by showing dramatic differences in results in a sample of countries that otherwise appear to share important cultural and geographical proximities.

The Financial Stability Institute (FSI) of the BIS assists financial sector authorities worldwide in strengthening their financial systems. Since the beginning of 2017, the FSI has been implementing a new strategy that includes achieving closer interaction with central banks and financial supervisory agencies, which are its main stakeholders. As part of these efforts, the BIS announced, on 15 November, that it has decided to reactivate the FSI Advisory Board that was originally created in 1998 and ceased to operate some time later. The Advisory Board will provide strategic advice and will comprise a small but diverse group of central bank governors, heads of financial sector supervision and chairs of standard-setting bodies and regional supervisory groups.

Also on 15 November, the EBA published a report on the peer review carried out to evaluate the implementation of its Guidelines on the criteria for the assessment and identification of other systemically important institutions (O-SIIs) across the EU. Overall, the peer review concluded that the majority of the authorities are compliant with the EBA Guidelines, although some of its requirements have not been fully applied in all jurisdictions and, therefore, the EBA recommends that such deviations be corrected as soon as possible.

On 16 November, EIOPA published survey results analysing trends in the investment behaviour of European insurers over the past 5 years. The survey, which was conducted during the first quarter of 2017 and focused on the asset side of the balance sheet of large insurance groups, revealed trends that could be associated with search-for-yield behaviour in the insurance industry such as increased exposures towards lower credit rating quality fixed income securities and more illiquid investments such as non-listed equities and loans. Additionally, the average maturity of the bond portfolios increased while equity allocation remained largely unchanged. Large insurance groups appear to invest more into non-traditional asset classes such as infrastructure, mortgages, loans and real estate.

On 20 November, speaking in his capacity as Chair of the ESRB, Mario Draghi addressed a hearing before the European Parliament's ECON Committee. Having first noted the publication of the ESRB's sixth Annual Report, which covers the period between 1 April 2016 and 31 March 2017, Mario Draghi concentrated his remarks on four topics: (i) developments in the macroprudential policy framework, in particular as regards countercyclical capital buffer and real estate instruments; (ii) the ESRB's report on the financial stability implications of the new IFRS 9; (iii) the ESRB's contributions to the policy framework beyond banking; and (iv) the ESRB's work to shed light on the derivatives markets.

On 24 November, the EBA published its tenth report on risks and vulnerabilities in the EU banking sector. The report is accompanied by the 2017 EU-wide transparency exercise, which provides key data in a comparable and accessible format for 132 banks across the EU. The data show further resilience in the EU banking sector amid a benign macroeconomic and financial environment, with an additional strengthening of the capital position, an improvement of asset quality and a slight increase of profitability. However, further progress on NPLs is needed whilst the long-term sustainability of prevailing business models remains a challenge. The importance of robust data management and IT and operational resilience is also a priority.

On 28 November, the Bank of England published its latest semi-annual *Financial Stability Report*, as well as the results of the 2H 2017 *Systemic Risk Survey*. In summary, the Bank's FPC judges that, apart from those related to Brexit, domestic risks are at a standard level overall, and that risks from global debt levels, asset valuations and misconduct costs remain material. The 2017 stress test shows the UK banking system is resilient to deep simultaneous recessions in the UK and global economies, large falls in asset prices and a separate stress of misconduct costs. There are also potential risks arising from the macroeconomic consequences of some possible Brexit outcomes; and the combination of a disorderly Brexit and a severe global recession and stressed misconduct costs could result in more severe conditions than in the stress test.

Market-based finance is an increasingly important component of the UK financial system, accounting for almost half of its total assets. The resilience of market-based finance relies on the behaviour of a range of intermediaries and investors that, in combination, determine how smoothly markets function. Core intermediaries, such as dealers, are more resilient and have recently increased their repo activity. Demand for illiquid and lower-rated assets from life insurers also remains strong. But dealers' willingness to "warehouse" risk remains constrained in some markets, making those markets susceptible to large-scale sales during stress, including from open-ended investment funds.

The FPC continues to assess the risks of disruption to UK financial services arising from Brexit so that preparations can be made, and action taken to mitigate them. Ensuring a UK legal and regulatory framework for financial services is in place is essential to financial stability; and the Government plans to achieve this with the EU Withdrawal Bill and related secondary legislation. It will however be difficult, ahead of March 2019, for financial companies on their own to mitigate fully the risks of disruption to financial services. Timely agreement on an implementation period would reduce risks to financial stability; and HM Treasury is considering all options for mitigating risks to the continuity of outstanding cross-border financial services contracts. Irrespective of the particular form of the UK's future relationship with the EU, and consistent with its statutory responsibility, the FPC will remain committed to the implementation of robust prudential standards in the UK.

