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# The importance of Asia in the global capital markets



## Foreword by Spencer Lake

**The past few years have witnessed strong growth in the Asian capital markets, brought about by rapid economic growth, increasing financial openness and strengthened trading ties between the region's economies.**

The region's infrastructure has come a long way in its development to facilitate this growth, with the establishment of clearing systems, sovereign yield curves, pricing and credit rating mechanisms and local intermediaries to provide market-making and liquidity. Thanks to the expansion of international banks into the region and fund managers coming from all over the world to set up their presence in this part of the world, issuers are now able to initiate and conclude benchmark-sized transactions with relative ease under normal market conditions. In addition, the application of extra-territorial laws (eg the Dodd-Frank Act and the Volcker Rule) and the introduction of new regulatory frameworks (eg Basel III) have reduced bank appetite for risk and credit provision and have prompted issuers to explore new financing channels.

These measures have contributed significantly to the growth of the region's capital markets, both in terms of size and the range of products available to those seeking to raise capital. Historically, Asia had been financed largely by banks (approximately half of total financing in 2008-2012) and equity (30-35%) with bonds contributing less than 20%. However, the bond markets have now emerged as the key area of growth as the other forms of financing are facing constraints. The year 2013 saw issuers across the region raise over US\$650 billion, representing a more-than-eightfold increase from the volume in 2008. China, South Korea and India were at the forefront of this market, accounting for 61.0%, 9.3% and 8.1% of the total regional volume in the year.

However, there remains much potential for further development as the quantum of the region's capital markets has evidently lagged behind the scale of its economic growth. South Korea leads the way in this respect, with outstanding corporate bonds amounting to nearly 80% of its GDP in September 2013, followed by Malaysia, Singapore and Hong Kong at 43%, 32% and 31% respectively. In contrast, the figures for China and India as two of the region's largest economies stand at a mere 13% and 11%, a much smaller proportionate share of their respective economies.

In terms of currency, the US dollar and the euro have largely remained the most dominant for international bond financing transactions, together accounting for over 85% of total volume in 2013. In stark contrast, the Asian local currencies have by and large remained on the sidelines despite the region's increasing share of global trade and financial flows. That being said, several currencies have already begun their course in expanding their usage beyond domestic borders, and we draw on the Chinese renminbi (RMB, also referred to as CNH in the offshore markets) as a prime example.

The Chinese Government has been very proactive in promoting the RMB as a global medium of payment, financing and investment in its path to become a global reserve currency. In recent years, the Chinese Government signed over 20 bilateral currency swap agreements with other central banks to exchange the RMB with the respective counterparties' currencies. The introduction of the Qualified Financial Institutional Investor (QFII) and Renminbi QFII programmes allowed foreign investments in China onshore securities via offshore funds, whilst the launch of new CNH HIBOR fixings in June 2013 as a CNH interest rate benchmark enabled currency hedging and relative value comparisons. The Ministry of Finance has also been very

active in setting pricing benchmarks for corporate issuers by coming to the offshore markets with publicly syndicated transactions amounting to more than CNH10 billion since 2008, and most recently priced its fifth batch of offshore RMB bonds in June 2013, the first to feature the 30-year tenor. The Shanghai Free Trade Zone was officially launched in September 2013 as part of China's strategic liberalisation plan to better support trade in services and to facilitate more two-way trade and investment between China and external markets. Technical support also remains strong, with Hong Kong emerging as the largest offshore RMB deposit base with total deposits and total remittance of RMB for cross-border trade settlement past the RMB1.35 trillion mark as of January 2014, amidst speculation of the currency as an appreciating asset. Additionally, London, Singapore and Taiwan have grown as offshore RMB liquidity pools, and have also expressed keen interest in expanding their presence as major offshore RMB centres.

This has prompted the offshore RMB market to grow exponentially in scale as issuers have come to the market to raise a total of nearly CNH280 billion in 2013, representing a compound annual growth rate of almost 90% since 2008. The market remains largely Sino-centric, as over 70% of issuers from 2008 to 2013 were incorporated either in Hong Kong or China. However, we have also seen an increasing number of overseas corporates, sovereigns and financial institutions from around the world coming to the RMB markets as they seek to fulfil their funding needs in China and to further diversify their investor bases. The pipeline for further primary activity remains strong as issuers are looking to refinance their borrowings in a year which sees record levels of offshore RMB bonds (over CNH90 billion) reaching maturity. Onshore Chinese issuers would also be keen to

utilise the remainder of the CNH75 billion offshore RMB issuance quota approved by the National Development and Reform Commission in the following months.

The year 2014 bodes well for the further development of the Asian capital markets and their increasing presence in the global platform – the region is once again on track to set another record year in terms of issuance volume with over US\$140 billion already issued to date. Region-wide initiatives and organisations, such as the Asian Bond Market Initiative, Association of South-East Asian Nations and the Asian Development Bank are in place to promote economic cooperation, financial openness and social progress of member countries. Coupled with strong underlying drivers, such as rapid economic growth and a rising share of inter- and intra-regional trade, the Asian capital markets are well poised to continue building on their momentum and to reach new heights in the forthcoming year.

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**Spencer Lake is Group General Manager and Global Head of Capital Financing at HSBC Bank plc and Deputy Chairman of ICMA.**

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## Message from the Chief Executive

Preparations for ICMA's 2014 Annual General Meeting and Conference on 5 and 6 June in Berlin – our 46<sup>th</sup> – are already well advanced, with most of the speakers and panellists confirmed and venues for the conference and the evening events booked. We have a host of eminent speakers from the public, financial and corporate sectors and have no doubt that this will be an important and informative conference. Registrations are already open and we are well on the way to surpassing the numbers at last year's widely praised AGM and Conference in Copenhagen. If you have not already signed up to attend please take a look at the details on [our website](#). We would be pleased to welcome you!

We also run many other events for members to allow for constructive debate and facilitate the flow of information to market participants. Our ICMA Capital Market Lectures, where we invite eminent individuals to speak to an audience of ICMA members have been very successful, well attended and interesting, with a wide range of speakers – Verena Ross from ESMA, David Wright from IOSCO and Mark Boleat from the City of London – addressing a variety of topics. We have an excellent roster of speakers lined up to continue the momentum in 2014. Details of forthcoming ICMA Capital Market Lectures can always be found on [our website](#).

This edition of the Quarterly Report provides a comprehensive summary of progress on the full range of market practice issues and policy initiatives where ICMA is engaged. To pick out a couple of topics where your association has made real headway, after months of intensive work with our members

we launched the comprehensive and practical *ICMA ERC Guide to Best Market Practice in the European Repo Markets*. And we have also just launched a paper entitled *Collateral is the New Cash – the Systemic Risks of Inhibiting Collateral Fluidity*, at a conference attended by senior policy makers and repo market participants in Brussels. We expect this to be a useful piece of work to stimulate discussion with regulators as we try to improve the consistency and effectiveness of market regulation.

Elsewhere in this Quarterly Report we also discuss developments in the secondary market and concerns at the low levels of secondary liquidity. The MiFID II package is designed to change fundamentally the workings of the secondary markets and, now that the Level 1 text has been agreed at political level, we are preparing ourselves for the considerable amount of work involved in making sure the implementation of these far reaching changes is as market-friendly as possible, and that the risk of any further deterioration in secondary liquidity is minimised. In addition, many of the other proposed regulations (CSDR for example) will also impact secondary markets. We see the coming 18 to 24 months as a critical period in the development of secondary markets. It is vital that the views of our members are properly represented. We have already recruited a new staff member to help us cope with this additional workload.

We are also making good progress with our work on collective action clauses for sovereign issuers located outside the euro area, and are receiving many thoughtful responses to our Consultation Paper outlining ICMA's proposed structure. Many thanks to those of you who have commented, as we try to reach consensus on this important, complex and far-reaching initiative.

We continue to widen our scope both geographically and on a product basis in response to our members' requirements. You will have seen the Foreword from ICMA Board member Spencer Lake of HSBC, who focuses on the important developments in the capital markets in Asia Pacific. We also carry an article from

NAFMII (the Chinese financial market association) with which we have close links, to complement the report from ICMA's Hong Kong office.

On a product basis, our pan-European Private Placement Working Group is now fully operational with official and private sector support. We are also in discussions to provide the Secretariat for the Green Bonds Principles (GBP). The GBP are a set of voluntary standards for bond market participants for the issue of Green Bonds drafted by a group of leading banks. ICMA would like to be a key player in the promotion of these voluntary standards in line with its self-regulatory philosophy.

Finally, I want to mention that we very much appreciate the extensive input we receive from member firms on our many committees, councils and working groups. This involves well over 400 individuals and is the core strength of ICMA in setting standards of market practice and interacting with the authorities. We strive continually to engage ever more actively with our members, large and small, wherever they are located, to understand the issues they are facing and ensure that we address these in our agenda. Our regional structure, where members fall into one of 13 different regions each with its own regional committee, is particularly important in reaching out to our broad membership and facilitating the all important two-way information flow, particularly with our smaller member firms.

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# Preventing another international financial crisis

Quarterly Assessment by Paul Richards

## Summary

The authorities are determined, not only to encourage economic recovery from the international financial crisis, but also to prevent another crisis in future, and in particular to ensure that taxpayers should never have to bail out financial institutions again. In the EU, regulatory measures taken in an attempt to achieve this include: much more intrusive regulation of financial institutions and markets; an extension of the regulated financial sector; measures to bail in creditors when necessary; and much greater emphasis on enforcement.

How effective will these measures be? In addition to the challenges ahead relating to monetary and fiscal policy, financial regulation needs to be both proportionate and consistent across borders. But the cumulative impact of separate regulations, together with inconsistencies between them, has created unintended consequences. It is also clear that the introduction of regulatory measures on their own will not prevent another crisis. A great deal will depend on: the credibility of the authorities; the restoration of trust by the public in financial institutions and between regulators and supervisors across borders; and the quality of supervision and of the management of market firms. There are also a number of important global issues to be addressed.

## Introduction

1 Following the most disruptive international financial crisis for 80 years, the purpose of this Quarterly Assessment is to review the measures introduced by the authorities in an attempt to prevent another crisis in future, taking account of the potential implications for international capital markets. The Quarterly Assessment covers the period until the end of the first quarter of 2014.

## Measures introduced in response to the last crisis

2 There is gathering evidence of international economic recovery from the last crisis, particularly in the US. Although the overall rate of growth in Europe is still relatively slow and uneven, and unemployment – particularly youth unemployment – remains very high in some countries in the euro area, and although growth has slowed in China and there has been considerable financial instability in several emerging markets, as well as political confrontation between Russia and the Ukraine, the economic recovery in developed economies has been accompanied by a gradual – but still fragile – return of confidence in capital markets. This has been encouraged by:



**The economic recovery has been accompanied by a gradual – but still fragile – return of confidence in capital markets.**

- historically very low short-term interest rates in the US and Europe over a prolonged period, supported by forward guidance and quantitative easing (or the equivalent) by central banks, and reflected in a substantial expansion in central bank balance sheets;
- fiscal bail-outs for euro-area governments which were cut off from funding in capital markets, and bail-outs for banks across Europe and the US which needed to be recapitalised;
- statements from the authorities making clear that they would stand together to overcome the international financial crisis: these commitments were made, following the G20 Summits in 2008 and 2009, in the initial – and most acute – phase of the crisis; but they were followed by the President of the ECB's commitment in July 2012, in response to the threat that the euro area would break up, to do "whatever it takes" to save the euro within the ECB's mandate. (Whether the ECB's Outright Monetary Transactions (OMT) programme, announced in September 2012, is within its mandate is currently the subject of a court case, which the German Constitutional Court has referred, before giving its final judgment, to the European Court of Justice.)

3 The authorities are determined, not only to encourage recovery from the international financial crisis, but also to prevent another crisis in future, and in particular to ensure that taxpayers should never have to bail out financial institutions again. In the EU, measures which have been, or are still in the process of being, taken to make the financial system safer include:

- *much more intrusive regulation of financial institutions*, through: higher capital requirements, higher liquidity requirements and the imposition of leverage requirements, which have led to bank recapitalisation and bank deleveraging in order to meet the requirements in advance;
- *much more intrusive regulation of financial markets*, by: separating wholesale trading activities within banks from their traditional banking, retail and payment activities; banning proprietary trading by banks; promoting transparency by pushing secondary market transactions over-the-counter

onto exchanges and platforms, whatever the consequences for secondary market liquidity; and requiring standard derivatives to be cleared and settled through central counterparties (CCPs);

- *extending the regulated financial sector* to a wider range of financial institutions and activities in an attempt to prevent regulation from being circumvented: eg through the regulation of hedge funds and through proposals to regulate "shadow banks";
- *preventing the need for taxpayer support* to bail out financial institutions in future by providing for their creditors and depositors (above a minimum level) to be bailed in first, and by making it less difficult for financial institutions to be resolved (ie wound up);
- *giving much greater emphasis to enforcement* through sanctions (eg by banning specified financial products, and by imposing much larger fines on financial institutions for mis-selling).

## Challenges in preventing another crisis

4 How effective will these measures be in preventing another international financial crisis in future? There are a number of challenges ahead:

### (i) Monetary policy

5 First of all, *monetary policy*: Central bank purchases of financial assets (in the form of government, corporate or mortgage securities), and loans to banks – eg in the case of the ECB through Longer-Term Refinancing Operations (LTROs) – need to be unwound: first through tapering of purchases and subsequently through sales of assets (and through repayment of LTROs), as the recovery gathers strength, so as to prevent a rise in inflation in general and "bubbles" (eg in the housing market) in particular. Steps have already begun to be taken towards achieving this objective: the Federal Reserve has begun to taper its monthly purchases of assets; and banks in the euro area have begun to repay their outstanding obligations under LTROs. But achieving the objective without disrupting international capital flows (eg to emerging markets) has proved a significant concern during the first quarter.

**(ii) Fiscal policy**

6 Second, *fiscal policy*: Fiscal consolidation is needed to reduce the high levels of public debt built up during the crisis. This would be difficult to achieve in any event, but it may be even more difficult to achieve if inflation stays low, as the level of public debt outstanding does not depreciate in real terms as much with low, as with higher, inflation. At the same time the high prevailing levels of youth unemployment need permanently and substantially to be reduced. There are different views about how best to handle these problems in the euro area on two issues:

- first, on the degree of flexibility in budget deficits that should be permitted in the short term; and
- second, in the medium term, on whether to impose central control over budget deficits and the issuance of public debt or whether to maintain national responsibility for reducing budget deficits and funding public debt, bailing in national resources – including in one case suggesting the imposition of a national wealth tax – before agreeing to bail-outs from other governments.

**(iii) Financial regulation**

7 Third, *financial regulation*: In Europe, the regulatory reforms introduced in response to the crisis are not yet complete, and have in some cases been agreed only with difficulty (eg the agreement in March 2014 on the decision-making process and funding of the Single Resolution Mechanism under European Banking Union in the euro area). In many cases, regulatory reforms have proved (eg EMIR) – or are likely to prove (eg MiFID II) – complex both for market firms to implement and for regulators to enforce.

This is particularly the case when deadlines for implementation of new regulations are unrealistically tight, or there is uncertainty in the market about how exactly to interpret them.

***Proportionality and consistency***

8 Nobody questions the need for financial regulation in response to the crisis to make the financial system safer and more resilient. But regulation needs to be proportionate, and it needs to be consistent:

- *Proportionality* is important so that the cumulative impact of new regulation does not stifle financial innovation and economic growth.
- *Consistency* is important, first of all, between different regulations in the same jurisdiction. Second, consistency is also important across borders between different jurisdictions because large market firms operate globally and so implementing different regulatory regimes in different jurisdictions increases cost and complexity. And third, consistency helps to prevent regulatory arbitrage between different jurisdictions.

***Regulatory differences***

9 At present, regulatory reforms are not wholly consistent in different jurisdictions: there are significant differences between the EU, the US and other countries, especially in Asia. The authorities in Asia have not always followed the same approach to regulation as the Western world on the grounds that Asia was not primarily responsible for the international financial crisis. But there are also differences in approach to regulation between the EU and the US, for example:



**Regulatory reforms are not wholly consistent in different jurisdictions.**

- differences in approach between the EU and the US (and within the EU) to *banning proprietary trading* by banks and distinguishing between proprietary trading and trading on behalf of clients; and differences in approach to the separation of wholesale from retail banking between the US (under the Volcker Rule), the UK (post the Vickers report), the national regimes in France and Germany and the new proposal from the European Commission (in response to the report by the Liikanen Group): the Commission proposes to ban proprietary trading by systemically significant EU banks in financial instruments and commodities, and to grant supervisors the power – and, in certain circumstances, the obligation – to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading subsidiaries within the group;
- differences in approach to *resolution regimes* between the EU, the US and other jurisdictions: resolution regimes are only likely to be effective across borders if they are globally coordinated, there is a consistent approach between resolution regimes on bail-in and mutual recognition, and there is the requisite degree of mutual trust and confidence between the resolution authorities themselves;
- differences in approach to *banking across borders*, where some supervisors have been encouraging banks to set up separately capitalised subsidiaries instead of branches so that, instead of capital being measured on a global basis, sufficient local capital is available in each jurisdiction to protect local depositors and investors (as under the Federal Reserve's rule requiring capital in the US from non-US banks), in case a bank needs to be resolved; or where the host supervisor of foreign bank branches wishes to ensure that standards of supervision in the home supervisor are as high as its own (as under the Prudential Regulation Authority's proposals in the UK);
- differences in approach to new regulations such as the *Financial Transaction Tax*, which is being proposed among 11 Member States within the euro area, but not in other national jurisdictions in the EU, nor in the US; in addition, within the EU Single Market, an increasing proportion of new legislation relates to the euro area rather than the Single Market as a whole; and
- differences between the EU and the US as regards the *timing of implementation* of some new regulatory measures: eg on Basel III in the US and CRDIV/CRR in the EU; and between Dodd-Frank in the US and EMIR and MiFID II in the EU. However, it is significant that the EU and US regulators have reached an agreement on supervising the OTC derivatives market, under which EU-approved platforms which trade derivatives will be exempt from US trading rules until equivalent EU rules come into force (under MiFID II) in around three years' time; and US banks trading on these venues will also be exempt. This replaces the previous ruling by the Commodity Futures Trading Commission (CFTC) that non-US companies had to use CFTC rules for most aspects of clearing, trading and data reporting.

### **Extra-territoriality**

10 The position is complicated because some of the new regulations introduced in the EU and the US are intended to have extra-territorial effect: for example, the proposal for the Financial Transaction Tax in 11 Member States within the euro area; and the Foreign Account Tax Compliance Act (FATCA) in the US, though the US authorities have reached bilateral agreements with a number of jurisdictions which allow them to receive information through FATCA without directly imposing regulations on foreign financial institutions.

### **A cross-border approach to regulation**

11 Despite these regulatory differences, it is not realistic to expect governments to eliminate regulatory differences by changing legislation which has already been enacted, even if regulators are minded to encourage them to do so. But it is possible to explore closer cooperation among regulators so as to encourage a "cross-border" rather than a "local" approach to regulation. A local approach (eg by requiring firms to set up national subsidiaries) involves costs by tying up capital and requiring market firms with global activities to operate in different ways in different jurisdictions.





## Promoting a cross-border approach to global securities regulation is not straightforward.

12 However, promoting a cross-border approach to global securities regulation is not straightforward, because:

- there are currently no global principles on cross-border regulatory action in the securities world;
- there is no common set of objectives among securities regulators globally;
- there are no global systems to enable securities regulators across borders to find out about overseas rules and regulations which have an extra-territorial impact on them;
- there is no precision on a global basis about the criteria for assessing “equivalence” nor about what is meant by “outcomes” (ie whether regulatory regimes are comparable even when rules are not the same line-by-line);
- regulators consider that there are insufficient data to make judgments about cross-border securities supervision globally; and
- global standards are not sufficiently granular to be useful in different jurisdictions.

13 The Financial Stability Board (FSB) is taking the lead in addressing these regulatory challenges at global level ahead of the G20 meeting in Brisbane in November 2014, with support from an IOSCO Task Force on cross-border regulatory issues in the international securities markets. In its statement on *Financial Reforms – Progress and Challenges* on 17 February 2014, the FSB recommends that G20 members, which are already committed to a multilateral approach to open and integrated cross-border regulation:

- defer to each other’s market regulatory regimes where they achieve equivalent outcomes;
- undertake peer reviews and impact assessments to ensure consistent implementation; and

- enhance cooperation to avoid domestic measures that fragment the global system.

### ***Unintended consequences from regulation***

14 The cumulative impact of separate regulations, together with the inconsistencies between them, has also created unintended consequences. ICMA’s work on avoiding counterproductive regulation is designed to identify these inconsistencies and suggest constructive ways of removing them without questioning the underlying rationale for regulation. A cross-cutting theme is the importance of collateral fluidity. New regulation is distorting the market by significantly increasing the demand for collateral, on the one side, while limiting the availability and restricting the fluidity of collateral, particularly in periods of market stress, on the other. The recent revision by the Basel Committee on Banking Supervision to provide for netting of securities financing transactions in the calculation of the Leverage Ratio is a welcome recognition of the importance of maintaining equilibrium between the demand for, and the availability of, collateral. But proposals such as the current framework for the Net Stable Funding Ratio run the risk of counteracting this revision.

### ***Systemic risk***

15 Apart from addressing the direct impact of regulation, the problem of removing implicit government guarantees for financial institutions which have hitherto been regarded as “too important to fail” is proving very difficult to resolve. A list of



**The problem of removing implicit government guarantees is proving very difficult to resolve.**



## The next crisis may well be different.

banks and insurers which are classified as being of global systemic importance has been drawn up, and methods for identifying non-bank and non-insurance institutions of global systemic importance are now due to be considered. Any proposal to broaden the systemic net would be especially difficult. For example, asset managers are very different from banks: asset managers act in a fiduciary capacity on behalf of their investor clients. Where financial risks are taken by their investor clients rather than by the asset managers themselves, treating asset managers like banks for regulatory purposes is therefore not appropriate.

16 Systemically important financial institutions are required to prepare “living wills” to make it less difficult to wind them up if necessary while keeping essential activities running. But it is not clear how well these measures would work in practice in a crisis: eg if creditors need to be bailed in. This is especially the case with institutions which may not on their own be too important to fail, but may still carry systemic implications in a crisis, when there is a risk that the system fails altogether unless the authorities intervene on a massive scale. Nor does systemic risk relate only to financial institutions, but to the financial markets which link them together (eg through a financial institution’s dependence on wholesale markets for short-term funding; or through the liquidity mismatch between a commitment by a bond fund to provide liquidity to investors, on the one side, and its ability to deliver this by liquidating its investments in a crisis, on the other side). It is also important to note that the regulatory response to the last crisis has created new institutions where risk is concentrated (like CCPs) and which may well in practice prove too important to fail.

### **Contingency preparations**

17 Finally, the regulatory measures introduced in response to the last crisis are designed primarily to prevent a repetition of a crisis like the last one. But the next crisis may well be different (eg as a result

of cyber-crime or terrorism). While contingency preparations are being made in advance, nobody can be certain how well they would work if needed.

### **(iv) Restoring trust**

18 It is clear that regulatory measures on their own will not prevent another crisis. A great deal will depend on: the credibility of the authorities; the restoration of trust by the public in financial institutions and between regulators and supervisors across borders; and the quality of supervision and the management of market firms. These three preconditions are all related:

- In the case of the authorities, the consensus in favour of operational independence for central banks as the best way of achieving low inflation and sustainable real growth, which lasted through the 1990s and early 2000s, has been challenged as a result of experience in the crisis. During the crisis, central banks and their governments have become much more interdependent: eg as a result of quantitative easing, which has led to large central bank purchases of government debt, very low interest rates and high levels of public debt outstanding. This will not change quickly.
- Public trust in financial institutions has been seriously damaged by the crisis, and is expected to take a long time to restore. This is widely recognised. Less attention has been paid to the loss of mutual trust between regulators and



## The loss of mutual trust between regulators and supervisors across different jurisdictions is equally important to restore.

supervisors across different jurisdictions as a result of the crisis, but trust between them is equally important to restore so that they are willing to rely on each other across borders.

- A great deal will depend on the quality of individual supervisors and regulators, on the one side, and the quality of the management in market firms, on the other. This cannot be prescribed solely by regulation, daunting though the task of implementing and enforcing new regulations as complex as Dodd-Frank, EMIR and MiFID II is likely to be. It involves expert judgment, effective corporate governance and mutual trust. Learning from experience, education and training can help.

## The global context

### Global regulation

19 Until now, all the regulatory changes in response to the international financial crisis have been introduced without significant changes in the international financial architecture at global level (though changes have been made in Europe: eg to introduce three new European Supervisory Authorities, and to make the ECB responsible for the Single Supervisory Mechanism):

- The IMF has played a prominent role during the crisis (eg in working with the ECB and the European Commission in bailing out countries on the periphery of the euro area). But reform of the IMF's voting structure has so far been blocked in the US Congress.
- The G20 at political level, and the FSB at technical level, have taken the lead in making recommendations for reform in response to the crisis. But the G20's role is an advisory one: only national or regional (eg EU) authorities can decide whether to implement them. In addition, after six years of crisis, a certain amount of regulatory fatigue has set in.
- IOSCO's global role in regulating securities markets is also an advisory one, without sanctions to back its judgments. It is seeking a role in arbitrating regulatory disputes between different national jurisdictions. But it is not clear whether a formal binding role of this kind would be acceptable (eg in

the US). However, IOSCO can help to encourage national regulators to follow a consistent approach to securities regulation across borders informally (eg through multilateral MOUs); produce guidance on criteria for "equivalence" or comparability; and provide a platform for regulators to share experience. Peer reviews may also help to rebuild trust among securities regulators following the crisis.

- There is a separate issue relating to the different remits of financial regulators in different geographical jurisdictions (eg some national securities regulators are "single peak" regulators covering both prudential and conduct of business regulation, while others follow a "twin peak" approach covering prudential and conduct of business regulation separately); and there are potentially overlapping roles at global level, under the auspices of the G20 and the FSB, between banking and securities regulators (eg between the BCBS, the CPSS and IOSCO). So cooperation between them is essential.

### The international monetary system

20 At global level, there is also an unresolved question about whether the international monetary system works in a way which benefits all its national participants. In response to the crisis, the US dollar remains unquestionably the international reserve currency of choice. The dollar is universally accepted as a means of exchange and a standard of value, and it is underpinned by a legal system with a long history. Currently, other potential reserve currencies such as the euro and the renminbi coexist with the dollar, but it may be a long time before they challenge the dollar's reserve currency status globally rather than regionally. Nor have steps so far been taken by the IMF to develop the SDR into a fully functioning reserve currency as a means of exchange as well as a standard of value.

21 Given the US dollar's reserve currency role, one of the key issues arising from recent disruption in emerging markets is whether the Federal Open Market Committee (FOMC) in the US should take account, not just of domestic conditions in the US, but also international conditions – including in emerging markets – in setting US monetary policy.



## An effective global safety net may well be needed.

Clearly, the FOMC has specific responsibility for setting monetary policy in the US economy alone; and spill-over effects from US monetary policy on emerging markets can in theory be addressed by the authorities in emerging markets themselves if they adjust their exchange rates or raise short-term interest rates or both. But it is also possible to conceive of circumstances in which disruption in emerging markets has a global impact in practice.

### ***A global safety net?***

22 This leads on to the question whether there should be closer central bank coordination, not just between central banks in developed economies, but between developed economies and emerging markets, as called for by the Governor of the Reserve Bank of India in response to recent disruption in emerging markets. That would at least raise awareness of each other's policies, whether or not it were to lead in due course to policy changes: eg through closer coordination over changes in short term interest rates, wider use of central bank swaps and central bank intervention in the foreign exchange market, as well as a more prominent role for the IMF.

23 In overcoming the most recent international financial crisis, a great deal of reliance has in practice been placed on central banks, because in many cases central banks can provide unlimited liquidity within their mandates quickly without the need to obtain new parliamentary authority and without immediate budgetary consequences. Close coordination between central banks is clearly very important. But it may not be sufficient to rely only on central banks to prevent the next crisis. An effective global safety net may well be needed involving the authorities across the financial system as a whole (eg including the IMF and the BIS), both to ensure that unlimited liquidity is provided when needed, and to ensure that the insolvency of individual financial institutions under the new resolution regime does not jeopardise confidence in the international financial system as a whole. There is still an outstanding question about what form this should take, both to help prevent another crisis, and also to address it, if another crisis occurs.

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## Practical initiatives by ICMA

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

### Short-term markets

- 1 The ICMA European Repo Council (ERC) met in Luxembourg on 22 January and elected a new European Repo Committee. The Council and Committee continue to be chaired by Godfried De Vidts of ICAP.
- 2 Pursuing the agenda set out in the ICMA paper last autumn on *Avoiding Counterproductive Regulation*, ICMA has prepared a new paper on *Collateral is the New Cash: the Systemic Risks of Inhibiting Collateral Fluidity*. The paper was launched at an ICMA Conference on Collateral for regulators, central banks and market experts in Brussels on 3 April.
- 3 The recent revision by the Basel Committee on Banking Supervision (BCBS) to provide for netting of securities financing transactions in the calculation of leverage ratios is a welcome recognition of the importance of maintaining equilibrium between the demand for, and the availability of, collateral. However, the ICMA ERC has written to the BCBS to ask for clarification of a number of details on the new standard.
- 4 The ICMA *ERC Guide to Best Practice in the European Repo Market* has been published.
- 5 ICMA is an observer on the new STEP+ initiative, which focuses on market liquidity and transparency in STEP-labelled short-term European commercial paper.

### Primary markets

- 6 The Public Sector Issuer Forum met in Frankfurt on 7 March. The agenda included a presentation from, and discussion with, Benoit Coeuré, Executive Director of Markets at the ECB, and Jukka Vesala, Director General of the Single Supervisory Mechanism, on the proposed Asset Quality Review and Stress Test.
- 7 The ICMA Corporate Issuer Forum held a discussion with Robert Parker of Credit Suisse, Chair of ICMA's Asset Management and Investors Council, on infrastructure financing.

- 8 The ICMA Financial Institution Issuer Forum responded to the consultation by the EBA on *Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets*.
- 9 David Hopkins of RBS has taken over as Chair of the ICMA Legal & Documentation Committee in place of Kate Craven, who has retired from Barclays.
- 10 ICMA has responded to the ESMA Discussion Paper on *Possible Implementing Measures under the Market Abuse Regulation*.
- 11 ICMA *pro forma* final terms and retail cascades legends have been approved and will be circulated shortly.
- 12 Good progress continues to be made on revising the ICMA Primary Market Handbook.

### Secondary markets

- 13 ICMA has consulted member firms on its secondary market liquidity survey.
- 14 ICMA is discussing with other trade associations cooperation on behalf of member firms in working on MiFID II Level 2.
- 15 ICMA has worked with a small group of our leading Swiss members and with ISDA on a response to the proposed Swiss Financial Market Infrastructure Law, which paves the way for the implementation of provisions similar to those in MiFID II.
- 16 ICMA is preparing members for the changeover under the CSD Regulation to settlement on trade date plus two business days (T+2).
- 17 ICMA has responded to the ECB survey on market making, and held a meeting on the subject with the Banque de France.

### Asset management

- 18 The ICMA Asset Management and Investors Council (AMIC), chaired by Robert Parker of Credit Suisse, is meeting in Zurich on 8 April.
- 19 ICMA set up at the beginning of 2014 an ICMA European Private Placement Working Group, including investors, to propose standard market practice and a framework for the documentation of private placements on a pan-European basis.

- 20 Tim Skeet of RBS is chairing an ICMA Bail-in Working Group to consider exposure that investors will have under the proposed resolution regime.
- 21 The AMIC has responded to ESMA's consultation on the *Revision of the Provisions on Diversification of Collateral in ESMA's Guidelines on ETFs and Other UCITS Issues*.
- 22 The AMIC has responded to FCA consultation CP13/17 on the use of dealing commission rules. The proposals are intended to clarify the criteria for research under the rules to help firms make better judgments about what can be paid for with dealing commission charged to the fund.
- 23 The AMIC has responded to the EBA consultation on *Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets* with the objective of ensuring that transparent and harmonised information on them is provided across the EU.

### Other meetings with central banks and regulators

- 24 Martin Scheck attended the ECB's Bond Market Contact Group on 21 January, at which there was a useful discussion on current and future secondary market developments.
- 25 René Karsenti attended the first meeting — in its new composition — of the ESMA Securities and Markets Stakeholders Group, to which he has been appointed, on 29 January.
- 26 ICMA is participating in the Cross-Border Regulation Forum, which the industry has established to engage with the IOSCO Task Force on Cross-Border Securities Regulation, and a meeting with the Chair of the Task Force, Ashley Alder, CEO of the Securities and Futures Commission in Hong Kong, took place at ICMA's London office on 11 February.
- 27 Paul Mills, Head of the IMF's office in London, led a discussion on financial stability and capital markets at the ICMA Regulatory Policy Committee on 11 March.
- 28 David Wright, Secretary General of IOSCO, gave an ICMA Capital Market Lecture at ICMA's London office on 1 April.

<sup>1</sup> ICMA responses to consultations by regulators are available on the ICMA website.

# Regulatory Response to the Crisis



by David Hiscock

## G20 financial regulatory reforms

On 8 January 2014, the FSB and IOSCO published a joint consultation, for comment by 7 April, regarding assessment methodologies for identifying non-bank non-insurer global systemically important financial institutions (NBNI G-SIFs). SIFs are those institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity. The assessment methodologies for identifying NBNI G-SIFs complement those that currently cover banks and insurers. While the consultative document proposes specific methodologies for the identification of NBNI G-SIFs, it does not designate any specific entities as systemically important or propose any policy measures that would apply to NBNI G-SIFs. Applicable policy measures will be developed once the methodologies are finalised.

Following endorsement on 12 January 2014 by its governing body, the Group of Central Bank Governors and Heads of Supervision (GHOS), the Basel Committee on Banking Supervision (BCBS) issued the full text of Basel III's *Leverage Ratio*

*Framework* and disclosure requirements. As reported in *Issue no. 30 of ICMA Quarterly Report*, a consultative version of this was published in June 2013. After carefully considering comments received and thoroughly analysing bank data to assess potential impact, the BCBS adopted a package of amendments, which pertains to the Leverage Ratio's exposure measure. These technical modifications to the June 2013 proposals relate to securities financing transactions (SFTs – as further discussed in the short-term markets section of this Quarterly Report); off-balance sheet items; cash variation margin; central clearing; and written credit derivatives. Reporting to national supervisors has begun and public disclosure will start from 1 January 2015. Following final calibration of the Leverage Ratio in light of these reported numbers, it is planned that it will become a minimum capital requirement on 1 January 2018.

Also following endorsement on 12 January 2014 by the GHOS, the BCBS issued proposed revisions to the Basel framework's Net Stable Funding Ratio (NSFR), for comment by 11 April 2014, which will require that banks maintain a stable funding profile in relation to their on- and off-balance sheet activities (repo market impacts of this proposal are discussed in the short-

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term markets section of this Quarterly Report). Proposals on the NSFR were first published in 2009, and the measure was included in the December 2010 Basel III agreement. The main revisions to the NSFR seek to reduce cliff effects within the measurement of funding stability, improve its alignment with the Liquidity Coverage Ratio (LCR) and alter its calibration to focus greater attention on short-term, potentially volatile funding sources. The BCBS intends that the NSFR will become a minimum standard from 1 January 2018.

Furthermore, on 12 January 2014, the BCBS announced the [finalisation of its LCR work](#):

- The BCBS issued final requirements for banks' LCR-related disclosures. Consistent with the Basel III agreement, national authorities will give effect to these disclosure requirements, and banks will be required to comply with them, from the date of the first reporting period after 1 January 2015.
- The BCBS published *Guidance for Supervisors on Market-Based Indicators of Liquidity*, to assist supervisors in their evaluation of the liquidity profile of assets held by banks, and, for the purposes of Basel III's LCR, to help promote greater consistency in High Quality Liquid Assets (HQLA) classifications across jurisdictions. Importantly, the guidance does not change the definition of HQLA within the LCR; rather, it helps supervisors assess whether assets are suitably liquid for LCR purposes.
- The BCBS agreed to modify the LCR's definition of HQLA to provide greater use of Committed Liquidity Facilities (CLFs) provided by central banks. The use of CLFs within the LCR has until now been limited to those jurisdictions with insufficient HQLA to meet the needs of the banking system. The BCBS has agreed that, subject to a

range of conditions and limitations, a restricted version of a CLF (an RCLF) may be used by all jurisdictions, albeit that central banks are under no obligation to offer such facilities. Whether jurisdictions choose to make use of RCLFs is a matter of national discretion.

On 24 January 2014, IOSCO announced that the Indonesian Financial Services Authority has [become the 100th signatory](#) to the IOSCO [Multilateral Memorandum of Understanding](#) (MMOU) on cooperation and exchange of information. The MMOU is the instrument used by IOSCO to combat cross-border financial services misconduct. There are currently 25 further eligible IOSCO members, 20 of whom have formally expressed their commitment to seek the legislative and administrative changes necessary for achieving MMOU compliance. The growing number of signatories in recent years has contributed to a sharp increase in cross-border cooperation among IOSCO members.

In a [letter dated 17 February 2014](#) the FSB Chair updated G20 Ministers and Governors on financial reforms. This letter reviews what remains to complete the job of financial reform; and then outlines the characteristics of financial supervision and regulation needed to realise fully the benefits of an open, integrated global financial system. It makes two main points:

- "First, if we remain focused and ambitious, we can complete the

remaining core elements of the reforms during the Australian G20 Presidency"; and

- "Second, the G20's approach beyond the Brisbane Summit will determine the openness of the global financial system and consequently the strength and sustainability of global growth."

IOSCO's [21 February 2014 press release](#) comments on the meeting of its Board in Kuala Lumpur, to drive its work on key issues facing global financial markets and securities regulators. Amongst other things:

- The meeting intensified IOSCO's commitment to regulators in growth and emerging markets in building resilient capital markets to withstand volatility in global markets while supporting sustained economic growth.
- The Board agreed to measures that deliver on its commitments to the G20/FSB reform priorities and to focus on supporting market based financing as a driver of economic growth.
- The Board made progress on organizational and cooperation initiatives designed to ensure that IOSCO has the funding, organizational framework and outlook needed to anticipate and respond to issues in emerging and advanced securities markets through to 2020.
- The Board made progress on a number



The G20's approach beyond the Brisbane Summit will determine the openness of the global financial system.

of initiatives to enhance the functioning of securities markets globally.

- The meeting progressed G20 reform work streams on ending “too big to fail”, shadow banking and building resilient OTC derivatives markets; and also heard updates on IOSCO’s work on cross-border regulation and fostering long term investment.

The Board also discussed a number of significant and emerging issues in the markets IOSCO members regulate – including crowd funding, cyber risk and resilience, liquidity in corporate bond markets, audit quality, approaches to deterrence and investor education.

A [communiqué](#) was issued following the meeting of Finance Ministers and Central Bank Governors, in Sydney on 22-23 February 2014. Of most direct relevance to the ongoing process of financial regulatory reform, paragraph #10 states: “In 2014 we are focusing our efforts on substantially completing by the Brisbane Summit key aspects of the core reforms we set out in response to the global financial crisis: building resilient financial institutions; ending too-big-to-fail; addressing shadow banking risks; and making derivatives markets safer. We want to promote resilience in the financial system and greater certainty in

the regulatory environment to support confidence and growth. We will implement these reforms in a way that promotes an integrated global financial system, reduces harmful fragmentation and avoids unintended costs for business. We commit to cooperate across jurisdictions with a renewed focus on timely and consistent implementation supported by meaningful peer reviews, including OTC derivatives reform. In relation to this reform, we agree that jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulatory regimes.”

On 6 March 2014, the BCBS published the results of its [latest Basel III monitoring exercise](#). A total of 227 banks participated in the current study, comprising 102 large internationally active banks (“Group 1 banks” – being internationally active banks with Tier 1 capital >€3 billion) and 125 Group 2 banks (ie representative of all other banks). Based on data as of 30 June 2013, the results of the monitoring exercise assume that the final Basel III package has been fully implemented. The average Common Equity Tier 1 (CET1) capital ratios under the Basel III

framework across the same sample of banks are 9.5% for Group 1 banks and 9.1% for Group 2 banks; as compared with the fully phased-in CET1 minimum requirement of 4.5% and a CET1 target level of 7.0%. Basel III’s LCR comes into effect on 1 January 2015, with the minimum requirement initially being set at 60% and then rising in equal annual steps to reach 100% in 2019. The weighted average LCR for the Group 1 bank sample was 114%, down from 119% six months earlier, whilst for Group 2 banks, the average LCR has increased from 126% to 132%. For banks in the sample, 72% reported an LCR that met or exceeded a 100% minimum requirement, while 91% reported an LCR at or above a 60% minimum requirement.

On 10 March 2014, IOSCO [published the Consultation Report](#) (for comment by 10 June), *A Comparison and Analysis of Prudential Standards in the Securities Sector*, which undertakes a high-level comparative analysis of the key prudential/capital frameworks for securities firms. IOSCO’s objective is to update its 1989 report on [Capital Adequacy Standards for Securities Firms](#), based on the issues identified in the Consultation Report. The Consultation Report highlights prudential regulatory and supervisory areas that might be considered in any update, particularly:

- to identify opportunities for regulatory capital arbitrage that might (or actually have) materialised from differences in prudential regulations across jurisdictions; and
- to account for the increasing use of internal models and the commensurate increase in infrastructure, systems and controls that are necessary to help ensure that firms are not undercapitalized compared to the risks posed by their positions and activities.