On 29 November, the ECB published its latest semi-annual *Financial Stability Review*. In summary, this reports that systemic stress indicators for the euro area have remained low over the past six months, with better growth prospects, as well as lower fiscal and external imbalances, contributing to reduced systemic stress indicators for the euro area. Nevertheless, risks of a repricing of global risk premia remain significant; bank profitability prospects are still challenged by structural vulnerabilities; and high private and public debt burdens could give rise to debt sustainability concerns in some countries.

The review reports that the UK's decision to withdraw from the EU could have adverse financial stability implications for the euro area, but the risk that access to wholesale and retail financial services would be materially restricted for the euro area economy appears limited. The impact on financial services is likely to be reflected more in the cost of financial services and in costs for financial institutions than in a reduction in the availability of services. The ECB underlines the need for the affected banks and other financial institutions to undertake all necessary preparations in a timely manner, in order to avoid any remaining "cliff" effects.

The review also contains four special features. The first discusses the use of NPL transaction platforms; the second provides an overview of euro area cross-border banking over the past decade; the third examines recent developments in repo markets and how regulatory reform is affecting the functioning of these markets; and the fourth examines the low volatility in financial markets and considers potential triggers and amplifiers that could lead to higher volatility in the future.

Published on 30 November, *Developing Macroprudential Policy for Alternative Investment Funds* is a joint ECB-DNB Occasional Paper, which aims to inform ongoing discussions about an EU-level framework for operationalising macroprudential leverage limits for AIFs. First, this paper presents new EU-level evidence suggesting that leveraged funds exhibit stronger sensitivity of investor outflows to bad past performance than unleveraged funds, which has the potential to exacerbate systemic risk. Second, it devises a framework for assessing financial stability risks from leverage in investment funds. And, finally, it discusses the potential effectiveness and efficiency of various designs for macroprudential leverage limits.

The General Board continues to highlight the repricing of risk premia in global financial markets as the main risk to financial stability in the EU.

On 5 December, ESMA issued its *Risk Dashboard No. 4 2017*, covering risks in the EU's securities markets for 3Q 2017. ESMA's overall risk assessment remains unchanged from 2Q at high levels. In 3Q 2017, EU financial markets remained relatively calm, although reactive to global geopolitical events. This was reflected in increased market expectations of the near-term volatility following global political tensions. While market and credit risks remain very high, ESMA's outlook for credit risk has declined reflecting improvements in risk indicators. The outlook for liquidity and contagion risk is stable, while operational risk continues to be elevated – with a worsening outlook given mounting concerns over potential cyber-attacks.

The General Board of the ESRB held its 28th regular meeting, on 7 December 2017. The General Board continues to highlight the repricing of risk premia in global financial markets as the main risk to financial stability in the EU. Despite solid prospects of recovery in the real economy, tail risks remain elevated, amid high geopolitical and policy uncertainties, and could trigger a repricing of risk. The General Board also discussed the vulnerabilities in the EU commercial real estate sector and the adverse scenario for the 2018 EBA EU-wide stress test.

The investment fund sector has grown strongly over the past decade, both in the EU and globally, and its role in financial intermediation is expected to increase further within the CMU. While the diversification of financing sources should help to enhance both the efficiency and the resilience of the financial system as a whole, there are concerns that the greater role of investment funds in financial intermediation may result in them amplifying any future financial crisis. Therefore, the General Board adopted a recommendation (to be published in early 2018) which addresses systemic risks related to liquidity mismatches and the use of leverage in investment funds.

The General Board took note of a report of the ESRB High-Level Task Force on Safe Assets. The technical report concerns a feasibility study on sovereign bond-backed securities (SBBS), which would comprise senior and subordinated claims on a diversified portfolio of sovereign bonds. The Task Force will publish this report in due course with the aim of informing wider policy discussions. The General Board also exchanged views on the macroprudential structural buffers framework and will publish a report on the macroprudential use of structural buffers, a revised chapter of the ESRB handbook on operationalizing macroprudential policy in the banking sector and its views on how this framework could be enhanced.