At its [plenary meeting in London](#) on 31 March 2014, the FSB discussed



Jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes.



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vulnerabilities affecting the global financial system and reviewed work plans for completing core financial reforms. The latter element included discussions regarding:

- *Ending “too big to fail”*: members discussed deliverables in the ongoing work to address SIFIs, as set out in the [St Petersburg G20 Leaders Declaration](#).
- *Shadow banking*: the FSB approved an information-sharing process among its members to support oversight and regulation of shadow banking entities other than money market funds. The FSB will start information sharing among authorities in May, using this agreed process, and will launch a peer review on national implementation of the FSB’s high-level policy framework in this policy area in 2015. The FSB also approved an implementation timetable, to be published in April, for the policy recommendations to address financial stability risks associated with securities financing transactions that were [published in August 2013](#); and reviewed the results of the public consultation and quantitative impact study on its proposed regulatory framework for haircuts on non-centrally cleared securities financing transactions. The framework for haircuts will be finalised by September, taking account of these results.
- *Making derivatives markets safer*: members discussed progress in implementation of OTC derivatives market reforms; noting that the remaining work of international standard-setting bodies is on track to be finalised by end-2014, and that good steps continue to be made in national implementation though some unevenness remains. Members welcomed the report published by the OTC Derivatives Regulators Group on its continuing [work to resolve cross-border regulatory issues](#) and looked forward to the group’s report ahead of the G20 Brisbane Summit on how the identified outstanding issues have been or will be resolved.
- *Benchmark reforms*: members received an update on the work of the FSB Official Sector Steering Group to ensure that widely-used interest rate benchmarks are held to appropriate standards of governance, transparency and reliability; and looked forward to receiving the analysis and recommendations of the Steering Group in June.
- *Data gaps*: the FSB welcomed the successful operation since March 2013 of Phase 1 of its [Data Gaps initiative](#); approved the launch of Phase 2, involving an expansion of data collection to include G-SIBs’ liabilities and funding; and reviewed a roadmap for Phase 3, planned for 2016. Further details on the next steps of the initiative will be provided to G-SIBs in April 2014 to seek feedback on the details of the data collection.
- *Implementation monitoring*: the FSB reviewed and approved a thematic peer review report on reducing reliance on credit rating agency ratings, in accordance with the FSB [Principles published in 2010](#).

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### European financial regulatory reforms

On 8 January 2014, the incoming Greek Presidency of the European Council [gave a presentation](#) of its priorities on economic and financial affairs; and [published its programme](#). Of note for financial regulatory reforms, Greece will work towards further deepening of the Economic and Monetary Union and strengthening of coordination of national economic and fiscal policies. Promoting



## Establishment of an effective SRM is intended to break the vicious circle between bank debt and public debt.

the Banking Union will constitute the main objective of the Presidency, which will contribute to restoring financial stability, improving the functioning of the internal market and strengthening public confidence in the financial system; whilst the establishment of an effective Single Resolution Mechanism (SRM) is intended to break the vicious circle between bank debt and public debt and effectively shield the European financial system. In the area of capital markets, the Presidency will put emphasis to the completion of work on legislative proposals relating to the reform of capital markets supervision (MiFID/MiFIR) as well as to the promotion of discussions on the benchmarking legislative proposal. The Presidency will also advance discussions for the financing of the economy, in particular SMEs' facilitation of access to financing; and will promote all pending legislative or other initiatives to tackle identified problems in the taxation field.

In his [14 January 2014 statement](#), Commissioner Barnier welcomed the agreement in principle reached that day by the European Parliament and the Council on updated rules for markets in financial instruments (as more fully discussed in the secondary markets section of this Quarterly Report). Commissioner Barnier states: "These new rules will improve the way capital markets function to the benefit of the real economy. They are a key step towards establishing a safer, more open and more responsible financial system and restoring investor confidence in the wake of the financial crisis." The European Parliament [issued its own press release](#) regarding the agreement.

On 29 January 2014, the European Commission [proposed new rules](#) to stop the biggest and most complex banks from engaging in proprietary trading. The proposal on structural reform of EU banks will apply only to the largest and most complex EU banks with significant trading activities. It will:

- ban proprietary trading in financial instruments and commodities, ie trading on own account for the sole purpose of making profit for the bank;
- grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) to separate legal trading entities within the group ("subsidiarisation"); and
- provide rules on the economic, legal, governance, and operational links between the separated trading entity and the rest of the banking group.

To prevent banks from attempting to circumvent these rules by shifting parts of their activities to the less-regulated shadow banking sector, an accompanying transparency proposal provides a set of measures aiming to enhance regulators' and investors' understanding of securities financing transactions (SFTs – as further discussed in the short-term markets section of this Quarterly Report).

In [Issue no. 32 of ICMA Quarterly Report](#) we reported on ESMA's [publication of its 2014 Work Programme](#), which sets out its planned activities for 2014. As anticipated, a more detailed regulatory work programme was adopted by the Board of Supervisors in the first quarter of 2014, with ESMA publishing a schedule of 211 tasks on 12 February 2014. These tasks relate to ESMA objectives of consumer protection and the development of the single rulebook. 106 of the tasks relate to MiFID/MiFIR, with all but three of these being mandatory rather

than discretionary. The two other largest blocks of work relate to CSDR – 34 tasks (all mandatory) – and MAR – 25 tasks (24 mandatory).

On 18 February 2014, the Council [approved a political agreement](#) reached with the European Parliament aimed at further harmonising EU rules on deposit guarantee schemes (DGSs) and enhancing depositor protection. The draft Directive recasts legislation currently in place in order to improve the protection provided for savers with "covered" deposits of up to €100,000.

On 6 March 2014, EBA [published its fifth report](#) of the Basel III monitoring exercise on the European banking system. This exercise, run in parallel with the one conducted by the BCBS at a global level, allowed aggregate results to be gathered on capital, Risk Weighted Assets (RWAs), liquidity and leverage ratios for banks in the EU. Results show that the CET1 capital ratio of the largest internationally-active European banks (Group 1 banks: capital > €3bn and internationally active) would be on average 9.1% compared to a ratio of 12% under the current regulation. Therefore, Group 1 banks would face a CET1 capital shortfall of €2.4 billion to achieve the minimum requirement of 4.5%, and of €36.3 billion to reach the target level of 7.0% or the higher threshold set for global systemically important banks. As for the LCR, results show that, as of June 2013, the average LCR of Group 1 banks would have been 104%. This means that two-thirds of the total sample of banks would have already met the final 100% requirement to be reached by 2019. In addition, the exercise

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reveals a shortfall of liquid assets of €262 billion for all banks in the sample.

On 11 March 2014, the European Parliament adopted in plenary session the Omnibus II Directive that completes the Solvency II Directive and finalises the new framework for insurance regulation and supervision in the EU. [In a statement](#), Commissioner Barnier said: “The European Parliament has just taken a very important step towards the introduction of a modern and risk-based solvency regime for the insurance industry in Europe as of 1 January 2016, making it both safer and more competitive. This long-awaited and vital reform will finally become a reality.” The Commission is now preparing the next stage of implementation of Solvency II, which will be the adoption of a Commission Delegated Act containing a large number of detailed implementing rules planned for the summer of this year. To ensure that everything will be ready for application of Solvency II on 1 January 2016, EIOPA is also working on a package of ITS.

On 20 March 2014, [it was announced](#) that the European Parliament and the Council have reached a provisional agreement on the proposed SRM for the Banking Union. The SRM is intended to complement the Single Supervisory Mechanism (SSM) which, once fully operational in late 2014, will see the ECB directly supervise banks in the euro area and in other Member States which decide to join the Banking Union. The SRM would ensure that – not withstanding stronger supervision – if a bank faced serious difficulties, its resolution could be managed efficiently with minimal costs to taxpayers and the real economy. The SRM will be governed by two texts: an SRM Regulation covering the main aspects of the mechanism and an intergovernmental agreement related to some specific aspects of the Single Resolution Fund (SRF). The European Parliament’s [associated press release](#) indicates that the deal has won the seal

of approval of Parliament’s political group leaders. On 27 March, the Permanent Representatives Committee [approved the agreed compromise](#) on behalf of the Council, enabling the Parliament to approve the text at first reading – which is scheduled for the plenary session on 14-17 April 2014, the last before the European elections.

On 27 March 2014, the European Commission adopted a [package of measures](#) to channel funds to the real economy, in particular to long-term investment. The package includes a communication on the long-term financing of the economy, a legislative proposal for new rules for occupational pension funds and a communication on crowdfunding. The Commission’s actions can be grouped around six main areas:

- (i) mobilising private sources of long term financing;
- (ii) making better use of public funding;
- (iii) developing European capital markets;
- (iv) improving SMEs’ access to financing;
- (v) attracting private finance to infrastructure to deliver on [Europe 2020](#); and
- (vi) enhancing the wider framework for sustainable finance.

Concerning the development of European capital markets, the Commission intends facilitating SMEs’ access to capital markets and to larger investment pools by creating a liquid and transparent secondary market for corporate bonds, reviving securitisation markets with due consideration to the risks as well as to the differentiated nature of such products, and improving the EU environment for covered bonds and private placement.

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## Credit Rating Agencies

On 10 January 2014, the Board of Appeal of the European Supervisory Agencies (ESAs) [handed down its decision](#) on an appeal by the appellant, Global Private Rating Company “Standard Rating” Ltd, against the refusal by ESMA to register it as a Credit Rating Agency (CRA). This is the first appeal against a decision by ESMA refusing an applicant registration as a CRA. The Board of Appeal unanimously decided that the appeal should be dismissed, and that ESMA’s refusal decision should be confirmed.

On 5 February 2014, the Joint Committee of the three ESAs [launched a consultation](#), for comment by 5 May, on draft Implementing Technical Standards (ITS). These draft ITS specify the elements that should be taken into consideration to determine the correspondence (or mapping) between risk weights and credit assessments provided by a particular External Credit Assessment Institution. The EBA is expected to submit these draft ITS to the European Commission by 1 July 2014.

On 6 February 2014, the Joint Committee of the three ESAs [published its final report](#) on mechanistic references to credit ratings in the ESAs’ guidelines and recommendations and on the definition of “sole and mechanistic reliance” on such ratings. In accordance with the CRA Regulation, the three ESAs have

reviewed all their existing guidelines and recommendations in order to identify, and where appropriate remove, references to external credit ratings that could trigger sole or mechanistic reliance on such ratings.

On 10 February 2014, IOSCO published a Consultation Report, for comment by 28 March, on [Code of Conduct Fundamentals for CRAs](#), which proposes significant revisions and updates to the current IOSCO CRA code of conduct. IOSCO proposes to revise the IOSCO CRA Code to take into account the fact that CRAs are now supervised by regional and national authorities. The proposed revisions are designed to strengthen the IOSCO CRA Code by:

- enhancing provisions regarding protecting the integrity of the credit rating process, managing conflicts of interest, providing transparency, and safeguarding non-public information;
- adding measures regarding governance, training, and risk management; and
- seeking to improve the clarity of the IOSCO CRA Code.

On 11 February 2014, ESMA [published a Consultation Paper](#) seeking stakeholders’ views (by 11 April) on the draft Regulatory Technical Standards (RTS) required for the implementation of the CRA 3 Regulation. A [related public hearing](#) was hosted by ESMA, in Paris on 14 March. The RTS

cover the following issues:

- disclosure requirements on structured finance instruments (SFIs);
- the European Rating Platform (ERP); and
- the periodic reporting on fees charged by CRAs.

Concerning the RTS on SFIs, this consultation paper has been drafted on the basis of Article 8b(3) which requires ESMA to develop a draft RTS specifying: (i) the information that the issuer, originator and sponsor of an SFI must publish; (ii) the frequency with which this information is to be updated; and (iii) the presentation of the information by means of a standardised disclosure template.

On 21 February 2014, ESMA published its [Annual Report 2013 on CRAs in the EU](#). This report also outlines ESMA’s CRA supervisory work plan for this year. ESMA has found that CRAs continue to progress in how they comply with the CRA Regulation, including improved internal transparency and disclosure to the market on credit rating activities as well as empowerment of the compliance function. However, ESMA considers that improvements are still necessary, notably in the following areas:

- validation of rating methodologies, to ensure that a credit rating assessment is a comprehensive risk assessment leading to high quality ratings;
- internal governance, ensuring the full independence of the internal review function and thereby reducing the risk of potential conflict of interest; and
- robust IT systems to support the rating process, including information security controls and protection of confidential rating information.



IOSCO proposes to revise the IOSCO CRA Code to take into account the fact that CRAs are now supervised.

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## OTC (derivatives) regulatory developments

The FSB has set up a study group to consider how to ensure that the data reported to TRs can effectively be used by authorities, including to identify and mitigate systemic risk, and in particular through enabling the availability of the data in aggregated form. The FSB, in consultation with the CPSS and IOSCO, will then make a decision on whether to initiate work to develop a global aggregation mechanism and, if so, according to which type of aggregation model and which additional policy actions may be needed to address obstacles. A [public Consultation Paper](#), published on 4 February 2014 for comment by 28 February, sets out and analyses the various options for aggregating OTC derivatives TR data. The paper examines the three broad types of model for an aggregation mechanism: a physically centralised model; a logically centralised model; and the collection and aggregation by authorities themselves of raw data from TRs. These aggregation options are being considered on the basis that they would complement, rather than replace, the existing operations of TRs and authorities' existing direct access to TR data. A finalised report, including recommendations, will be submitted to the FSB in May 2014 for approval and published thereafter.

On 12 February 2014, CFTC Acting Chairman Wetjen and European Commissioner Barnier announced that staff of the US CFTC and staff of the European Commission had made significant progress towards [harmonizing a regulatory framework](#) for CFTC-regulated swap execution facilities (SEFs) and EU-regulated multilateral trading facilities (MTFs), as contemplated under the Path Forward statement issued in July 2013 (which was itself described in [Issue no. 31 of ICMA Quarterly Report](#)).

CFTC [no-action letters](#) relating to MTFs were published on 12 February and 21 March.

On 14 February 2014, the European Commission endorsed (without modification) ESMA's draft RTF setting out the circumstances in which the EMIR clearing obligation, risk mitigation techniques and margin requirements will apply to contracts between two non-EU entities (the draft RTS for which was discussed in [Issue no. 32 of ICMA Quarterly Report](#)). Following the one month scrutiny period afforded to the European Parliament and the Council, the final RTS was [published in the Official Journal](#) on 21 March. Accordingly, this RTS enters into force on 10 April 2014 (20 days after *OJ* publication), although Article 2 (which sets out which contracts have a direct, substantial and foreseeable effect within the EU) only applies from 10 October 2014.

EMIR entered into force on 16 August 2012, following which stipulated regulatory technical standards were prepared and entered into force on 15 March 2013. With respect to the continuing implementation of EMIR, ESMA's most recently updated [Questions and Answers](#) document was published on 20 March 2014. ESMA's [information page on EMIR](#) exists to provide access to the key documents and information about the regulation. From 12 February 2014 all counterparties are [required to report details](#) of any derivative contract (OTC or exchange-traded) they have concluded, or which they have modified or terminated, to a registered or recognised trade repository (TR) under EMIR reporting requirements. Reporting to trade repositories under EMIR does not replace any transaction reporting obligation under MiFID and firms should continue to submit required transaction reports.

The UK FCA is undertaking a number of implementation reviews on key EMIR

obligations, with pre-implementation reviews being conducted in advance of obligations taking effect, to assess readiness and establish any areas of concern, and post-implementation reviews conducted shortly afterwards. Results from a number of these reviews have been [published in the form of factsheets](#).

ESMA has published a list of [CCPs established in non-EEA countries](#) which have applied for recognition under Article 25 of EMIR and which expressly agreed to have their name mentioned publicly. This list, last updated on 13 March 2014, is not necessarily exhaustive and it remains subject to further updates. The list is provided for information purposes only and it is without prejudice to any future ESMA decision of the recognition of the applicant CCPs.

On 18 March 2014, Nasdaq OMX became the first European CCP to be reauthorised under EMIR, upon appropriate notification by the Swedish national competent authority (Finansinspektionen). Further information around Nasdaq OMX and the financial instruments it is authorised to clear have been published by ESMA on its [Public Register](#). In line with the clearing obligation procedure set out in Article 5(2) of EMIR, ESMA has up to six months from the time of the notification to decide whether to recommend a clearing obligation for any of the classes of OTC derivative cleared by Nasdaq OMX. Any recommendation to impose a clearing obligation would be subject to a public consultation by ESMA. If any clearing obligation is imposed, frontloading could apply as set out in Article 4 of EMIR depending on the minimum residual maturity of the relevant derivative contracts.

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The FTT in its current design is likely to conflict with rather than complement a number of key regulatory initiatives.

### Financial Transaction Tax

In Issue no. 31 of the ICMA Quarterly Report there was a report on an important challenge to the FTT proposal, for implementation by 11 EU Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) under enhanced cooperation. The Commission and several participating Member States subsequently rebutted the claims that the harmonised FTT framework as proposed by the Commission would contain provisions with illegal extraterritorial effects or not respect the rights of non-participating Member States. In this regard, the Commission has published a 23 January 2014 speech by the European Commission's Director for Indirect Taxation, Mr Bergmann, at a conference in Paris; and a technical note concerning the legality of the "counterparty principle". A 4 February 2014 speech by Commissioner Šemeta, given at a plenary debate of the European Parliament in Strasbourg, stressed that now is the time to engage, compromise and deliver on FTT.

Now under the auspices of the Greek Presidency, discussions continue to try and find common ground for an FTT under enhanced cooperation amongst the 11 EU Member States, with consideration being given to possible exemptions and modifications; but as yet there is still no formal alternative proposal. The Franco-

German Council of Ministers, on 19 February 2014, included discussion of this topic and in response to a direct question on the FTT during the press conference President Hollande made some comments. He made clear that France and Germany are committed to enhanced cooperation on FTT and wish to see this agreed before the European elections. On the need for compromise, he noted that an imperfect tax is preferable to no tax at all.

Authored by Deloitte, *Implications of a Financial Transaction Tax for the European Regulatory Reform Agenda*, was prepared for the International Regulatory Strategy Group (IRSG); and was published by the City of London in January 2014. The main objective of this qualitative research paper is to consider the extent to which the FTT is compatible with a number of significant financial sector regulatory initiatives based on evidence combining existing research, impact assessments and analysis, supplemented by two interviews with financial services groups. The authors conclude: "The FTT in its current design is therefore likely to conflict with rather than complement a number of key regulatory initiatives aimed at increasing financial stability in the financial services sector. This is in addition to the FTT also being likely to fail in achieving its own policy objectives." "The FTT is therefore generally considered an ineffective instrument to enhance financial stability. Its impact on

financial stability is likely to be negative or, at best, neutral."

Authored by London Economics, *The Effects of a Financial Transaction Tax on European Households' Savings* was also prepared for the IRSG; and was published by the City of London on 17 February 2014. This study looked at the potential impact of the FTT on six EU Member States – four (Germany, Italy, Spain and Slovakia) of which are planning to participate in the FTT and two of which (the UK and Luxembourg) are not. Using studies from the ECB and the IMF, the report calculated that the level of GDP would be between 0.5% and 0.8% lower in the long run as a result of the impact on the value of savings arising from the proposed FTT. Mark Boleat, Deputy Chairman of the IRSG, said: "This report highlights the negative impact that the FTT could have on economic prospects across Europe by hitting household savings. It is not a 'tax on markets' but rather a tax borne by end users such as pension funds. The tax could also increase the cost of capital for businesses and sovereign governments. This proposal should be revisited by European policy makers so that we do not damage the future economic prospects of our citizens.

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# Financial benchmarks

By Lalitha Colaco-Henry

There have been four main developments over the past quarter relating to financial benchmarks:

First, ICE Benchmark Administration took over the administration of LIBOR, as of 1 February 2014. The UK's Financial Conduct Authority gave the Intercontinental Exchange's ICE Benchmark Administration (IBA) formal authorisation to become the new administrator of the London Interbank Offered Rate (LIBOR). IBA is using a new surveillance methodology to ensure the quality of the submissions. These new surveillance methods are aimed at helping IBA identify errors or potential misconduct such as collusion in the submission process.

Second, ESMA and the EBA published the results of their [joint review of the EURIBOR-EBF](#) on 20 February. The review found that EURIBOR-EBF had made significant progress in implementing the ESMA-EBA Recommendations addressing weaknesses and shortcomings in its governance and technical framework. Amongst others, some of the steps taken by EURIBOR-EBF include:

- changing the composition of the Steering Committee to reduce the number of members affiliated with panel banks and increasing the frequency of meetings;
- discontinuing the less frequently used tenors;
- reinforcing the EURIBOR-EBF Code of Conduct and creating a Code of Obligations for Panel Banks setting minimum requirements for the submission process and control mechanisms;
- developing a Code of Conduct for the calculation agent's operations in order to improve internal procedures and controls;
- implementing post-fixing checks and back-testing analysis;
- adopting two new conflict of interest policies covering potential conflicts at EURIBOR level and the EURIBOR-EBF level respectively.

Third, the European Commission sent a [letter](#), dated 26 February, to the UK Government dismissing the UK's concerns with the proposed regulation on financial benchmarks. The UK's House of Commons European Scrutiny Committee had sent a letter to the Commission in December 2013 arguing that the Commission's proposal

was too broad to cover the variety of benchmarks available across Europe. The UK's letter went on to state that the Commission's proposal would impose "significant" burdens on users and administrators of benchmarks that are not widely used, and would not properly cover the use of non-EU benchmarks in the region.

The Commission's response argued that the "patchwork of divergent national rules would result in an inconsistent and uncoordinated approach" and that few benchmarks are entirely national in their production and use. It added that without a harmonised EU regime, the risk of benchmark manipulation would not be effectively addressed.

Finally, it also became clear in March that members of the European Parliament had failed to agree on what rates should be included in the proposed regulation on financial benchmarks. Talks broke down after objections from some European political groups over how the rules would apply to commodity benchmarks and non-critical benchmarks. Sharon Bowles, the UK Liberal Democrat MEP leading the negotiations, had proposed narrowing the scope of the proposed rules to avoid imposing the rules on commodity benchmarks and rates deemed to be critical. However, other political parties sought a broader application of the rules and in particular wanted to ensure that commodity benchmarks would fall under tough requirements that could force firms operating in those markets to contribute submissions. Concerns were also raised about the role that ESMA should play in defining certain benchmarks. The failure to agree means that Parliamentary approval will not be achieved before the EU elections in May. The process will therefore start from scratch in the newly elected Parliament which will mean that political agreement is unlikely to be reached this year.

At around the same time, the Council's Working Group held its first meeting to discuss the proposed benchmark regulation. Discussions were introductory and touched on scope, the role of ESMA, critical benchmarks and the third-country regime. The next Council Working Group meeting is scheduled for 10 April.

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# Short-Term Markets

by Andy Hill

## Collateral fluidity

Following on from the ICMA European Repo Council (ERC) paper, *Avoiding Counterproductive Regulation in Capital Markets: a Reality Check*, published in October 2013, the ERC has launched a new initiative to build on these themes and in particular to highlight the importance of collateral in the new regulatory environment. *Collateral is the New Cash: the Systemic Risks of Inhibiting Collateral Fluidity* is aimed principally at policy makers and regulatory authorities, and seeks to raise awareness of the critical role that collateral plays in the smooth and efficient functioning of global capital markets. The paper was developed by the ICMA ERC with input from market practitioners, operations experts, regulation and policy advisors, as well as external commentators.

The paper identifies the main drivers of collateral demand as being a continued move from unsecured to secured funding, Basel III liquidity provisions, and requirements for margining both cleared and non-cleared OTC derivatives trades. While estimates of the incremental collateral requirements vary, and effective collateral supply is equally unpredictable, the paper establishes collateral fluidity as being the important variable for ensuring collateral demand-supply equilibrium. This requires both sound plumbing – the connectivity and interoperability of various market participants and settlement systems – and a functioning pump: essentially the bank funding desks.

The paper also discusses a number of factors, both regulation and market-based, which have the potential either to enhance or inhibit collateral fluidity. Some of these relate to inefficiencies in the settlements system architecture, while others potentially impact the ability of bank funding desks to provide liquid markets for

securities financing transactions, which enables collateral to be pumped around the system.

The paper highlights the systemic risks of inhibiting collateral fluidity, the negative impact this could have on the stability and efficiency of capital markets, and, most importantly, the potential ramifications for the real economy. It concludes that, while sound regulation is essential, it should avoid inhibiting collateral fluidity and, where possible, it should aim to enhance it.

The paper formed the centrepiece for an ICMA ERC Conference in Brussels on 3 April 2014, entitled *New Regulation and Collateral Fluidity*. The conference was hosted by the European Banking Federation, and was specifically aimed at policy makers and regulatory authorities.

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## The Leverage Ratio and the repo market

In January, the Basel Committee on Banking Supervision (BCBS) published the *Basel III Leverage Ratio Framework and Disclosure Requirements*.

The ICMA ERC had previously responded to the Consultative Report on the Leverage Ratio in [September 2013](#), expressing concerns about the proposed treatment for securities financing transaction (SFT) exposures, and in particular the lack of recognition of legally enforceable netting agreements in the calculation.

The framework published in January 2014 has been revised to recognise the netting of SFT exposures between counterparties, with respect to cash payables



and cash receivables, where trades have the same explicit final settlement date and settle in the same settlement system. This can be seen as an inducement for clearing SFTs through central counterparties (CCPs), where most netting opportunities will be provided, but also allows for some netting of bilateral counterparty exposure.

However, the ICMA ERC considered that there were still some ambiguities or omissions in the wording of the framework with respect to SFTs. Regarding the provisions for netting, the text suggests that this is allowable where transactions settle subject to a settlement mechanism that is consistent with normal delivery-versus-payment (DVP) facilities (Paragraph 33(c)). However, a footnote (22) appears to contradict this criterion, suggesting that any issues arising from the securities leg of an SFT should not interfere with the completion of the net settlement of the cash leg. Furthermore, the framework does not outline the treatment for forward-starting SFTs, nor for open or callable SFTs.

In March, the [ICMA ERC wrote to the BCBS](#) asking for clarification and guidance on these particular issues. The ICMA ERC also raised concern over the apparent contradiction in the settlement criterion for SFT netting at a [European Commission Public Hearing on Liquidity Coverage Ratio and Leverage Ratio](#), held in Brussels on 10 March. It is hoped that these issues will be addressed in a forthcoming *Frequently Asked Questions* in relation to the Leverage Ratio, published by the BCBS.



**The ERC considered that there were still some ambiguities or omissions in the wording of the framework with respect to SFTs.**

As regards timing, the implementation of the Leverage Ratio requirements began with bank-level reporting to national supervisors from 1 January 2013, and will proceed with public disclosure starting 1 January 2015. The BCBS will continue monitoring the impact of these disclosure requirements, with the final calibration and any further adjustments to the definition to be completed by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018.

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## **The Net Stable Funding Ratio and the repo market**

In January 2014, the BCBS published a [Consultative Document on the Basel III Net Stable Funding Ratio](#). The Net Stable Funding Ratio (NSFR) requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. It is designed to limit over-reliance on short-term wholesale funding, encourage better assessment of funding risk across all on- and off-balance sheet items, and promote funding stability.

The NSFR is defined as the amount of available stable funding (ASF) relative to the amount of required stable funding (RSF). The ASF is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The RSF calculation is a function of the liquidity characteristics and residual maturities of the various on- and off-balance sheet assets held by a specific institution. The ratio should be equal to at least 100% on an on-going basis. It is the intention of the Committee that the NSFR, including any revisions, will become a minimum standard by 1 January 2018.

The proposed framework has been updated since the framework first published in 2010. Most significantly, from the perspective of the repo markets, it now requires a 50% RSF factor for non-renewable loans to non-bank financial institutions with a residual maturity of less than one year, regardless of the underlying asset. This would mean that all reverse-repos with non-banks under one-year maturity would require the provision of stable funding against 50% of the value of the reverse-repo. For example, a bank transacting a US\$100 million overnight reverse in AAA government bonds with an insurance company or hedge fund

would carry a requirement for US\$50 million of long-term stable funding, even if this reverse were match-funded by repo. Reverse-repos with residual maturities of less than six months transacted with another bank, however, would carry no RSF weighting, and so not require a provision for stable funding. It is not clear from the document whether the definition of banks would include central counterparties (CCPs).

It would seem that this asymmetric treatment between banks and non-banks for reverse-repos is intentional, and is designed to reduce the availability of leverage to non-banks (particularly hedge funds) as well as to mitigate the risks associated with large repo matched-books.

Not only does the proposed RSF weighting for non-banks not distinguish between the liquidity and credit quality of the underlying securities; neither does it differentiate between the reasons for reverse repo. Reverses to cover firm shorts (and which supports market-making) or for liquidity buffer management would also be impacted by the 50% RSF factor.

The BCBS has indicated that it would appreciate understanding better the potential consequences of the asymmetric treatment for non-banks in the RSF calculation, and that any qualitative arguments should be supported by a detailed quantitative impact study (QIS).

It is the intention of the ICMA ERC to respond to the Consultative Document, pointing to the potential disruptive and distortive impact of the current proposals on global repo markets. The ICMA ERC is concerned that the effects are likely to be far reaching, impacting not only liquidity and pricing in the underlying bond markets, but, in turn, harming real economy activity.

In March, the ICMA ERC reached out to its members to request data, by means of a survey, to better ascertain the portion of the market likely to be impacted by the NSFR, and to form the basis of a QIS to support the ICMA ERC's response.

The deadline for responses to the Consultative Document is 11 April 2014.

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## Asset encumbrance and the repo market

In December 2013, the European Banking Authority (EBA) published a Consultation Paper on *Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets*. The guidelines are seen as the first step in this disclosure framework and are intended to enable market participants to compare institutions in a clear and consistent manner. The EBA intends to review the guidelines after one year, and this will form the basis of the binding technical standards for more extensive disclosure to be developed by 2016.

While the ICMA ERC is supportive of consistent and accurate disclosure of asset encumbrance, it is concerned by the EBA's definition of asset encumbrance arising from securities financing transactions (SFTs), and the danger of applying a catch-all approach for different types of SFTs, pledges, and securitisation. The ICMA ERC therefore used the consultation as an opportunity to restate its concerns, particularly regarding the treatment of SFTs transacted under the Global Master Repurchase Agreement (GMRA). Under such an agreement, legal title is passed to the borrower of the securities, and it is the view of the ICMA ERC, and others, that the correct guidance should be to report these transactions as unencumbered assets and on a net basis.

Where haircuts (in the form of over-collateralisation) are applied to these transactions, the ICMA ERC recognises that this is a form of encumbrance. Accordingly, it would expect guidance for reporting net haircuts received as a form of encumbered assets. Similarly, the marginal contingent encumbrance arising out of SFT margining should also be recognised. In this instance, the ICMA ERC would suggest some form of appropriate risk-weighting be applied to the underlying asset to represent this marginal contingent encumbrance.

These points were included in the [response to the consultation by the ICMA Financial Institution Issuer Forum](#) that was submitted in March 2014.

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by Lisa Cleary

### **ICMA ERC Guide to Best Practice in the European Repo Market**

ICMA's European Repo Council (ERC) has launched its *ERC Guide to Best Practice in the European Repo Market*, setting out standards for the orderly trading and settlement of repos. Much repo trading in Europe is between banks in different countries, making it essential to have consistent, internationally-recognised standards. Although impacted by the effect of the crisis on general financial activity, the latest threshold figure for market size is €5.5 trillion. Recent regulatory initiatives encouraging the collateralisation of risk, directly and through the use of CCPs, have further heightened the importance of the repo market, which is the place where collateral demand and supply meet.

The updated *ERC Guide* covers the full scope of the repo trading life-cycle including: fixing dates; affirmation and confirmation of transactions; margining; non-standard interest calculations; issuing notices; delivery issues; and dealing with negative repo rates. ICMA ERC Chairman Godfried De Vidts commented: "The repo market proved uniquely resilient over the course of the financial crisis, in part because of the high standards that market participants maintained in the way they conducted their business and settled issues, even under very difficult circumstances. They were supported by a robust legal agreement in the form of the GMRA and recommendations on best practice that had been distilled from practical experience over many years. The new guide updates and considerably expands those recommendations to take account of recent experience. As change in the market shows no sign of slowing down, the new guide will inevitably have

to change as well. It is therefore very much a "living" document, which will be continually adapted to evolving market conditions."

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### **2014 ICMA GMRA legal opinions update**

The 2014 [ICMA GMRA legal opinions](#) update has concluded with updates of each of the 2013 legal opinions being obtained in over 60 jurisdictions. In addition, a new GMRA legal opinion has been obtained for Liechtenstein. ICMA is the sole provider of industry standard opinions on the GMRA 1995, 2000 and 2011 versions, as well as the 1995 version as amended by the Amendment Agreement to the 1995 version, and the 1995 and 2000 versions as amended by the 2011 ICMA GMRA Protocol. The 2014 GMRA opinions have been obtained by ICMA for the benefit of ICMA and its members (excluding associate members). The 2014 GMRA opinions cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole. Furthermore, the opinions address the issue of recharacterisation risk (in respect of both the transfer of securities and the transfer of margin). While all 2014 GMRA opinions cover, as a minimum, companies, banks and securities dealers, the opinions for 37 jurisdictions additionally cover insurance companies, hedge funds and mutual funds as parties to the GMRA.

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## Transparency and reporting of SFTs

On 29 January 2014, the European Commission published a draft *Regulation on Reporting and Transparency of Securities Financing Transactions* (TSFT Regulation) alongside a draft *Regulation on Structural Measures to Improve the Resilience of the EU Banking Sector* (SBR Regulation). These two proposed Regulations follow the *Final Report of the Liikanen Group*, which was published on 2 October 2012, and also build on the *Recommendations of the Financial Stability Board* related to shadow banking.

The draft SBR Regulation seeks to prohibit banks from proprietary trading in financial instruments and commodities, or investing in alternative investment funds for its own account. However, the draft acknowledges that: “It is difficult to distinguish proprietary trading from market making. To overcome this difficulty, the prohibition of proprietary trading should be limited to desks, units, divisions or individual traders specifically dedicated to proprietary trading” (Recital 16). Additionally, the draft SBR grants supervisors the power to transfer high-risk trading activities (such as market-making, complex derivatives, and securitisation operations) to separate legal entities within the group (“subsidiarisation”).

The draft TSFT Regulation is aimed at preventing banks from circumventing the rules set out in the proposed SBR Regulation by shifting parts of their activities to the less regulated shadow banking sector. It does this by increasing the transparency of certain securities financing transactions (SFTs) outside the regulated banking sector. The heightened transparency provisions also seek to enhance regulators’ and investors’ understanding of such transactions. The Commission had previously argued in its *Communication on Shadow Banking* that SFTs were a source of contagion, leverage and procyclicality during the financial crisis and therefore were in need of better monitoring.

It is proposed that the TSFT Regulation apply to UCITS, AIFMs, all counterparties to a SFT, and all counterparties engaging in “rehypothecation”. SFTs include: (i) repos and reverse repos; (ii) securities/commodities lending and borrowing; and (iii) any transaction having an equivalent economic effect and posing similar risks, in particular a buy-sell back or sell-buy back transaction. “Rehypothecation” is defined as the use by a receiving counterparty of

financial instruments received as collateral in its own name and for its own account or for the account of another counterparty. Members of the European System of Central Banks and other Member State bodies performing similar functions and other EU public bodies charged with or intervening in the management of public debt are exempt.

The draft TSFT Regulation does not appear to impact on the ability of firms to enter into SFTs. Instead, it would impose a regulatory/administrative burden on firms to report SFTs to a trade repository registered with ESMA pursuant to the European Market Infrastructure Regulation (EMIR). There would also be a burden of record-keeping for 10 years following the termination of the transaction. Similarly, for UCITS and AIFMs, there would be a regulatory/administrative burden to disclose to fund investors the use they make of SFTs and other financing structures.

It remains to be seen whether the proposed TSFT Regulation will provide the authorities with useful data on the build-up of risks. Much depends on the technical work that will flesh out the detailed reporting requirements and the ability of industry and supervisors to work together in understanding the aggregated, anonymised data.

The draft TSFT Regulation could potentially make engaging in transactions involving rehypothecation more costly. The counterparty providing the underlying securities must be made aware, in writing, of the risks involved and must also provide prior written consent before the transaction can take place. Additionally, the underlying financial instruments must be transferred to an account opened in the name of the receiving counterparty before the rehypothecation can take place.

The draft TSFT Regulation is expected to be reviewed by the Council of Ministers and the European Parliament after the European Parliament elections in May 2014, and agreed before the end of 2014, with trilogue in early 2015. This would mean that the Regulation would pass into law towards the end of 2015

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## ECP market

The ECP market is a professional short-term debt market which offers opportunities for issuers to raise working capital and other short-term funding as well as for institutional investors to make varied and reliable short-term investments. ECP is the largest and most liquid CP market in Europe. ECP, including in the form of ABCP, plays an important role in providing much needed funding to the benefit of issuers and investors; and as efforts continue to stimulate economic growth, the case for an efficient and effective CP market is more evident than ever.

As with other sectors of the financial markets, ECP markets are affected by a wide range of measures being taken in order to reregulate the way in which these markets work. Whilst the instigation of these measures is an understandable reaction to the financial crisis, their cumulative effect is a costly burden and there is the risk of unintended consequences. Amongst the many pieces of regulation influencing the operation of the ECP market are new rules for liquidity and capital requirements applicable to banks and securities firms, including specific rules relating to securitisations (which affect ABCP); new trading rules; rules concerning the recovery and resolution of financial institutions; and rules applicable to previously less regulated market actors, including alternative investment funds, money market funds (MMFs) and CRAs.

Year-end outstanding ECP amounts (in US\$ million), as shown in Euroclear data, provide an illustrative picture of the scale of the ECP market.

It can readily be seen that the market has declined in size from its pre-crisis peak but is still providing a reasonably steady amount equivalent to around half a trillion dollars of funds. Euroclear data also show that this amount covers around 7,000 outstanding deals with a weighted average number of days to maturity in excess of two months. In an ideal world action would be being taken to nurture this valuable source of funding, but concerns remain that current efforts to reduce risk in the financial system will in fact serve to further impede the ECP market's development.

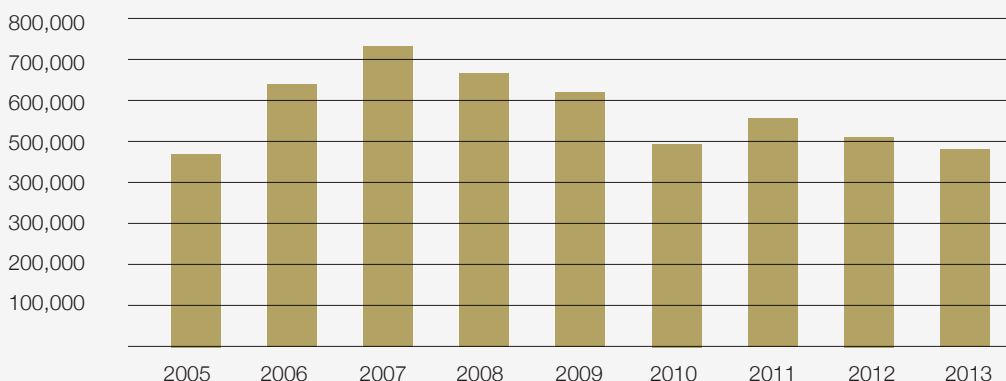
A topical example of such concern is the European Commission's proposed [MMF Regulation](#). As reported in [Issue no. 32 of ICMA Quarterly Report](#), MMFs play a very significant investor role in the ECP, and especially the ABCP, market; and ICMA is very concerned about the negative impacts that the proposed MMFR could have on these valuable financing instruments. The exact nature of the restrictions which the MMFR will introduce for MMFs is now set to remain uncertain for quite some time, the European Parliament's ECON having decided that its debate on this proposal will have to be picked up in the new European Parliament which will be formed following elections in May 2014.

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### Year-end outstanding ECP amounts (US\$ million)



Source: Euroclear





by Ruari Ewing  
and Charlotte  
Bellamy

# Primary Markets

## Prospectus Directive

There have been a number of developments connected with the Prospectus Directive (PD) regime.

On 7 March 2014, the European Commission adopted a [Delegated Regulation](#) supplementing the PD with regard to RTS for publication of supplements to the prospectus, which specifies situations where a significant new factor, material mistake or inaccuracy relating to the information included in the prospectus requires a supplement to the prospectus to be published. The Delegated Regulation is in substantially the same form as the draft Regulation proposed by ESMA in its [Final Report](#), mentioned in the [First Quarter 2014 edition](#) of the ICMA Quarterly Report. For vanilla debt securities, the circumstances in which a supplement is always required are limited to two situations: (i) where an issuer is seeking admission to trading on an additional regulated market in an additional Member State or is intending to make an offer to the public in an additional Member State other than the ones provided for in the prospectus; and (ii) where the aggregate nominal amount of the programme is increased. The Delegated Regulation will enter into force on the 20th day following its publication in the *Official Journal*.