On 13 December, EIOPA published the results of its *2017 Occupational Pensions Stress Test*. This year's exercise assessed the resilience of Institutions for Occupational Retirement Provision (IORPs) to a "double-hit" scenario, combining a drop in risk-free interest rates with a fall in the price of assets held by IORPs. The exercise also assessed the potential transfer of shocks from IORPs to the real economy and financial stability through sponsor support and benefit reductions. The stress test is not a pass-or-fail exercise for the participating IORPs, however it was found that the European DB and hybrid occupational pension sector has, on average, insufficient assets to meet pension liabilities on the national balance sheet, both in the baseline and adverse market scenario. And, more than a quarter of IORPs providing DB and hybrid schemes are covered by a sponsor that may not be able to (fully) support the pension promise following the adverse scenario, although it is noted that national recovery mechanisms do allow sponsor support and benefit reductions to be spread over substantial timeframes.

Can Macroprudential Measures Make Cross-Border Lending More Resilient? is a BIS staff working paper, published on 14 December. Using a novel dataset, the authors study the effect of macroprudential measures on cross-border lending during the taper tantrum, which a saw strong slowdown in cross-border bank lending to some jurisdictions. Their results suggest that macroprudential measures implemented in borrowers' host countries prior to the taper tantrum significantly reduced the negative effect of the tantrum on cross-border lending growth. The shock-mitigating effect of host country macroprudential rules are present both in lending to banks and non-banks, and are strongest for lending flows to borrowers in advanced economies and to the non-bank sector in general. Source (lending) banking system measures do not affect bilateral lending flows, nor do they enhance the effect of host country macroprudential measures.

Crises in the Modern Financial Ecosystem is an ESRB working paper, published on 15 December. The authors build a moral hazard model to study incentives of financial intermediaries ("bankers") facing a leverage-insurance trade-off in their investment choice. They demonstrate that the choice is affected by two recent transformations of the financial ecosystem bankers inhabit: (i) the rise of institutional savers, such as treasurers of global corporations, which manage huge balances in need of parking space and (ii) the proliferation of balance sheets with asset-liability mismatch, like those of insurance companies and pension funds, which allocate capital to bankers to reach for yield and meet their liabilities offering guaranteed returns. Post-crisis regulatory reforms, while improving the resiliency of the regulated banking sector, create room for bank disintermediation and do not unambiguously limit systemic risks which can build up in the asset management complex. Fiscal and structural reforms that directly address relevant real economy developments are essential to complement financial and banking regulations and promote financial stability and balanced growth.

On 19 December, the ECB published the fourth issue of its semi-annual *Macroprudential Bulletin*. The first chapter in this issue discusses the short-term impact of MREL on financial markets and banks from a financial stability perspective, shedding some light on the ability of debt markets to absorb new issuances of bank debt related to the new requirement and also providing an assessment of the extra cost to banks' funding relating to the issuance of bail-inable liabilities.

Chapter two gives an example of a recently developed analytical tool, which is an income flow-based contingent claims model, for a large sample of European banks, that can be used to estimate the market value of different bank claimants and how these values may change in response to capital-based macroprudential policy actions. The last chapter discusses the macroprudential policy aspects of the recently published ECB opinions on the European Commission's proposals for amending the EU banking rules. And, as in previous issues, this issue ends with an overview of recent announcements relating to macroprudential instruments in the euro area.

On 20 December, the ESRB published Issue 22 of its *Risk Dashboard*. This reports that market-based measures of systemic stress in the EU have remained at low levels, despite existing uncertainties in the policy area and high geopolitical tensions. However, these low levels of expected volatility, in particular those of implied volatility, do not necessarily imply an absence of risks in financial markets; and volatility in the financial markets could rise rapidly and significantly. In terms of macro risk, although most countries have deleveraged in the years following the global financial crisis, debt levels remain elevated across countries and sectors in the EU; and government debt levels are exceeding the 60% of GDP Maastricht Treaty reference level in the majority of the EU countries. Considering the financial sector, bank profitability in the EU improved in the second quarter of 2017, but remains low on average and the median capital ratios of EU banks increased in the second quarter of 2017. Meanwhile, the size of the non-banking part of the EU financial sector has increased over the past years relative to the total assets of credit institutions.

Also on 20 December, EIOPA published its latest *Financial Stability Report* for the (re)insurance and occupational pensions sectors in the EEA. According to the report, while the global economic outlook continues to improve, the prolonged low yield environment and low market volatility coupled with high levels of economic and political uncertainty continues to represent major challenges for European insurers and pensions funds; and, in this context, the impact of a sudden yield spike scenario should be assessed. Additionally, the insurance sector is responding to the ongoing macroeconomic environment and technological challenges by adapting investment strategies and business models; in the reinsurance sector, the 2017 hurricane season may add to rising claims towards the end of the year; and in the European occupational pensions sector, total assets increased for the euro area as did the average rate of return.