Separately, the UKLA has introduced a tailored approach for reviewing certain

wholesale debt prospectuses, known as the “Wholesale Debt Approach” (WDA). The WDA currently applies to a limited range of wholesale prospectuses (mainly corporate or non-UK bank, investment grade, non-emerging market issuers in the vanilla space), although we understand the UKLA wishes to keep the scope of the WDA flexible. If a prospectus is approved under the WDA, then it is expected that the UKLA will raise fewer comments and review fewer drafts of the prospectus.

The European Parliament adopted [Omnibus II](#) on 11 March 2014. The only changes from the trilogue outcome (a note of which was included in the [First Quarter 2014 edition](#) of the ICMA Quarterly Report) relating to the Prospectus Directive are: (i) to change to 1 July 2015 (from 1 July 2014) the date by which ESMA must prepare draft regulatory technical standards on information incorporated by reference, prospectus approval time limits, prospectus publication and dissemination of advertisements; and (ii) to clarify drafting. The Directive will need to be formally adopted by the European Council and be published in the *Official Journal* before it enters into force. The Parliament and the Council have agreed that the Solvency II Directive (including the amendments introduced by Omnibus II) should apply as of 1 January 2016.

ESMA has published the *21st Version of the Q&A on Prospectuses*, which includes two new questions. New question 91 relates to the format for an issue specific summary relating to more than one security, with ESMA suggesting two alternative formats. New question 92 relates to the applicable registration document schedule where a listed issuer proposes to issue convertible or exchangeable debt securities where the underlying securities are the issuer's shares.

Although there continue to be developments in regulation and market practice in relation to the recent review of the PD (PDII), the Commission is required to further review the PD (PDIII) and present a report to the European Parliament and the Council by 1 January 2016. We expect the Commission will need to begin engaging with industry on PDIII in 2015, and ICMA therefore plans to begin engaging with members in relation to their views on how PDIII should look in the coming months.

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## Market Abuse Regulation

As anticipated in the *First Quarter edition* of the ICMA Quarterly Report, ICMA submitted a response to ESMA's *Discussion Paper* on its policy orientations on possible implementing measures under the Market Abuse Regulation (MAR). ESMA was able to allow just over two months for responses, which is a significant improvement over the average times allowed for consultation responses in recent times.

Regarding stabilisation, the ICMA response suggests that MAR should generally reiterate the current approach in the MAD safe harbour, subject to a few exceptions to improve certainty. First, publication of pre-stabilisation notices should not be required prior to the fixing of the issue's final spread. Second "input" responsibility for stabilisation notices and reporting should be within the control of the stabilisation managers who need the benefit of the safe harbour. However, in a syndicated context for logistical efficiency, a central stabilisation coordinator should be allowed (but not compelled) to undertake the notification and reporting responsibilities on behalf of the various

stabilisation managers. Third, the notice publication mechanism should generally be aligned with the TD. Fourth, notice and reporting "output" should be centralised to promote certainty and efficiency. Just one EU Member State's TD publication and regulatory reporting mechanisms should apply, based on the issuer's place of incorporation (with non-EU issuers to formally select an EU home Member State as in the TD). This is important, as MAR's expansion of scope to include the plethora of trading venues on which a particular bond might be traded (some potentially unknown to the issuers concerned) would cause a venue-based publication and reporting conundrum. Fifth, there should be clarity as to how any of the safe harbour requirements for actual stabilisation purchases are to apply to any prior and related overallocation (which ideally should be permissible up to 10% of the issue size to maximise effectiveness).

Regarding soundings, the ICMA response firstly emphasises generally that compliance with the safe harbour provisions will deem disclosure of inside information not to breach MAR's

## ICMA *pro forma* final terms and retail cascades legends

Following extensive work by law firms, approval by the ICMA Legal & Documentation Committee and other internal ICMA bodies, ICMA is preparing to publish revised versions of the ICMA *pro forma* final terms and *pro forma* pricing supplement for MTN programmes and new ICMA retail cascades legends. The purpose of the revision to the ICMA *pro forma* final terms and *pro forma* pricing supplement is to reflect the changes to the European prospectus regime as a result of amending Directive 2010/73/EU and relevant implementing measures in Member States. Certain other updates

have also been made, such as allowing the flexibility for the ICMA *pro forma* final terms and *pro forma* pricing supplement to be used for the issuance of registered notes. The purpose of the publication of new ICMA retail cascades legends is to provide market participants with standard language that may be used in prospectuses where the issuer wishes to consent to the use of the prospectus in a subsequent resale of securities or final placement of securities through financial intermediaries, pursuant to Article 3(2) of the Prospectus Directive, as amended by Directive 2010/73/EU.

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prohibition on the improper disclosure of inside information. Soundings that are otherwise proper or do not involve inside information should not be impacted by the safe harbour procedural requirements as they do not in any case breach the primary MAR prohibition. However, the ESMA Discussion Paper suggests specific mandatory procedures that are inconsistent with this concept. Distinctly and more generally, the response notes that: (i) an overburdening of required procedures (bearing in mind the relative market impact of bond issues compared to, for example, major IPOs or takeovers) could put into question the safe harbour's relevance in practice; and (ii) appropriate application of MAR's definition of inside information in regulatory enforcement (notably acknowledging the importance of significant price sensitivity) is crucial to avoiding a fundamental chilling of issuers' communication with the markets.

Second, and more specifically, the response highlights that the soundings safe harbour should recognise that:

- issuers often leave the management of their bond issuance transactions (including whether, what and how to

sound) entirely to their syndicates;

- only a few "core" members of such syndicates are actively involved in the early active management of such transactions (including any soundings);
- sounding information is often required on very short notice (potentially a matter of hours if not minutes);
- wallcrossed soundees can only be proactively "cleansed" through the inside information becoming public (either by the transaction proceeding or the issuer agreeing to a public statement) and soundees cannot (under MAR itself) rely on any private sell-side views as to, for example, the fading of significant price sensitivity;
- many issuers will prefer to defer a bond issue or take it to another market rather than commit themselves to potentially making public statements that the markets might potentially misconstrue as a sign of issuer weakness (often transaction postponements/cancellations relate to issuer expectations of better funding opportunities elsewhere); and

- any insufficiency (eg as to cleansing strategy or other sounding "script" content) in a proposed wallcrossing can be policed by potential soundees simply refusing to be wallcrossed as their prior consent is mandated in MAR itself (which is common occurrence in practice).

Third, the response comments on various other points of detail concerning soundings, including: selecting soundee type and numbers (which can in practice evolve based on initial feedback received); permitting sounding in trading hours (essential to increase the likelihood of soundees being reachable); sounders maintaining gatekeeper/"unwilling" soundee lists either reactively (a point of market convenience only that is unsuitable for legislative entrenchment) or proactively (a practical impossibility absent legislative compulsion upon investors); wallcrossing scripts (which generally need to be calibrated to specific circumstances and so cannot be standardised); audit trail requirements (which must be proportional to be justified); recorded lines (workable for banks as they already have recorded lines); written confirmation procedures either *ex ante* (impractical) and *ex post* (workable); disagreement on information inside status; and related reporting to regulators (parties should be free to act as they deem appropriate).

Finally, the response also briefly addresses related concerns on issuers delaying the publication of inside information and the level of detail required for insider lists.

ICMA will continue to engage the authorities in this area. It is to be hoped that ESMA's expected follow-up consultation (anticipated in late spring but subject to EU *Official Journal* publication of MAR) will include a feedback statement on the responses received to explain ESMA's proposed policy approach.



**Soundings that are otherwise proper or do not involve inside information should not be impacted by the safe harbour procedural requirements**

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## Review of the ICMA Primary Market Handbook

By Lalitha Colaco-Henry

We reported in the ICMA [Quarterly Report for the First Quarter of 2013](#) on the work being done by the Wider Working Group (WWG) to review the ICMA Primary Market Handbook. The WWG has now spent a considerable amount of time and effort carrying out a top-to-bottom review of the Handbook and has made significant progress.

The Handbook has been restructured with all of the Recommendations set out over 12 Chapters that broadly follow the chronology of a typical vanilla bond offer. Accordingly, the chapters are as follows: Programme establishments and updates; Prior to deal announcement; Deal announcement; Bookbuilding and launch; Allocation/allotment; Pricing; Confirmation to managers; Stabilisation; Issue documentation and Signing; Closing and settlement. There is also a chapter for ECP. The 12 Chapters contain Recommendations, clearly identified as such, with the remainder of the provisions being provided as guidance. There are also a number of Appendices which contain explanatory notes and model ICMA language.

From a substantive perspective, the WWG has focused particularly on ensuring that the Handbook clearly sets out the information that needs to be communicated to different market participants at different stages of a deal, such as the information that needs to be communicated to prospective managers in an initial syndicate communication and the information to be included in a confirmation to managers. The WWG has also aimed to ensure that the new Handbook

clearly identifies those provisions that apply to certain types of deal only, such as retention deals (ie where managers received an allotment of securities at the discretion of the Lead Manager, which the managers then sell directly to their clients). Otherwise, the new Handbook has been drafted from a pot deal perspective (ie where the whole of the issue is set aside to be allocated to investors out of a central order book run by one or more of the bookrunners for the issue). A further element of the review has been to ensure that the Handbook continues to be consistent with all relevant EU Directives. Finally, considerable work has been done to simplify and rationalise the Handbook. The current Handbook lacks an index, which makes locating provisions within the Handbook difficult and time-consuming. Therefore, a detailed index will be included in the new Handbook. The new Handbook will also contain a glossary of terms, which is intended to be a helpful guide to the way certain market terms have been used in the Handbook.

Once the review stage is over, the next steps will be to discuss the amendments with syndicate desk administrators as well as with ICMA's Legal and Documentation Committee and Primary Market Practices Committee. The new Handbook will be published once it has received all the necessary approvals, including competition law sign-off.

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## Green bonds

### by Nicholas Pfaff

ICMA is in discussions to provide the Secretariat for the Green Bonds Principles (GBP). The GBP are a set of voluntary standards for bond market participants for the issuance of Green Bonds drafted by a group of leading intermediaries – Bank of America Merrill Lynch, Citi, Crédit Agricole Corporate and Investment Bank and JPMorgan Chase – supported now by more than 20 banks. These principles represent in ICMA's view the leading effort to promote the standardisation of the GB market. The [updated version](#) of the GBP released in January 2014 follows the initial [Framework for Green Bonds](#) originally published in September 2013. The GBP give guidance on “use of proceeds, process for project evaluation and selection, management of proceeds, and reporting”; and also recognise the following green bond categories that can be broadly described as follows:

- **Green Use of Proceeds Bond:** a recourse-to-the-issuer debt obligation for which the proceeds shall be moved to a sub-portfolio or otherwise tracked by the issuer, and attested to by a formal internal process, before they are used for eligible green investments.
- **Green Use of Proceeds Revenue Bond:** a non-recourse-to-the-issuer debt obligation in which the credit exposure in the bond is to the pledged cash flows of the revenue streams, fees, taxes etc, and the proceeds of the bond goes to related or unrelated green project(s). The proceeds shall be moved to a sub-portfolio or otherwise tracked by the issuer, and attested to by a formal internal process.

- **Green Project Bond:** a project bond for green project(s) for which the investor has direct exposure to the risk of the project(s) with or without potential recourse to the issuer.
- **Green Securitised Bond:** a bond collateralized by one or more specific projects, including but not limited to covered bonds, ABS, and other structures. The first source of repayment is generally the cash flows of the assets.

The Green Bonds market was launched by landmark transactions by the EIB and the WB. In 2007, the EIB raised €600 million through its [inaugural Climate Awareness Bond \(CAB\)](#) which was the first with proceeds earmarked for disbursement to climate action projects in the fields of renewable energy and energy efficiency. After finalising its *Strategic Framework for Development and Climate Change*, the World Bank issued in 2008 a [SEK2.7 billion bond](#). The EIB and the World Bank are still the leading issuers in the market (the largest Green Bond presently outstanding is EIB's €2.25 billion CAB 11/2019), and other major multilateral institutions such as the International Finance Corporation, the European Bank for Reconstruction and Development and most recently the African Development Bank are now active issuers as well.

The market has also expanded significantly to other types of issuers such as regional and local authorities (Région Ile de France, the Commonwealth of Massachusetts), banks (Bank of America Merrill Lynch) and corporations (Vasakronen, EDF, Unibail-Rodamco, Toyota Financial Services). It is

in the corporate space that there has been a string of recent landmark transactions further underlining both the potential of the market, and supporting efforts towards greater standardisation.

After EDF's November 2013 €1.4 billion Green Bond dedicated to financing future renewable energy projects, Unibail-Rodamco announced in February 2014 that it had successfully placed a [€750 million Green Bond](#) representing the first such issuance of a real-estate company in the Euro market. Funds will serve to finance buildings that meet amongst others agreed high standards of energy efficiency. In the US, Toyota Financial Services issued the auto industry's first-ever [Asset-Backed Green Bond](#) in the amount of \$1.75 billion. The offering was upsized from \$1.25 billion to accommodate demand as institutional investors demonstrated strong interest in this inaugural clean transportation investment opportunity. The proceeds of this bond will be used to fund new retail finance contracts and lease contracts for Toyota vehicles that meet specific criteria, including power train, fuel efficiency and emissions.

If appointed Secretary of the GBP, ICMA will expect to be a key player in the promotion of these voluntary standards in line with its self-regulatory philosophy. It will keep members informed of these activities and generally of further developments in the GB market.

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# Issuers and asset encumbrance disclosure

by Katie Kelly

As reported in the [Third Quarter 2013](#) edition of the ICMA Quarterly Report, the European Banking Authority (EBA) launched a consultation on [Draft Implementing Technical Standards \(ITS\) On Asset Encumbrance Reporting](#), which set out reporting templates (and corresponding user instructions) for reporting asset encumbrance. The consultation came about as a result of the mandate under Article 95a of the CRR for the EBA to develop reporting templates for asset encumbrance and of the ESRB [Recommendations on Funding of Credit Institutions](#) (the Recommendations), which task the EBA with developing guidelines on market transparency requirements for credit institutions on asset encumbrance. In accordance with the mandate contained in Article 443(a) of the CRR and the Recommendations, the EBA has now released a [Consultation Paper](#) comprising [Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets](#), which will be reviewed after one year and will form the basis of the binding technical standards on more extensive disclosure that will be developed by 2016.

ICMA has filed a [response](#) to the Consultation Paper on behalf of the Financial Institution Issuer Forum (FIIF), which includes representations from the ICMA European Repo Council. In doing so, ICMA stated that it considers that the standardisation of a minimum amount of information, which can be accompanied by additional narrative explanations (although in itself, this may present a challenge without guidelines in terms of consistency of drafting and extent of narrative disclosure), is beneficial for comparability and for investors' analysis, and that an appropriate balance has been struck between the amount of information which is useful for an investor and excessive disclosure which can be overwhelming and lead to confusion.

Of the main observations, ICMA restated concerns to the EBA over the definition of asset encumbrance – in particular, the inclusion of repo therein, and

the subsequent danger and potential unintended consequences of using a catch-all approach to reporting securities financing trades (SFTs). While ICMA fully supports the reporting of SFTs where legal title remains with the lender of the security (such as pledges) as encumbered, where legal title is passed to the borrower (as is the case with repo transacted under the GMRA), ICMA considers that the correct guidance should be to report these transactions as unencumbered assets and on a net basis. However, where haircuts (in the form of over-collateralization) are applied to these transactions, ICMA noted that it would expect guidance for reporting net haircuts received as a form of encumbered assets. Similarly, ICMA stressed that marginal contingent encumbrance arising out of SFT margining should also be reported, and that maybe some form of appropriate risk-weighting should be applied to the underlying asset to represent this marginal contingent encumbrance.

The Consultation Paper provides that firms should not disclose the amount of emergency liquidity assistance (ELA) provided by central banks, with assets and matching liabilities encumbered to central banks via ELA being reported as unencumbered. However, the ICMA response highlights the danger that such non-disclosure may render the overall disclosure incomplete and misleading, and may distort the full picture for the investors in that first, it could lead to over statement of contingent funding capacity and availability of collateral, and second, certain numbers may not match with other sections of the accounts. Mindful of these considerations, ICMA suggested that further guidance on how to account for ELA across the accounts should be provided.

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### Other primary market developments

- ESMA has launched a “one-stop shop for EU regulated investment information”. The [ESMA Registers](#) provide, *inter alia*, a list of prospectuses, supplements and certificates of approval that have been approved under the PD. There are also registers for MiFID investment firms, UCITS management companies, Alternative Investment Fund Managers and sanctions under MAD, MiFID and UCITs.
- A *corrigendum* to the amended Transparency Directive was [published](#) in the *Official Journal* on 18 January 2014. The *corrigendum* changes the date by which the European Commission shall report on the operation of the Directive from 27 November 2015 to 27 November 2018.
- The US Internal Revenue Service [issued](#) on 20 February 2014 the last substantial package of regulations necessary to implement FATCA. The key amendments and clarifications relate to: (i) the accommodation of direct reporting to the Internal Revenue Service, rather than to withholding agents, by certain entities regarding their substantial US owners; (ii) the treatment of certain securitisation SPVs; (iii) the treatment of disregarded entities as branches of foreign financial institutions; (iv) the definition of an expanded affiliated group; and (v) transitional rules for collateral arrangements prior to 2017. These regulations are not expected to impact on documentation in the primary DCM space.
- Anticipated trilogue negotiations concerning PRIPs opened between the European Council, Parliament and Commission on 29 January. An agreement was [announced](#) by the Parliament on 1 April, with possible formal adoption by the institutions concerned ahead of the European elections due in May. In this respect, the JAC (Joint Associations Committee on retail structured products), whose PRIPs work ICMA supports, has recently produced a [paper](#) recapping the KID content/length, purpose/liability, product intervention and synthetic risk indicator concerns expressed in prior editions of this quarterly report. Though technically focused on structured securities, the papers’ concerns are equally relevant to vanilla securities.

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# Secondary Markets

by John Serocold

## The MiFID II package: first steps to implementation

Following political agreement, reached on 14 January 2014, the MiFID II legislative package, comprising a Directive (MiFID) and a Regulation (MiFIR) is scheduled to be voted on by the European co-legislators soon after this Quarterly Report is issued. This article provides a brief update on ICMA's priority issues some of which were still open at the time of the Quarterly Report for the [First Quarter](#) of 2014, and looks at the expected timetable between now and the dates when the legislation is expected to come into force.

### Priority issues

The main issues of concern to ICMA and its members remain the requirements for price and volume transparency in the secondary markets, both pre- and post-trade; the requirements on market structure more broadly, including systematic internalisers; and the "third country" regime, governing relationships between EU markets and firms and investors from outside the EU.

Secondary market conditions in the international bond markets continue to be a hot topic for market participants. The MiFID reforms come at a time when the market is actively considering new solutions. The scene is therefore set for an important debate about how trading venues will continue to operate, detailing and specifying what the exemptions are (called "waivers" in the MiFIR text) and how they will apply to securities markets

in practice. Evidence of current practice will be important; we describe current work on liquidity in the box.

*Pre-trade transparency:* The requirements for trading venue operators to make public continuous bid and offer prices and actionable indications of interest, and depth of trading interest at prices which are advertised through their systems, is new to fixed income markets. Given the range of types of systems which are used in the bond and repo markets, in particular quote-driven, hybrid, and voice trading, the specified calibration of the requirement to different types of trading system will be vital to the market's ability to service client need. Different systems will have different protocols for the proper conduct of trading. Proper treatment of hybrid systems will be particularly important in view of the mixture of voice and electronic systems that characterises international fixed income markets. Regulation will need to continue to adapt if new forms of market organisation emerge. The requirement to publish at least indicative bid and offer prices may not fit with how some of these types of system operate. The publication of advertised prices needs to be distinguished from the trading access that membership of the trading venue confers, and which venue operators must be able to control. Further consideration may be needed of what "advertised through the system" means in international fixed income markets where, unlike the dedicated server and network of many trading venues, market participants draw data from a range of sources into their own systems for onward distribution to clients. As in other markets,



## Regulation will need to continue to adapt.

there is a need to recognise that the last executed trade is a valuable input to trading decisions, alongside pre-trade information.

It will be particularly important for National Competent Authorities (NCAs) to waive pre-trade transparency requirements as permitted from time to time in order to seek to ensure the market's ability to service customer needs. Similarly, the provision for NCAs to be able to suspend pre-trade transparency obligations when liquidity falls will provide vital flexibility, since the liquidity of fixed income instruments typically declines substantially shortly after issue. There needs to be a ready ability to move from suspension to recalibration of transparency obligations where it becomes evident that a decline in liquidity is not localised but market-wide.

NCAs will need to manage the procedures for granting waivers, and for granting and maintaining suspensions, adaptively and responsively, to ensure that the six-month approval regime for the former, and the three-monthly renewal regime for the latter, do not give rise to unnecessary obstacles to trading in less liquid instruments. Furthermore, it will be necessary to devise arrangements to cater efficiently for the multinational nature of international fixed income markets, in which participants will typically use multiple platforms, without there being a simple one to one relationship with NCAs.

ICMA will work closely with members and ESMA and NCAs on the development of the standards relating to the pre-trade and post-trade transparency rules and waivers, which will be crucial to protect the efficient operation of fixed income markets.

*Post-trade transparency:* Here, as expected, the MIFIR text provides for publication of price, volume and time of trade information "as close to real time as reasonably possible". Deferral, which is

granted by NCAs following an opinion from ESMA, is permitted in a number of circumstances including where orders are large in scale relative to "normal market size"; where there is no liquid market; and where the size of the trade would expose liquidity providers to undue risk.

Technical standards will cover the details to be published, and the time limit for publication of trades executed outside ordinary trading hours: the former should specify that it is the "clean" price (ie without deferred interest) that is to be published, to provide a consistent valuation basis; the latter will need to take account of the international nature of fixed income markets – both across the time zones of the EU, and across global markets. Technical standards will also specify the treatment of transactions involving the use of instruments for collateral or lending, or where the price is determined by other factors than the current market valuation, so that the price formation function of completed transactions is not distorted. Delegated acts will cover the conditions for authorising deferred publication and the criteria for determining the size or type of transaction for which limited details in aggregated form may be published, or volume omitted, with particular reference to allowing extended deferral depending on the liquidity of instruments. All of these aspects will need to be straightforward and principled, without over-specification, and consistently applied across the EU.

*Systematic Internalisers:* A set of requirements apply to "systematic internalisers", defined as firms who deal on own account on an "organised and frequent, systematic and substantial basis". Broadly, this translates to single dealer platforms and may be appropriate to include some OTC transactions. The systematic internaliser requirements are new to fixed income markets. Systematic internalisers in instruments where there is a "liquid market", as defined, must publish quotes they provide to clients, and make those quotes available, subject to stated criteria and limits, to other clients. Where the quote is below the "size specific to the instrument" used for pre-trade transparency waivers, firms/clients must enter into transactions under these published conditions.

It will be important to apply the systematic internaliser rules to fixed income markets in a way that recognises the limited liquidity in

many instruments. As well as taking account of the exemption for illiquid instruments, it will be important to give full weight to the specified ability of systematic internalisers to update and withdraw quotes; to decide objectively which clients are to have trading access to those quotes; to refuse transactions on commercial considerations; to set limits on the number of transactions entered into in relation to a particular quote; and to improve on the quote.

*Third country regime:* The international fixed income market by its nature involves interaction with third country firms that perform a variety of trading or advisory intermediation functions between third country issuers and investors and European markets, and between EU issuers and investors and third country markets. It is necessary to enable typical interactions in international fixed income markets, such as the use of syndicates involving both EU and third country firms, and dealings between EU and third country firms on an agency basis without attributing any obligations to underlying retail clients. It will be particularly important to maintain the existing daily contacts with third country firms that enable the passage of information and facilitate third country clients' business with EU markets and EU clients' business with third country markets. The international fixed income market is largely wholesale, and in that case the rules for professional clients and eligible counterparties apply, allowing Member States to continue with existing arrangements but requiring third country firms to register with ESMA once the European Commission has decided that the third country's regulatory regime is equivalent to the EU's.

The following are vital elements of the regime that should enable continuing smooth functioning of international fixed income markets: the obligation for ESMA to register an applicant third country firm subject to the stated conditions; the ability of third country firms that establish a branch to passport their services across the EU; the priority that the European Commission must give to assessing the equivalence of the most important third country jurisdictions; the continuation of existing national regimes pending an equivalence decision; and the three year transitional period during which national regimes will continue alongside the ESMA registration regime.

To enable efficient and smooth communications with third country firms that may not have registered, it will be important to interpret the exemption for clients that seek services on their own exclusive initiative in such a way that the routine contacts by EU firms with third country firms described above are not treated as solicitation giving rise to the need for registration.

It will be important to ensure that the six month period allowed for ESMA to consider applications for registration by third country firms does not impede smooth interactions with third country expertise, for example in the case of new entrants to third country markets.

ICMA will look to ensure that the specified technical standards on the information that third country firms must provide to ESMA for registration are technically workable and conducive to smooth interactions between EU and third country markets.

*Market structure:* We recognise the need to ensure that, where necessary, the market infrastructures



We want to keep the best of what we have  
and develop it to be fit for the future.



– trading venues, clearing houses and settlement systems – can work together to deliver solutions for users. The international bond markets are leaders in this field, having offered clients a choice of settlement venue for many years. We want to keep the best of what we have and develop it to be fit for the future.

There is also work to be done to ensure that the trading landscape evolves in a way in which market users benefit from competition and choice without excessive fragmentation.

### **Expected timetable**

The MiFID II package follows the three level approach for European legislation. There are two Level 1 texts: MiFID, a Directive which requires national transposition at Member State level within two years of official publication; and MiFIR, a Regulation which enters into force 20 days after publication in the *Official Journal* of the European Union (OJ). Level 2 texts comprise “delegated acts”, made by the European Commission with the consent of the European Parliament, after advice from ESMA; these can be either regulations or directives, but are expected to be regulations based on recent experience of delegated acts on other financial market dossiers; and RTS, or implementing technical standards (ITS), which are regulations drafted by ESMA and endorsed by the European Commission. Level 3 texts comprise ESMA guidelines, European Commission FAQs and national implementation texts, including legislation, regulatory rules and penalty regimes.

The key dates to bear in mind are as follows:

- Q2 2014 (expected June): Publication in the OJ;
- Q2 2014 (expected June): ESMA consults on its advice, RTS and ITS;
- Q1 2015: ESMA delivers its advice to the Commission;
- Q2 2015: Commission makes delegated acts;
- Q2 2015: ESMA delivers draft RTS and ITS to the Commission
- Q2 2016: deadline for national transposition
- Q4 2016: new rules begin to apply.

### **Conclusion**

MiFID raises significant implementation challenges for firms affecting their business strategy, relations with clients and business and technical systems. ICMA is ready to help you prepare. Please do not hesitate to follow up with me if you would like more information on our work, or if you or your firm would like to be more closely involved.

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### **Central Securities Depositories Regulation**

In the Quarterly Report for the [First Quarter](#) of 2014, we reported that we expected the final draft text to be available early in the New Year. In the event, a [text](#) was agreed between representatives of the Council of Ministers and the European Parliament on 26 February 2014. The draft Regulation is now scheduled to be adopted by the European Parliament at its plenary session scheduled to be held in mid-April, which is the last session before Parliament breaks up for the 2014 elections. This article provides a brief summary of the key provisions and identifies areas where further work is in hand or will be required. We also report on the recently published ESMA Discussion Paper and on recent work to develop an industry-wide position on the transition from T+3 to T+2 as the norm.

### **Summary of key provisions**

**T+2:** The Regulation specifies that the intended settlement date for transactions in transferable securities which are executed on regulated markets, MTFs or OTFs shall be no later than the second business day after the trading takes place. But this does not apply to transactions which are negotiated privately but executed on trading venues, nor to transactions which are executed bilaterally but reported to a trading venue.

**Settlement discipline and penalties:** On settlement discipline generally, the Regulation states that the procedures and penalties related to settlement fails should be commensurate to the scale and seriousness of such fails whilst being scaled in such a way that maintains and protects liquidity of the

relevant financial instruments. There is a welcome recognition that market making activities play a crucial role in providing liquidity to markets within the Union, particularly to less liquid securities and a clear statement that measures to prevent and address settlement fails should be balanced against the need to maintain and protect liquidity in these securities.

The Regulation prescribes monitoring of settlement performance, reporting to competent authorities and publication of information about settlement performance on an aggregated, anonymised basis. It also prescribes a penalty mechanism which will serve as an effective deterrent for participants that cause the settlement fails, including cash penalties, to be levied on a daily basis.

*Buy-ins:* The Regulation also prescribes that a buy-in shall be initiated four days after intended settlement date, without prejudice to daily penalties and the right bilaterally to cancel the transaction.

There is an exemption for operations composed of several transactions including securities repurchase or lending agreements. The buy-in procedure shall not apply where the timeframe of these operations is sufficiently short and renders the buy-in ineffective.

We shall need to do further work to align the ICMA Secondary Market Rules and Recommendations with the new provisions in these three areas.

*Regulation of CSDs and ICSDs:* The market will want to understand in more detail the likely effect of the new compliance burden. While there are a number of areas where the new provisions replicate existing provisions, there is, properly, a policy objective to improve the safety, soundness and robustness of the system.

*Implementing measures and regulatory standards:* In a number of areas, the Regulation empowers the European Commission and ESMA to make further regulatory provisions. Key provisions of interest to ICMA and its members are highlighted in the next section.

### **The ESMA Discussion Paper**

ESMA Discussion Paper [2014/299](#) was published on 20 March. It seeks stakeholders' views on the possible contents of most of the regulatory and technical implementing standards which ESMA is required to draft under the CSDR. There are 31 items in the legislative mandate to ESMA; EBA is expected

to draft RTS in respect of three further items, relating to the capital requirements, retained earnings and reserves of a CSD; the proposed risk-based capital surcharge; and the monitoring and management of credit and liquidity risks by a CSD. ESMA's views as set out in the paper are preliminary and should not be regarded as binding.

Two areas are covered in the Discussion Paper: settlement discipline (7 items) and CSD authorisation (24 items), so the majority of the paper is taken up with the regulatory requirements for CSD authorisation. The principal areas likely to be of interest to ICMA members include: the timing of implementation of the T+2 settlement cycle; the timing of implementation of the settlement discipline regime; the buy-in mechanism; the proposed "extension period" between the intended settlement date and the date when a buy-in comes into effect; the extent of the repo exemption from buy-in; and the provisions covering links between CSDs.

### **Items of particular interest to ICMA members**

*Timing of implementation of T+2:* Although the Regulation prescribes that the requirement to settle on T+2 shall apply from 1 January 2015, it also requires that for a trading venue which has access to a CSD which is going to be part of T2S, the deadline is (i) at least six months before such a CSD outsources its activities to T2S, and (ii) from 1 January 2016 at the latest. The first wave of CSDs is scheduled to move to T2S in May 2015. It is for that reason that active consideration is being given to a widespread move to T+2 in October 2014, discussed further below.

*Timing of implementation of settlement discipline regime:* We reported in the ICMA Quarterly Report for the [First Quarter](#) of 2014 on our suggestion that monitoring and reporting of settlement performance was required prior to the introduction of the harmonised settlement discipline regime. The Regulation provides for the monitoring and reporting of settlement performance, which is welcome. There is also a requirement for ESMA to submit an annual report on a number of matters, including the appropriateness of penalties for settlement fails, and in particular the need for additional flexibility in relation to penalties for settlement fails in relation to illiquid financial instruments.

In addition, the implementation of the settlement discipline regime requires ESMA to draft regulatory technical standards for the Commission to adopt. So a harmonised settlement discipline regime is unlikely to be implemented until the middle of 2015 at the earliest. National settlement discipline regimes are expected to remain in place until then.

*Buy-in mechanism:* The buy-in provisions are complex and detailed. The level of detail is expected to be enhanced by the required regulatory technical standards and implementing measure. There are provisions relating to: the timetable, with special arrangements for illiquid securities and SME markets; those by whom the regime is to be operated and those to whom it will apply; and an exemption for operations composed of several transactions including securities repurchase or lending agreements, described above.

*The “extension period” for application of the buy-in mechanism:* The Regulation states that in most cases a buy-in procedure should be initiated where the financial instruments are not delivered within four days of the intended settlement date. However, for illiquid financial instruments it is appropriate that the period before initiating the buy-in procedure should be increased up to a maximum of 7 business days. Based on asset type and liquidity of the financial instruments concerned, the extension period may be increased from 4 business days up to a maximum of 7 business days where a shorter extension period would affect the smooth and orderly functioning

of the financial markets concerned. The basis for determining when financial instruments are eligible for extension is to be established through regulatory technical standards. These standards will take account of the corresponding judgements to be made in the elaboration of the definition of “liquid securities” under MiFIR.

*Repo exemption:* ESMA is required to set regulatory technical standards specifying the type of operations and their specific timeframes which render buy-in ineffective. It will be vital to explain clearly to ESMA the circumstances in which a buy-in will be ineffective, including the application of the provisions of the GMRA.

*Links and access:* Since the Euroclear-Clearstream “bridge” is at the heart of the international markets settlement arrangement, regulation in this area will be of keen interest to market users and an area where we can potentially contribute considerable experience and expertise. The effective monitoring and management of credit and liquidity risks are key.

Work is in hand to develop an ICMA response to the ESMA Discussion Paper by the deadline of 22 May; if you would like to be involved, please contact John Serocold. Further work is also likely to be required in the following areas: the European Commission delegated act on the levels of penalties and the possible ESMA advice on that matter; ESMA work to issue technical standards on collection and redistribution of cash penalties; and some aspects of the new regulatory régime applying to CSDs.



Pressure is mounting for the transition from T+3 to T+2 as the norm to take place over the weekend of 4/5 October for as many markets as possible.

### **Position on the transition from T+3 to T+2**

Pressure is mounting for the transition from T+3 to T+2 as the norm to take place over the weekend of 4/5 October for as many markets as possible. Two factors are pushing ICMA to adopt this date. First, it seems that the next feasible date for the ICSDs is in late March 2015, which is potentially uncomfortably close to the proposed date for the first wave of migration to Target-2 Securities (T2S). This first wave includes Monte Titoli, which is an important settlement location for repo business as the Italian domestic CSD. Second, although the CSDR allows OTC trades to continue to settle as they do today, it seems that the practical and operational consequences of a mis-match between the OTC convention and the convention adopted by trading venues are potentially unattractive. The emerging conclusion is that ICMA's Secondary Market Rules and Recommendations should be amended to provide for T+2 settlement in the absence of agreement to the contrary. This change will be subject to ICMA's normal rule change process.

We are also working closely with a number of industry associations to establish a clear view from market users and the operators of financial market infrastructure on the way forward in respect of the timing of the migration to T+2.

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### **Secondary market liquidity**



In the First Quarter edition of the ICMA Quarterly Report, we updated members on our secondary market liquidity survey where sell side members were invited to respond to questions

designed to measure liquidity in cross-border bond markets. We developed a set of questions, both quantitative and qualitative, seeking data about stocks and flows as well as information about how secondary market participants see market quality. Participation was voluntary and individual responses were kept confidential.

The questionnaires were circulated in early December 2013, and responses were received through the first quarter of 2014. The survey went out to approximately forty sell-side houses that provide a dealing facility for syndicated SSAs and investment grade corporate bonds. Of those we approached, a number of firms have responded.

Most importantly, this exercise has shown that the data we have been seeking is regarded by firms as sensitive and valuable. Anecdotally, the economic fundamentals of fixed income trading are changing and this is reflected to some extent in the published financial results of members, looking particularly at FICC revenues which are down significantly year-on-year for some of the largest firms.

When designing the survey, a number of respondents to whom we spoke suggested that ICMA should turn towards a commercial data provider to seek appropriate analysis of the cross-border bond markets in Europe. In order to complement our survey results, ICMA to date has been successful in forming a relationship with one provider and is currently conducting careful analysis. A report outlining the findings to this liquidity project, including the extent to which members are content to allow publication will be discussed at the next ICMA Secondary Market Practices Committee meeting in May.

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# Asset Management

by Dr. Nathalie Aubry-Stacey



## Covered bonds

The covered bond market has shown continuing growth in recent years, both in terms of volume as well as geography. As the market keeps growing as well in terms of diversity and products, the [ICMA Covered Bond Investor Council \(CBIC\)](#) wants to keep pace with new developments and is therefore setting up a new working group. This group will deal with existing and, if and when the need arises, new and innovative covered bond structures. The aim of the working group is to increase understanding of the specific nature of innovations and put them into context within already established structures and/or legislation.

The first programme considered by the Covered Bond Look-Alike (COLA) Working Group is the [recent programme launched by NIBC](#) that uses a “conditional pass-through”. The COLA Working Group is unanimously of the opinion that the new product by NIBC is a covered bond:

The bonds are hard bullet obligations of the issuer but may turn into a pass-through structure after the default of the issuer. If the bonds were to switch into pass-through, the repayment of the bonds may deviate

**The aim of the working group is to increase understanding of the specific nature of innovations and put them into context.**

from the originally scheduled payment date, as it is the case with soft bullet covered bonds. The COLA WG believes that there is a degree of uncertainty about the timing of the principal repayment following the default of the issuer – not only due to a possible extension period but also because the principal can also be repaid significantly before the original maturity date if the amortisation test has been breached. A hard bullet structure is of course also subject to early repayment risk.

From an economic point of view, the COLA Working Group does not see a material difference between an ultra-long soft bullet structure (eg 25 years) and a conditional pass-through one. This statement needs to be seen in the light of net asset value perspective (NAV). It has to be noted

however that, in case of NIBC, there is an obligation for the cover pool administrator in the full pass-through scenario to check every six months whether a sale of the cover assets is sufficient to repay outstanding bonds which might lead into different cash flow structures. The sale of assets is also mandatory.

In addition, despite using prime Dutch residential mortgages with a maximum maturity limit of 30 years, there does not seem any provision in the legislation or prospectus, in the view of the COLA Working Group, as far as the number of amortising loans in the cover pool, and this could affect the composition of the cover pool over time. Therefore the pool could potentially develop into a pool made up of very long-running interest-only mortgages.



The extension risk may affect investors as the composition of the cover pool assets is allowed to vary over time.

The full conclusions of the COLA Working Group are available [here](#).

The COLA Working Group will be considering other programmes in the coming months, and will be sharing some of its news at the forthcoming CBIC/ Covered Bond Report Conference to be held on 15 May in Frankfurt.

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## Dealing commissions for investment managers

The FCA proposed in CP13/17 new rules and guidance governing investment managers' use of client commissions with the aim of ensuring that dealing commissions paid by consumers are fairer and more transparent. Specifically, the FCA believes the industry needs to consider the potential for wider reforms to address flaws in the use of the dealing commission regime in light of potential EU reforms in this area and a growing consensus in the industry that existing practices can be improved.

The Consultation Paper is part of the FCA's wider asset management strategy, which focuses on ensuring that investment managers, acting as agents on behalf of their clients, put the customer's best interest first. AMIC members note that transaction cost reduction is one aspect but others like security of transactions or operational risk reduction should not be overlooked. They also acknowledge the importance of ensuring that clients can be confident that managers are acting in their best interest when they produce or purchase research, and support rules changes that are designed to enhance investor protection and market integrity.

The following general points were highlighted in the AMIC response:

- *The international dimension* of the change of rules in the UK, and global level playing field: The proposed change in the rules provides a level playing field to asset managers operating solely within the UK. However, UK-based international managers operating sub-advisory arrangements internationally will be left at a regulatory disadvantage in other markets.
- *Incremental cost of compliance*: The introduction of a more prescriptive analysis of eligible research will result in additional administrative costs by virtue of demonstrating compliance with the four, cumulative, evidential tests for every piece of commissionable research. The costs associated with the changes proposed in this consultation are not considered.
- *Corporate access*: AMIC members do not oppose *per se* the proposed ban on corporate access being paid for with dealing commissions. However, the main concerns relate to how this ban manifests itself in an international context and its impact on smaller asset managers.

Meanwhile the UK Investment Management Association (through its Research Review Working Group) has examined all possible funding approaches for institutional research provision, but with a view so far to dealing with its central concern, that unless UK asset managers do a better job of accounting for and controlling research commissions, and direct it for the payment of research, regulators might question the practice of using commissions to buy research. [The White Paper](#) was published in February 2014.

The conclusions of the Consultation Paper – expected to be summarised in a Policy Statement to be published in the spring – may have global implications



## The Consultation Paper focuses on ensuring that investment managers put the customer's best interest first.

as the UK's FCA is the *de facto* global regulator for equity commissions – so changes implemented may result in the harmonisation of operational procedures at global asset managers.

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## Bail-in

ICMA has been discussing asset encumbrance in different fora and undertaken a thorough review of the issue in the course of a series of meetings between investors, issuers and regulators over the past couple of years. Building on the success of this earlier work, the AMIC has set up a new dedicated working group consisting of investors (and which may also involve some regulators) to look at various aspects of asset encumbrance reporting, the impact of the resolution regime and the proposed application of the "bail-in" to investors.

Amongst the various specific items to consider will be the level of reporting and disclosure expected under the new regime, including responding to the EBA on its asset encumbrance reporting

initiative. The group will consider the practical implications and technical operation of the bail-in regime, the imposition of a “point of non-viability” by regulators, the valuation of a failed bank’s assets, the hierarchy of creditors and other points of interest relevant to investor claims. Recent relevant regulatory developments to review include revised proposals as outlined in the Liikanen Report, the consultation on asset encumbrance from the EBA, the resolution regime and the Single Supervisory Mechanism to be overseen by the ECB.