Monetary and Macroprudential Policies Under Rules and Discretion is a Bank of England staff working paper, published on 21 December, in which the authors study the policy design problem faced by central banks with both monetary and macroprudential objectives. They find that a time-consistent policy is often superior to a widely studied class of simple monetary and macroprudential rules. Better outcomes result when interest rates adjust to macroprudential policy in an augmented monetary policy rule.

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ICMA Capital Market Research

The Panda Bond Market and Perspectives of Foreign Issuers
Published: 19 October 2017
Authors: ICMA/NAFMII Joint Report

Market Electronification and FinTech
Published: 3 October 2017
Author: Gabriel Callsen, ICMA

Use of Leverage in Investment Funds in Europe
Published: 19 July 2017
Authors: AMIC/EFAMA Joint Paper

European infrastructure finance: a stock-take
Published: 13 July 2017
Authors: ICMA/AFME Joint Paper

The European Credit Repo Market: The cornerstone of corporate bond market liquidity
Published: 22 June 2017
Author: Andy Hill, ICMA

Closed for Business: A Post-Mortem of the European Repo Market Break-Down over the 2016 Year-End
Published: 14 February 2017
Author: Andy Hill, ICMA

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 & Education

Save the date

ICMA 50th AGM & Conference

May 30 – June 1, 2018 Madrid

Registrations open 5 Feb 2018

ICMA

ICMA and its regions

ICMA with members in 61 countries relies on regional committees to inform its work and to deliver relevant and focused services to capital market participants wherever they are. All the regions listed below have committees of members meeting regularly to discuss the issues relating to market practice and regulation which are of particular concern in their region.

They are active in providing feedback on specific points to the ICMA Board and in helping ICMA to organise regional events, such as the MiFID II/R implementation seminars organised in the autumn of 2017.

ICMA's regions and the regional chairs

Africa - Monwabisi Zukani, The Standard Bank of South Africa
Asia Pacific - Valerian Crasto, DBS Bank
Austria, Eastern and South-Eastern Europe - Michael Kuen, Raiffeisen Bank International
Greece, Turkey, Cyprus and Balkan States - Nick Kaltsogiannis, GMM Global Money Managers
Belgium - Herman Van Cauwenberge, Delen Private Bank
France and Monaco - Benito Babini, BNP Paribas
Germany - Joachim Heppe, Commerzbank
Iberia - Enrique Prados del Amo, Asociacion de Mercados Financieros
Italy - Alberto Zaffignani, Natixis
Luxembourg - Yves Bodson, Banque et Caisse d'Epargne de l'Etat
Middle East and North Africa - Fawaz Abu Sneineh, First Abu Dhabi Bank
Netherlands - Marinus van Schaik, InsingerGilissen Bankiers
Nordic - Johan Wijkstrom, SwedBank
Russia and other CIS countries - Andrey Krylov, The Central Bank of the Russian Federation
Switzerland and Liechtenstein - Beat Gabathuler, Zürcher Kantonalbank
Ireland - Gerard Scully, The Irish Stock Exchange

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Get Involved!

We want you to get the maximum value from your firm's membership of ICMA. To help you to do this we've produced *Get Involved!*, a quick guide to what ICMA does and how it works with its members. This has been prepared by the members of the ICMA Future Leaders group, who are all professionals in the early stages of their careers, to provide an insight into the work of the association and the services it offers.

As an individual you can access ICMA's expertise and international network of contacts through our events, professional education courses, legal help desk and our reports and publications.

- Find out how ICMA brings together the borrower, sell-side, buy-side and investor communities and how to join them.
- Take advantage of our regionally based networking by signing up for the Future Leaders or Women's Network.
- Follow us on social media and sign up for our newsletters to keep in touch with the latest regulatory developments.
- Join the new ICMA mentoring platform.
- Get fast access to our standard documentation for primary, secondary and repo markets.

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ICMA Women's Network
Networking. Progression. Support.

Taking conscious action against unconscious bias!