Following its first meeting held in February, the Bail-in Working Group responded to [the EBA public consultation on Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets](#) aimed at providing transparent and harmonised information on the subject across EU Member States. Working group members welcomed a comprehensive and harmonised disclosure across the EU, and the standardisation of a minimum amount of information, which can always be supplemented by further explanations, is beneficial for comparability and for investors’ analysis. However, an open narrative such as proposed in Template D would not only reduce comparability over time and across institutions. The working group raised concerns on the fact that ELA would not be disclosed. Regulators will have access to information that investors will not be able to monitor in an event of default. As far as the timing of the disclosure is concerned, the working group would recommend that all relevant financial information is disclosed at the same time. Disclosures on asset encumbrance should be no exception and therefore information on asset encumbrance should be provided in conjunction with regular financial reporting, ideally on a quarterly basis, and there should be clear criteria that define when a time delay of up to six months is appropriate.

The working group will be meeting in May to further discuss the bail-in regime and its implications for investors.

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## Non-bank non-insurer SIFIs

Systemically important financial institutions (SIFIs) have been defined as institutions whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity.

The implementation of the SIFI framework requires, as a first step, the assessment of the systemic importance of financial institutions at a global level (G-SIFIs). The framework recognises that SIFIs vary in their structures and activities, and that systemic importance and impact upon distress or failure can vary significantly across sectors. It requires that the FSB and national authorities, in consultation with the standard-setting bodies, and drawing on relevant indicators, determine which institutions will be designated as G-SIFIs. The assessment methodologies to identify G-SIFIs need to reflect the nature and degree of risks they pose to the global financial system. To date, assessment methodologies have been developed for global systemically important banks (G-SIBs) and insurers (G-SIIs).

This document sets out, for [public consultation](#), the proposed assessment methodologies for identifying non-bank non-insurer (NBNi) G-SIFIs, extending the SIFI framework which currently covers banks and insurers to all other financial institutions. This is challenging as the high-level framework and specific methodologies have to capture a wide range of business models and risk profiles, while maintaining broad consistency with the methodologies for

banks and insurers. Also, unlike banks and insurers, the NBNI financial entities generally face limitations on the availability of data.

This Consultation Paper follows the US debate over whether fund managers need to be regulated to prevent future financial shocks. The US Treasury's Office of Financial Research suggested in a [September report](#) that fund managers could be "vulnerable to shocks", despite fund managers arguing that this was not the case. This Consultation Paper seeks feedback on how best to identify these institutions. It may constitute a step towards the creation of new regulations that could apply to NBNI G-SIFIs in the future.

Here are some key points in the Consultation Paper:

- *Identifying these firms is difficult:* IOSCO and the FSB stress how difficult it is to evaluate non-bank and non-insurer SIFIs because their structures and activities are so diverse.
- *Data on these firms is lacking:* Inconsistent or unavailable data makes identifying non-bank and non-insurer

SIFIs even harder. Because these businesses have traditionally been regulated from a consumer protection or business conduct perspective, there is often not a lot of data on the financial stability risks firms pose. As a result, the FSB and IOSCO argue that supervisors' own judgment will probably need to play a bigger role in identifying non-bank, non-insurer SIFIs.

- *Fund managers will come under the spotlight:* The consultation identifies two channels through which asset management entities could transmit systemic risk: to counterparties and to other market participants. It does, however, acknowledge that the fund management industry and risks therein are very different from banking.
- *Understanding the interconnectivity of firms is crucial:* The FSB and IOSCO see three main "channels" through which a non-bank, non-insurer SIFI could affect other firms or the broader market. These include exposure to creditors, investors and counterparties; the liquidation of assets which could disrupt trading or funding in key markets; and if there is a substitute for a

critical function that a firm performs.

- *But size matters too:* Size is a major factor in identifying SIFIs. The consultation proposes "materiality thresholds" to serve as an initial filter for which firms are classified as systemically important. It suggests that the filter apply to finance companies, broker-dealers and other market intermediaries with US\$100 billion in "balance sheet total assets". For investment funds, it proposes a threshold of US\$100 billion in net assets under management and for other entities it sets the US\$100 billion in balance sheet total assets threshold.

The AMIC prepared a general response following a discussion at its last Executive Committee meeting in February, assessing the role of asset managers in capital markets; questioning the assessment methodology and whether it will provide clarity on systemic risk; and proposing specific relevant areas that could be considered by FSB/IOSCO in the context of systemic risk.

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**This Consultation Paper may constitute a step towards the creation of new regulations that could apply to NBNI G-SIFIs in the future.**



## A pan-European private placement market

By Nicholas Pfaff

Following its creation at end-2013, ICMA's European Private Placement Working Group had its first meeting on 13 February 2014 hosted by Natixis Asset Management in Paris. The meeting was attended by LGIM, M&G, PIMCO, Federis GA, KBC Group, Kramer Levine, SocGen, Natixis AM, AF2I and EBRD. The Banque de France joined the meeting (and the working group) as a permanent observer.

The meeting covered in particular an overview of the Euro PP market with presentations from representatives from the industry group coordinated by the Banque de France that produced the recently released *Charter for Euro Private Placements*. This document is a comprehensive non-binding framework of best practices for the Euro PP market. As a reminder, the Euro PP was launched in order to help medium-sized French companies access a new source of financing, and to offer an asset diversification opportunity for long-term investors, mostly French insurers. The Euro PP market has grown dynamically, with €6 billion raised since 2012.

There was a presentation at the meeting on the status of the EUPPA project launched in 2013 by a number of Dutch and British parties including amongst others NIBC, Delta Lloyd and M&G, with support from Clifford Chance and Allen & Overy. The EUPPA is also cooperating with the LMA that aims to develop [a template for private placement documentation](#). The meeting benefited furthermore from a summary on developments in Germany regarding an intermediated mid-market private placement initiative. A Steering Committee for the Working Group was established with representatives from Federis GA, KBC Group and Natixis AM. A number of priority workflows were agreed

of which market practice and principles, documentation standardisation, regulation and taxation.

It is interesting to note that participants decided not to create for the time being a workflow on ratings or credit scoring on the basis that the European market should be supported by investors developing their own investment and credit processes. Some expressed the view that the introduction at an early stage of a rating system could limit the development of the market aimed especially at medium-sized companies. The argument made was that such companies have by definition a greater diversity of credit profiles that requires a more individualised assessment.

The Working Group has attracted a great deal of interest from a number of parties including law firms, other industry associations and the official sector. The European Commission has recently recognised in its *Communication on Long Term Financing of the European Economy* the potential of the private placement market to provide a significant alternative funding source to European medium-sized and large companies, and the importance of facilitating the development of a pan-European market. Active contacts are ongoing with all of these parties, and especially with the Euro PP sponsors and the EUPPA initiative, with the objective of moving forward towards common practices, documentation standardisation and regulatory recognition for a pan-European private placement market. ICMA's European Private Placement Working Group aims to be a driving force in all of these areas.

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# Market Infrastructure

by David Hiscock

## **ECB: Contact Group on Euro Securities Infrastructures (COGESI)**

Work sponsored by [COGESI](#) is continuing, including in respect of an important report on the efficient functioning of the repo market. In support of this, significant effort has also been put into examination of the role of commercial bank money settlement, which is now expected to provide the basis for a separate report for the broader benefit of the securities settlement industry. Members of the ICMA ERC continue to provide input to relevant aspects of this work.

## **ECB: Money Market Contact Group (MMCG)**

An *ad hoc* meeting of the MMCG was held in Frankfurt on 18 February 2014. The main agenda item was discussion of the results of the study carried out by the EURIBOR-EBF task force based on the money market transaction data collection exercise, with consideration of the proposals for money market benchmark reform. A regular quarterly [meeting of the MMCG](#) was then held in Frankfurt on 18

March 2014. The agenda included review of the latest market developments and an update on the current status of regulatory work, alongside a presentation of the main findings and recommendations of the *ad hoc* COGESI group on collateral. The next regular quarterly meeting is scheduled for 16 June 2014.

## **ECB: Bond Market Contact Group (BMCG)**

The [BMCG's fifth meeting](#) took place in Frankfurt on 21 January 2014. The agenda comprised:

- bond market outlook and other topics of relevance;
- sovereign funding challenges for 2014 and private sector bond issuance;
- review of the latest developments of electronic trading in bond markets; and
- trading risk metrics.

The full agenda, together with a summary of the discussion and the supporting meeting papers are published on the [BMCG's website pages](#). The sixth BMCG meeting is scheduled for 8 April.

## **ECB: TARGET2-Securities (T2S)**

In 2013, the T2S project advanced significantly in its preparations for the go-live date, which is scheduled for June 2015. Strong commitment and cooperation within the T2S community enabled key achievements and activities to be completed in 2013. These are summarised in a newly published annual review, [T2S in 2013](#).

On 13 January 2014, [T2S Spotlight](#) highlighted the publication of a [new paper](#) describing the general set-up of corporate actions processing in T2S. On 21 January 2014, T2S Spotlight reported that the first connection between the ECB and T2S was successfully established on 20 January, as part of the preparations that will enable the T2S team at the ECB to initiate their testing of the platform on 31 March 2014. Eurosystem acceptance tests are set to run between April and September, following which the T2S application will be delivered to the CSDs on 1 October for the user testing phase. On 10 February 2014, T2S Spotlight announced that the T2S



Board has approved [the tests](#) that the CSDs, central banks, directly connected parties and directly connected dedicated cash account holders will have to pass in order to be certified by the Eurosystem. Further information on the procedures and forms for Eurosystem certification will be provided in April 2014.

The [T2S Advisory Group](#) (AG), which provides advice to the Eurosystem on T2S-related issues, to ensure that T2S is developed and implemented according to market needs, met in Rome on 12-13 February 2014. Following some introductory points, members of the AG took note of the debriefing of the [T2S Board](#) Chairman; and of [the CSG](#) Chairman. There was then an update on the CSDR and discussion of the T2S Programme Status. Under the topic, “Eurosystem collateral policies”, the AG was informed about Eurosystem collateral initiatives which are relevant for T2S – the repatriation requirement will be removed in May 2014; cross-border triparty services via CCBM will be available as of September 2014; and simplification has been undertaken on the assessment of eligibility of CSD links for collateral acceptance. Next the work of the [Harmonisation Steering Group](#) (HSG) was praised and the AG approved the final version of the Fourth Harmonisation Progress Report. It was noted that the next AG meeting will be held on 17-18 June 2014. Dated 19 March 2014, the AG has subsequently published the

[Fourth T2S Harmonisation Progress Report](#). The report focuses on monitoring the compliance of T2S markets with the harmonisation standards that have been defined so far. The current status of implementation in all T2S markets is presented via a “traffic light” approach.

The HSG itself [met on 20-21 January 2014](#) in Frankfurt and will next meet on 3-4 June 2014. The T2S Cross-border Market Practice sub-group ([X-MAP](#)) met on 22 January 2014, 4-5 March and at the beginning of April. These X-MAP meetings include discussions relating to “CSD Restriction Rules”, which cover a number of business processes including collateral management.

On 19 June 2013, the T2S AG decided to set-up an HSG [Task Force](#) to facilitate broad coordination across T2S markets when migrating to T+2. The second meeting of this Task Force was held on 27 January 2014, in Frankfurt, and the third on 21 March. Proposals from the Task Force will then be discussed by the HSG and finally endorsed as AG proposals/recommendations.

A [T2S Info Session](#) was held in London on 4 April 2014. In addition to the status update of the T2S project, the key theme of this Info Session was harmonisation, with a panel of market stakeholders presenting and discussing the main findings of the 4th Harmonisation Progress Report. Furthermore, CSDs presented their T2S service offers.



The first connection between the ECB and T2S was successfully established on 20 January.



## EBA recommends that all competent authorities use a single supranational identifier for each credit and financial institution.

Marking the achievement of Synchronisation Point 5 (SP5) on the date scheduled in the T2S Programme Plan, on 31 March 2014 the 4CB delivered the T2S platform to the ECB for testing. The Eurosystem acceptance testing (EAT) will now begin, with the objective of determining whether the T2S platform is compliant with the T2S [scope-defining set of documents](#).

### **Global Legal Entity Identifier System (GLEIS)**

On 14 January 2014, it was announced that the FSB Plenary, in its capacity as the Founder of the Global Legal Entity Identifier Foundation (GLEIF), has [endorsed 16 nominees](#) to the initial Board of Directors of the GLEIF, based on a recommendation to the FSB by the LEI Regulatory Oversight Committee (ROC). On the formal establishment of the GLEIF by the FSB, it is expected that the nominees would be appointed as the GLEIF's Board.

As reported in [Issue no. 31 of ICMA Quarterly Report](#), a note published by the [LEI ROC](#), dated 27 July 2013, establishes the [principles that should be observed](#) by the [Local Operating Units \(LOUs\)](#) participating in the Interim GLEIS as pre-LOUs. Adding to a few earlier cases, ROC notes of 27 December 2013, 7 January 2014, 6 and 7 February, and 5 March announced the endorsement of further pre-LOUs in accordance with

the process described in Annex 1 of the principles. This brings the number of ROC endorsed GLEIS pre-LOUs up to 14 (operational); and, there is a broader [list of four digit prefixes](#) allocated to sponsored pre- LOUs (which currently includes eight unendorsed pre-LOUs).

Attached to a ROC [memorandum of 24 February](#) 2014 there is a table which sets out the basic elements of a common data format to be used by pre-LOUs as a standard for data publication in the interim GLEIS. A second part to this will be issued to set out the more detailed technical specification. After consultation with pre-LOUs and other relevant stakeholders to finalise the technical specifications of the common data file, the ROC will publish the technical specifications and set out a deadline for endorsed pre-LOUs to introduce and publish the data file. The deadline will be set in recognition of market and technology needs; and will also apply to prospective pre-LOUs seeking endorsement to join the interim system.

Further to the 28 October 2013 EBA consultation reported on in [Issue no. 32 of ICMA Quarterly Report](#), on 29 January 2014 the EBA published [a Recommendation](#) on the use of unique identification codes for supervisory purposes for every credit and financial institution in the EU. The EBA recommends that all competent authorities use a single supranational

identifier for each credit and financial institution. Considering that the GLEIS is not yet fully operational, the EBA considers that the use of a pre-LEI by competent authorities is the best short-term solution, which will enhance supervisory convergence and will contribute to ensuring high quality, reliability and comparability of data. Competent authorities must notify the EBA as to whether they comply or intend to comply by 29 March 2014.

[Issue no. 32 of ICMA Quarterly Report](#) also reported on a 3 November 2013 ROC [letter to business registries](#) seeking confirmation of the absence of various data impediments. A ROC issued [list of 5 March 2014](#) shows those business registries which have consequently provided written clarification/confirmation that there are no such impediments.

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# Macroprudential Risk

by David Hiscock

On 20 December 2012, the European Systemic Risk Board (ESRB) approved [Recommendation 2012/2](#) (and [annex](#)) to reduce systemic risks related to bank funding and asset encumbrance. This Recommendation was addressed to EBA and to the national competent authorities of the EU Member States. On 15 January 2014, [the ESRB announced](#) that, to ensure that the ESRB's assessment of implementation is able to benefit from the complete set of information coming out of on-going initiatives, the General Board of the ESRB decided on 31 December 2013 to extend the deadlines of this Recommendation by up to 12 months.

The ESRB General Board held its [12th regular meeting](#) on 22 January 2014, discussing the risks and vulnerabilities in the global financial system; and considering a number of steps taken by macroprudential authorities in some EU Member States, including action to contain pockets of vulnerabilities in real estate markets. In addition, the Board discussed progress towards bank balance sheet repair across the EU and possible propagation of risks from major emerging markets to the EU's financial system. The ESRB General Board also agreed on two sets of documents, which are designed to help macroprudential authorities put into operation the new macroprudential policy framework that came into force on 1 January 2014 under the revised prudential rules for banks (CRD/CRR). The documents comprise:

- A [Decision](#), which sets out the process and coordination framework for preparing ESRB opinions or issuing recommendations on macroprudential measures, notified to the ESRB by relevant authorities, in line with the CRD/CRR; and
- A [Flagship Report](#) and a [Handbook](#): the Flagship Report, which provides an overview of the macroprudential framework and instruments, is aimed at high-level policy makers; and the Handbook, which

is aimed at macroprudential authorities, offers more detailed operational advice.

The ESRB General Board also published the [sixth issue of the Risk Dashboard](#), which is a set of quantitative and qualitative indicators of systemic risk in the EU's financial system.

Published on 11 February 2014, an IMF staff working paper, [What Is Shadow Banking?](#), proposes to describe shadow banking as "all financial activities, except traditional banking, which require a private or public backstop to operate". Backstops can come in the form of franchise value of a bank or insurance company, or in the form of a government guarantee. The need for a backstop is viewed as a crucial feature of shadow banking, which distinguishes it from the "usual" intermediated capital market activities, such as custodians, hedge funds, leasing companies, etc. It is stated that acknowledging the need for a backstop as a critical feature of shadow banking offers some useful policy implications and guidance for future research and data collection.

- First, it gives direction on where to look for new shadow banking risks: among financial activities that need franchise value or government guarantees to operate.
- Second, it explains why shadow banking poses significant macro-prudential and other regulatory challenges.
- Third, it suggests, when the right questions are asked, that shadow banking is nevertheless almost always within regulatory reach, directly or indirectly.
- Finally, it suggests that the migration of risks from the regulated sector to shadow banking is a lesser problem than some fear.

On 12 March 2014, [ESMA published](#) its latest semi-annual report on [Trends, Risks and Vulnerabilities No.](#)

1, 2014, and its quarterly *Risk Dashboard* for 4Q 2013. The report looks at the performance of EU securities markets, assessing both trends and risks in order to develop a comprehensive picture of systemic and macro-prudential risks in the EU that can serve both national and EU bodies in their risk assessments. Overall, ESMA's report finds that EU securities markets and investment conditions in the EU improved in the second half of 2013, based on better macroeconomic prospects, which also contributed to reduced systemic risk in that period. However, overall risks remained at high levels for EU securities markets as reflected by the rapid propagation of uncertainty from emerging markets countries to EU markets in early 2014. EBA's *Risk Dashboard for 4Q 2013*, summarising the main risks and vulnerabilities in the banking sector in the EU, was published on 14 February 2014. This EBA dashboard looks at the evolution of key risk indicators from 55 banks across the EU in the third quarter of 2013.

*The Regulatory Responses to the Global Financial Crisis: Some Uncomfortable Questions* is an IMF staff working paper, published on 14 March 2014, which seeks to identify current challenges for creating stable, yet efficient financial systems using lessons from recent and past crises. The authors consider that reforms need to start from three tenets:

- adopting a system-wide perspective explicitly aimed at addressing market failures;
- understanding and incorporating into regulations agents' incentives so as to align them better with societies' goals; and
- acknowledging that risks of crises will always remain, in part due to (unknown) unknowns – be they tipping points, fault lines, or spillovers.

Corresponding to these three tenets, specific areas for further reforms are identified. Policy makers need to resist, however, fine-tuning regulations: a “do not harm” approach is often preferable. And as risks will remain, crisis management needs to be made an integral part of system design, not relegated to improvisation after the fact.

The IMF's *March 2014 Research Bulletin* includes an article which answers *Seven Questions on Financial Interconnectedness*:

- What is financial interconnectedness?
- What can be learned from modelling financial

interconnectedness among economic agent as a network?

- Is there a link between the structure of a financial network and financial stability?
- What does financial network analysis tell us about social efficiency?
- What do empirical financial networks tell us about contagion and systemic risk?
- Does financial interconnectedness predict crises?
- What are the policy implications of recent research on financial connectedness?

Future research should focus on better understanding the structure of financial networks originating not just from interbank liabilities, which are relatively well studied, but also from other linkages such as derivative contracts, common exposures, and ownership. Ongoing efforts to enhance regulatory data collection and dissemination practices, both at the national and international levels, can help narrow the gap between the theory and empirics of financial networks, and further support the development of recommendations for policy.

The General Board of the ESRB held its *13<sup>th</sup> regular meeting* on 20 March 2014, discussing the risks and vulnerabilities in the global financial system. The EU regulations establishing EBA and EIOPA call for EU-wide stress tests to be initiated and coordinated by EBA and EIOPA in cooperation with the ESRB. As part of this cooperation, the ESRB contributes to the design of scenarios of adverse economic and financial market developments to assess the resilience of financial institutions – upon completion, these adverse scenarios will be transmitted to EBA and EIOPA, for publication by end April 2014. The General Board also discussed possible systemic risks that may emerge from large banking systems, based on a draft report representing the views of the Advisory Scientific Committee; and approved a response to a public consultation by the Central Bank of Ireland entitled *Loan Origination by Investment Funds*. Alongside the meeting, the *seventh issue of the Risk Dashboard* was published, including some improvements which have been introduced in the “methodology indicators” following an annual review exercise.