The IWN recently partnered with UniCredit's Diversity Network for an event which was kindly hosted by UniCredit in London. Entitled "Challenging perceptions: Unconscious bias – how it affects networking & career progression", this event, attended by a record 170 guests, comprised a presentation by Louise Weston (Managing Psychologist and Assessment, Development & Diversity specialist, Pearn Kandola), followed by a panel featuring Mandy DeFilippo (Managing Director and Head of Risk Management for Fixed Income & Commodities, EMEA, Morgan Stanley and ICMA Board Member), Georgiana Lazar (Head of HR UK & Global Markets, UniCredit Bank AG) and Armin Peter (Global Head of Syndicate, UBS Investment Bank and ICMA Board Member).

The evening started with Louise's interesting presentation on unconscious bias, which was delivered in such a way as to fully engage the audience by reference to psychometric testing. Using these well-developed tests, Louise demonstrated how unconscious bias works, and its effects on the psyche; how we are primed towards "confirmation bias" (we see what we expect to see) and are affected by the "contrast effect" (how our decisions can change depending on the day and the other circumstances). Couple these ideas with the concepts of "selective attention" (where the brain tries to direct our attention to where it thinks it should focus, and in ways we might not want it to) and "priming" (where the brain tries to make sense of randomness), and it is easy to see how unconscious bias affects us in so many ways, which is not only difficult to spot, but also to overcome.

We all suffer from unconscious bias through no fault of our own, but rather as a result of the human condition. This will not change without conscious action on the part of the individual, but does it really matter? Well, yes, particularly in the context of career strategy, and with the benefit of extremely candid insights from the panellists, the next part of the evening focused on the importance of recognising, addressing and overcoming unconscious bias.

We all know the importance of networking, and how it can impact on our careers – in terms of who gets the job, performance, ratings, promotion prospects, salary and bonus, as well as retention rates. Yet with humankind suffering from homophily – the fact that we like people like ourselves, albeit unconsciously – we are not naturally inclusive. Although we may think we are being objective, the brain can perceive "different" as "dangerous". Human behaviour dictates that change or restructuring worries us, and drives us towards comfort and familiarity, safety and predictability. In this regard, bias acts as a self-protection mechanism, and helps to ensure that we are invulnerable.

Elsewhere in our professional lives, challenging our unconscious biases is hard, even unnatural. It is easier to consult people who we know are like us, and who will agree with us. Although it is important to ensure diversity in a team, it is almost counter-intuitive to include someone who will challenge a particular decision.

So, what can we do about unconscious bias? Once we have recognised and identified our biases, it is important to set about consciously creating inclusive networks that are not only gender-diverse, but also have a purpose; as well as making our networks "social" and supportive, we should also ensure they are "instrumental", so that they have substance and include individuals who can provide career capital and dividends, who can open doors for us and help us to progress. Networks should consist of all levels of seniority – peers, juniors, bosses, even bosses' bosses, so think diagonal, side-to-side, downwards and upwards in terms of structure. Networking should not be a one-way street. Reciprocity is important, so think about what you can offer to your network, and how you can get involved with others' networks.

This should not only improve the career prospects of the individual, but also in a team situation, bringing outsiders into the network and taking account of a range of views – no matter how controversial or far from our own – can lead to a more rounded, considered result, often for the greater good. Relevant tips from the panel on this aspect include engaging your full team, getting to know those you would usually pass over, challenging yourself over the informal choices you make and, fundamentally, trying to relate to the human!

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Diary 2018

DATE

ICMA Events in January 2018

19-21 January
Register

ICMA Switzerland & Liechtenstein Ski Weekend, Arosa, 19-21 January The ICMA Region for Switzerland & Liechtenstein will hold its annual ski event for ICMA members in Arosa. The weekend usually attracts over 150 professionals and provides ICMA members, and non-members, the opportunity to combine business, networking and pleasure.

24 January
Register

Annual ICMA and NCMF Joint Seminar – MIFID II/R Implementation Update, Copenhagen, 24 January The Annual ICMA and NCMF joint seminar will focus on progress with MIFID II implementation and the lessons learned for both primary and secondary bond markets. It will also feature an update on other regulatory changes relating to primary markets including PRIIPs and the new Prospectus Regulation.

25 January
Register

ICMA Future Leaders Networking Reception, Madrid, 25 January ICMA members are invited to an evening networking reception to launch the IFL initiative in Spain. The evening will feature a keynote speech from ICMA Board member, Juan Blasco. Juan, the Global Head of Syndicate at Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), will talk about his own experiences within the capital market and provide tips for navigating the industry towards a successful career.

ICMA Workshops

20 February
Register

European Regulation: An Introduction for Capital Market Practitioners, London, 20 February 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? How do the institutions of Europe work together to develop new regulation? 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.

1 March
Register

Bond Syndication Practices for Compliance Professionals and Middle Office Professionals, London, 1 March This workshop aims to give compliance professionals an in-depth and thorough understanding of the practices that are involved in launching a deal in the international debt capital market. It explains precisely how the deal is done, starting with first steps in the pre-launch process - looking at the pitch book, the mandate, the roadshow and the prospectus - through syndication, including book building and allocation, up to and including the final public launch of the issue.

7-9 March
Register

Repo and Securities Lending under the GMRA and GMSLA, London, 7-9 March 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. These two separate but increasingly overlapping master agreements are the essential underpinnings of the cross-border repo and securities lending markets.

26-27 March
Register

GMRA Masterclass – a Clause-by-Clause Analysis & Annex I Negotiation, London, 26-27 March This two-day advanced-level workshop systematically reviews the Global Master Repurchase Agreement (GMRA) 2011 clause by clause, giving a thorough grounding in all of its key provisions and the most commonly-used Annexes. An experienced repo negotiator conducts a case study of a typical negotiation of Annex I, offering hints and tips on the most effective approach for both sell-side and buy-side counterparties.

For more information, please contact: ICMAevents@icmagroup.org or visit www.icmagroup.org/events

ICMA Executive Education

Courses 2018

Five reasons why an ICMA foundation course is for you!

1. No previous knowledge needed: Our foundation courses are designed for people starting out in their careers in finance, each one will take you right through from the basics to a professional level of understanding, giving you skills and knowledge to use daily in your job and preparing you for further study with our Advanced courses.

2. Expert teachers: Our tutors have real-world experience in financial markets as well as sound academic knowledge. Over the course of our 3-day classroom programme you can ask questions on any concepts, analytics or processes that you don't understand. (It will also give you the chance to spend 3 days in a classroom with international professionals from different firms working in the same area of finance, what better opportunity is there to grow your worldwide network!)

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5. Available online: We also run all of our foundation courses online, so if you prefer, you can study at your own pace and gain the same qualification.

Foundation Qualifications

Financial Markets Foundation Qualification (FMFQ) Online
Next start date: **2 February 2018**
(registration deadline 31 January 2018)

Securities Operations Foundation Qualification (SOFQ) Online
Next start date: **2 February 2018**
(registration deadline 31 January 2018)

Securities Operations Foundation Qualification (SOFQ)
Brussels: **7-9 March**

Introduction to Primary Markets Qualification (IPMQ)
London: **14-16 March**

Introduction to Fixed Income Qualification (IFIQ)
London: **19-21 March 2018**

Financial Markets Foundation Qualification (FMFQ)
London: **9-11 May 2018**

Advanced Qualifications

ICMA Fixed Income Certificate (FIC) Online
Next start date: **2 February 2018**
(registration deadline 31 January 2018)

ICMA Operations Certificate Programme (OCP)
Brussels: **12-16 March 2018**

ICMA Fixed Income Certificate (FIC)
Amsterdam: **16-20 April 2018**

ICMA Primary Markets Certificate (PMC)
London: **14-18 May 2018**

Specialist Programmes

Collateral Management
London: **9-10 April 2018**

Securitisation
London: **12-13 April 2018**

Fixed Income Portfolio Management
London: **3-4 May 2018**

Corporate Actions – An Introduction
London: **22-23 May 2018**

Corporate Actions – Operational Challenges
London: **24-25 May 2018**

Credit Default Swaps – Pricing, Applications and Features
London: **30-31 May 2018**

Compliance in Fixed Income
London: **5 June 2018**

Securities Lending & Borrowing
London: **18-19 June 2018**

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

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
ADB	Asian Development Bank
AFME	Association for Financial Markets in Europe
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
AMI-SeCo	Advisory Group on Market Infrastructure for Securities and Collateral
ASEAN	Association of Southeast Asian Nations
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
BMR	EU Benchmarks Regulation
bp	Basis points
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
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
ESG	Environmental, social and governance
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
ETP	Electronic trading platform
ESG	Environmental, social and governance
EU27	European Union minus the UK
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 Markets Standards Board
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FRTB	Fundamental Review of the Trading Book
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
GHOS	Group of Central Bank Governors and Heads of Supervision
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
HQLA	High Quality Liquid Assets
HY	High yield
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IBA	ICE Benchmark Administration
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
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
NPL	Non-performing loan
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
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-Based Investment Products
PSEs	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
RFRs	Near risk-free rates
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 asset
SBBS	Sovereign bond-backed securities
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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