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# ICMA in Asia-Pacific

by Mushtaq Kapasi

## **Introduction**

Since launching its Asia-Pacific representative office in Hong Kong in September 2013, ICMA has continued to strengthen ties with members, regulators, central banks, intermediaries, and infrastructure providers in the region.

In ICMA's recent discussions in Asia, three common themes have emerged: (i) financial liberalisation, particularly in China; (ii) growth in intra-regional investment; (iii) demand for new products to finance infrastructure development and trade. Each of these trends supports and complements ICMA's efforts to develop efficient, liquid and well-governed cross-border capital markets across the Asia-Pacific region.

In Asia, as in other regions, ICMA's main focus will continue to be on international debt capital markets and repo. ICMA has promoted fruitful dialogue between Asia and Europe on emerging reforms and good practices in both regions, and is active in international efforts to avoid regulations that have unintended or contradictory consequences across borders into Asia.

## **Asian primary markets**

Over the last six months, ICMA has held two Asia debt syndicate meetings, attended by leading Asian underwriters from global and regional banks. The subjects covered, including pre-sounding, order book transparency, pricing iterations,

allocations, stabilisation, and the dynamics and risks of a growing market, have echoed to some extent many of the discussions in the ICMA Primary Market Practices Committee, but from an Asian perspective.

ICMA plans to continue the Asia Syndicate Managers' Forum to formulate better practices relevant to the regional markets, underwriters, and issuers, and plans to facilitate similar discussions in Asia on the legal and documentation aspects of primary markets as well.

Also, ICMA has had extensive dialogue with China's [National Association of Financial Market Institutional Investors \(NAFMII\)](#) to aid in the development of standards in the onshore interbank bond market (see sidebar) as this market continues to grow in volume, attract new entrants, and diversify its products.

## **Repo markets**

The repo markets in Asia, both local and cross-border, are growing quickly, but remain small and disjointed due to the variety of regulatory regimes and market dynamics. The adoption of international practices and increased use of standard documentation would improve liquidity, collateral risk, and market transparency. Asian repo market participants recognize ICMA's leadership in global market knowledge, regulatory expertise, underlying opinions and documentation. The recently



released *ICMA ERC Guide to Best Practice in the European Repo Market* has been recognized as a useful model for market conventions in the cross-border Asian repo markets, and work is underway, in cooperation with regional associations, to adapt the Guide to Asia and its various domestic markets.

ICMA has worked closely with NAFMII over the last two years on repo as NAFMII created its own master agreement for the domestic China market, involving both pledge and true sale. ICMA has also led the development of GMRA legal opinions for many Asia-Pacific countries. However, enforcement for some of these is not robust, and work remains to be done to improve the relevant regulatory regimes and judicial procedures to enable more efficient markets. ICMA has renewed dialogue with national regulators to assist them in the development of regulations, infrastructure, and standard documentation relevant to repo in their domestic markets.

### **Other areas of cross-regional relevance**

While ICMA's focus in Asia will be on primary markets and repo, a number of other areas of ICMA's work in market practice and regulatory policy are also relevant to Asia:

- *Resolution regimes:* Global banks face pressure to formulate internal resolution and recovery plans to satisfy both home regulators and Asian regulators in jurisdictions where affiliates operate. Asian regulators in particular are requiring safeguards in place to ensure that onshore liquidity and operations are not threatened in the case of difficulties in a home jurisdiction.
- *Basel III bonds:* Several Asian banks have issued or plan to issue contingent convertibles or bail-in bonds. In Asia there is considerable debate over the precise mechanisms for determining and effectuating the bail-in, and over the

suitability of these bonds for individual investors.

- *Collective action clauses:* Sovereign issuers in Asia, particularly those in emerging markets, are closely following ICMA's work on a revised standard collective action clause to include an aggregated voting mechanism and balance, fairly and efficiently, the interests of investors and issuers in a sovereign restructuring.
- *Wealth management:* Continuing its efforts to promote integrity, transparency, and professionalism in the global wealth management industry, ICMA has introduced the *Charter of Quality* to private banks, regulators, and local associations in Asia, and will continue to promote its adoption in the region.

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# China's bond market: development and outlook

The [National Association of Financial Market Institutional Investors \(NAFMII\)](#) is a self-regulatory organisation established in 2007 by the People's Bank of China (PBoC) to conduct daily management and supervision in China's interbank market. NAFMII is the first and only SRO in China's interbank market.

## Overview of China's bond market

China's bond market is relatively young, with a history of thirty years. Since the

Ministry of Finance resumed the issuance of treasury bonds in 1981, China's bond market has experienced three stages of development: the "Stage of the Bank Counter Market" (1981-1990), the "Age of the Exchange Market" (1991-1996) and the "Boom of the Interbank Market" (1997-present).

Since 1997, China's onshore bond market has been growing rapidly. By the end of 2013, China's bond market reached a total outstanding volume of US\$4.87 trillion. Issuance volume in 2013

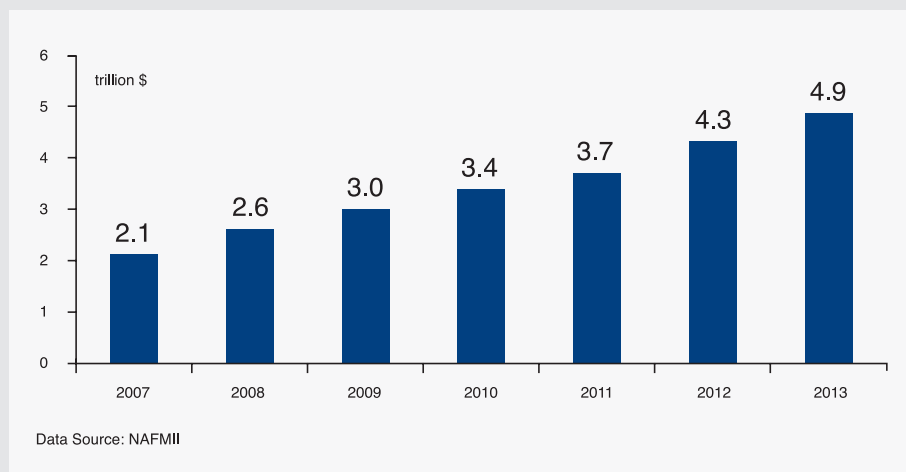
was US\$1.47 trillion. Products available to the market include government bonds, central bank bills, financial bonds, listed-company corporate bonds, enterprise bonds, and non-financial enterprise debt financing instruments (such as medium-term notes, short-term commercial paper, SME collective notes, and asset-backed notes).

## Overview of China's interbank bond market

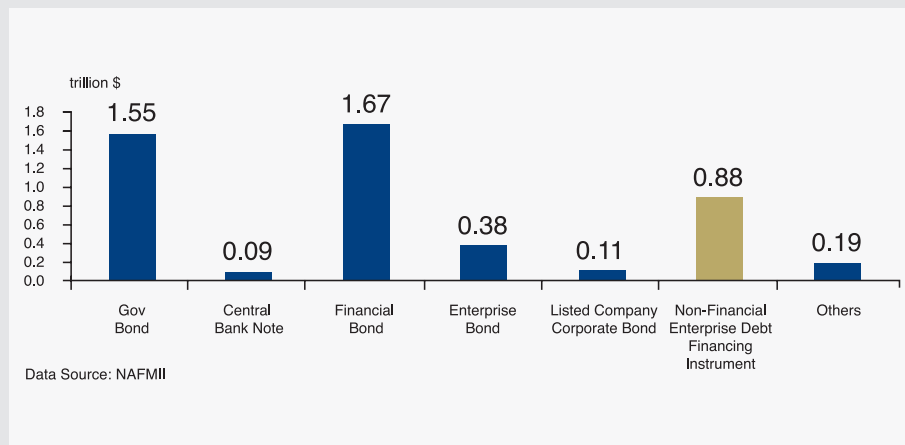
Today, bonds are offered and traded both in the exchange market and the interbank market. The interbank market is the most important primary and secondary market, on which over 90% of the new issues are quoted and traded. Central bank notes, treasury securities, financial bonds, enterprise bonds and non-financial enterprise debt financing instruments are all traded in the interbank market, which is regulated by PBoC.

With the continuous reform of China's financial markets, the interbank market is opening up gradually. In 2005, Panda Bonds (bonds issued by offshore entities on the onshore market) were issued by approved supranational organisations in the interbank market.

## Bond Outstanding Volume



## Distribution of Outstanding Volume (at the end of 2013)



In 2008, foreign banks were allowed to underwrite treasury bonds. In 2010, PBoC released the *Pilot Program on Investment in the Interbank Bond Market with RMB Funds by Three Types of Institution* including foreign central banks or monetary authorities, clearing banks for RMB business and overseas participating banks for RMB settlement of cross-border trade. In 2013, Qualified Foreign Institutional Investors (QFII) were allowed to apply to invest in the interbank bond market. At the end of 2013, there were 138 institutions under the above-mentioned pilot program and 223 licensed QFII investors with a total quota of \$49.7 billion to invest in China's capital market. In December 2013, Daimler AG issued RMB 5 billion private placement instruments in the interbank market, marking the first overseas non-financial enterprise to raise funds directly in China's domestic capital market.

### Focus on NAFMII

NAFMII has a diversified membership. By the end of 2013, 4,332 market participants had joined NAFMII, including commercial banks, securities houses, insurance companies, non-financial enterprises and intermediaries such as

rating agencies, accounting firms and law firms.

Since its establishment, apart from being responsible for the registration of non-financial enterprise debt financing instruments, NAFMII has focused on three areas:

- *Market innovation:* NAFMII has introduced many products into the market including medium-term notes, SME collective notes, asset-backed notes, credit risk mitigants and many others.
- *Self-regulation:* NAFMII has released 44 self-regulatory rules and regulations in the primary and secondary bond markets, and standard documentation such as the NAFMII Master Agreement on Trading Financial Derivatives. NAFMII has also built comprehensive post-registration management systems and secondary market monitoring and surveillance systems.
- *Providing quality services to members:* NAFMII has an extensive and wide-ranging training system, playing a prominent role in guiding and standardising market development. In addition, NAFMII also provides

research reports on international and national economic and financial market development, publishes the *Financial Market Research* journal, and holds various conferences and seminars for members.

In June 2010, NAFMII and ICMA signed a Memorandum of Understanding in Beijing, marking NAFMII's first bilateral collaboration agreement with a foreign institution. NAFMII and ICMA have continued active cooperation in the context of sharing market standards and mutually promoting good market practices, both internationally and in China, particularly in the areas of repo and debt primary capital markets. Up to now, NAFMII has built links with 29 SROs worldwide, 103 financial and business institutions from 35 countries, 12 universities and think tanks, and nine multilateral international organisations.

After the financial crisis, countries have realised that national financial markets have a high degree of integration and interdependence with the global economy. Cooperation on financial market management in a global context is becoming ever more important. Self-regulatory organisations play a key role in such cooperation. NAFMII will retain an open mind to jointly explore and develop an effective market management system with different kinds of international agencies. We look forward to continuing extensive and in-depth cooperation and exchanges with partners around the world, and together contributing to the development of the international market globally.

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# diary

## ICMA Capital Market Lecture series 2014

ICMA has launched a series of Capital Market Lectures featuring senior industry figures, including regulators, government officials, central bankers and commentators. These lunchtime lectures take place in financial centres around Europe with the aim of giving our members an opportunity to hear directly from the policy makers and commentators who are shaping the financial markets of the future.

**Sajid Javid, Financial Secretary to the Treasury, London. 8 May 2014**

**Hosted by:** European Bank for Reconstruction and Development (EBRD)

[Register here](#)

**Benoît Cœuré, Member of the Executive Board, the European Central Bank, Paris, 19 May 2014**

**Venue:** Cercle National des Armées, 8 Place Saint Augustin, 75008 Paris

[Register here](#)

08 MAY

**ICMA European Regulatory and Financial Markets Developments and the Brazilian Perspective, Sao Paolo.**

The new regulatory framework for Europe will have far reaching consequences on how banks and capital markets operate in other parts of the globe. This half-day conference, organised by ICMA and ANBIMA, will bring together ICMA experts and market participants from leading institutions in Brazil to discuss how these developments will impact primary and secondary fixed income markets, specifically market liquidity, collateral management and market infrastructure, and what it will mean for the Brazilian capital market.

[Save the date](#)

15 MAY

**The ICMA CBIC and The Covered Bond Report Conference, Frankfurt.**

The 2014 Covered Bond Investor Conference will focus on topical investors' issues and provide an ideal opportunity for those wishing to engage in a constructive dialogue with the buy-side. The agenda for the one day conference has been drawn up by members of the ICMA Covered Bond Investor Council (CBIC) and *The Covered Bond Report*, and it will explore those issues that are at the top of the investor base's agenda.

ICMA organises over 100 market-related events each year attended by members and non-members. For full details see [www.icmagroup.org](http://www.icmagroup.org) Most ICMA events are accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. (See the ICMA website for details.)

Panel discussions will include a review of improved transparency in the market as well as looking at new structures, and recent regulatory developments (such as the treatment of covered bonds in European legislation).

[Register here](#)

27 JUN

**European Regulation: An Introduction for Capital Market Practitioners, London.**

This one-day, fast-track course is aimed at sales people, traders, originators, syndicate personnel, and middle and back office staff who would benefit from a better understanding of the current regulatory landscape in the cross-border bond markets. It is specifically not aimed at lawyers or compliance staff. The focus of the programme is the cross-border capital markets and the bias is towards practitioners working largely with institutional rather than retail clients. The course provides updates on the major regulatory developments relevant to the market and will consider recent case studies in the regulatory crackdown.

This course is aimed at giving practitioners a keener understanding of the current regulatory environment and alerting them to areas of their own activities where the highest standards of integrity and professional business conduct must be maintained.

[Register here](#)

# ICMA Annual General Meeting and Conference Berlin, 4-6 June 2014

The ICMA Annual General Meeting (AGM) and Conference is a long established and internationally respected event for the global debt capital markets, bringing together the global financial community to discuss market and regulatory developments. The 2014 AGM and Conference will be held at the InterContinental Hotel, Berlin and will feature sessions on:

- Capital markets and economic growth
- The issuer-intermediary-investor value chain - are the markets up to the job?
- Repo – the cure or the culprit?
- China globalising, RMB rising - what does it mean for us?
- Developments in the German capital markets



## With contributions from market participants, regulators and politicians, including:

**Dr. Paul Achleitner**, Chairman of the Board, Deutsche Bank

**Andrea Beltratti**, Chairman, Eurizon Capital SGR S.p.A.

**Ulrich Bindseil**, Director General Market Operations, European Central Bank (ECB)

**Sharon Bowles MEP**, Chair, European Parliament Committee on Economic and Monetary Affairs

**Günther Bräunig**, Member of the Executive Committee, KfW

**Eduard Cia**, Head of Treasury, UniCredit

**Natasha de Teran**, Head of Public Affairs, SWIFT

**Godfried De Vidts**, Chairman, ICMA European Repo Council (ERC), Member of the Board, ICMA and Director of European Affairs, ICAP Securities Limited

**Dr. Tammo Diemer**, Managing Director, Finanzagentur

**Martin Egan**, Member of the Board, ICMA and Global Head of Primary Markets & Origination and Head of UK Fixed Income, BNP Paribas

**Arnold Fohler**, Managing Director and Head DCM, DZ Bank

**Robert Gray**, Chairman Debt Finance & Advisory at HSBC Bank

**Georg Grodzki**, Head of Credit Research, Legal & General

**Rongrong Huo**, Head of RMB Business Development, Europe, HSBC Bank

**Spencer Lake**, Member of the Board and Global Head of Capital Financing, HSBC Bank

**Anne Leclercq**, Chair, Economic and Financial Sub-Committee on EU Sovereign Debt Markets and Director Treasury & Capital

Markets, Belgian Debt Agency

**Thierry de Longuemar**, Vice President, Finance & Risk Management, Asian Development Bank

**George Magnus**, Economic consultant and former Chief Economist, UBS

**Steven Maijor**, Chairman, European Securities and Markets Authority (ESMA)

**Greg Markouzos**, Managing Director and Global Head of Fixed Income, Citigroup Global Market Limited

**Dr. Michael Meister**, Parliamentary State Secretary, Federal Ministry of Finance of Germany

**Keith Mullin**, Editor, IFR

**Dr. Joachim Nagel**, Member of the Executive Board, Bundesbank

**Robert Parker**, Chairman of ICMA Asset Management and Investors Council (AMIC), Member of the Board, ICMA and Head of the Strategic Advisory Group, Credit Suisse

**Michael Reuther**, Board Member, Commerzbank

**Roman Schmidt**, Divisional Board Member Investment Banking, Commerzbank

**Dr. Ralf P. Thomas**, Chief Financial Officer, Siemens

**Hakan Wohlin**, Vice Chairman and Member of the Board ICMA and Global Head of Debt Origination, Capital Markets and Treasury Solutions, Deutsche Bank AG

*The conference is open to all financial market participants, with free registration for ICMA members. For full details see the [ICMA website](#)*



# ICMA Executive Education

Book now for these ICMA Executive Education courses in 2014. ICMA Executive Education courses are accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme – please see ICMA website for details.

## Part I: Introductory Programmes

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### Financial Markets Foundation Course (FMFC)

London: 7-9 May 2014  
Luxembourg: 2-4 June 2014  
Luxembourg: 22-24 September 2014  
London: 5-7 November 2014

### Securities Operations Foundation Course (SOFC)

London: 10-12 September 2014  
Brussels: 12-14 November 2014

## Part II: Intermediate Programmes

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### International Fixed Income and Derivatives (IFID) Certificate Programme

Barcelona: 27 April – 3 May 2014  
Barcelona: 26 October – 1 November 2014

### Operations Certificate Programme (OCP)

Brussels: 16-22 November 2014

### Primary Market Certificate (PMC)

London: 19-23 May 2014  
London: 17-21 November 2014

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## Part III: Specialist Programmes

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### Corporate Actions – An Introduction

London: 28-29 April 2014

### Corporate Actions – Operational Challenges

London: 30 April – 1 May 2014

### Trading and Hedging Short-Term Interest

Rate Risk London: 6-7 May 2014

### Trading the Yield Curve with Interest Rate

Derivatives London: 8-9 May 2014

### Measuring and Mitigating Counterparty

Credit Risk London: 12-13 May 2014

### Capital Market Overview of Islamic Finance & Sukuk

London: 9-10 June 2014

### Corporate Governance and Culture

London: 16-17 June 2014

## ICMA Executive Education Skills Courses

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### Successful Sales

London, 1-2 May

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The full 2014 course schedule is available here, [www.icmagroup.org/Training-Development](http://www.icmagroup.org/Training-Development)

# Glossary

<b>ABCP</b> .....	Asset-Backed Commercial Paper	<b>EFC</b> .....	Economic and Financial Committee (of the EU)	<b>LCR</b> .....	Liquidity Coverage Ratio (or Requirement)
<b>ABMI</b> .....	Asian Bond Market Initiative	<b>EFSA</b> .....	European Financial Stability Facility	<b>L&amp;DC</b> .....	ICMA Legal & Documentation Committee
<b>ADB</b> .....	Asian Development Bank	<b>EGMI</b> .....	European Group on Market Infrastructures	<b>LEI</b> .....	Legal entity identifier
<b>AFME</b> .....	Association for Financial Markets in Europe	<b>EIB</b> .....	European Investment Bank	<b>LIBOR</b> .....	London Interbank Offered Rate
<b>AIFMD</b> .....	Alternative Investment Fund Managers Directive	<b>EIOPA</b> .....	European Insurance and Occupational Pensions Authority	<b>LMA</b> .....	Loan Market Association
<b>AMF</b> .....	Autorité des marchés financiers	<b>EMIR</b> .....	European Market Infrastructure Regulation	<b>LTRO</b> .....	Longer-Term Refinancing Operation
<b>AMIC</b> .....	ICMA Asset Management and Investors Council	<b>EMTN</b> .....	Euro Medium-Term Note	<b>MAD</b> .....	Market Abuse Directive
<b>ASEAN</b> .....	Association of Southeast Asian Nations	<b>ERC</b> .....	ICMA European Repo Council	<b>MAR</b> .....	Market Abuse Regulation
<b>BBA</b> .....	British Bankers' Association	<b>ESA</b> .....	European Supervisory Authority	<b>MEP</b> .....	Member of the European Parliament
<b>BCBS</b> .....	Basel Committee on Banking Supervision	<b>ESFS</b> .....	European System of Financial Supervision	<b>MiFID</b> .....	Markets in Financial Instruments Directive
<b>BIS</b> .....	Bank for International Settlements	<b>ESMA</b> .....	European Securities and Markets Authority	<b>MiFID II</b> .....	Proposed revision of MiFID
<b>BMCG</b> .....	ECB Bond Market Contact Group	<b>ESM</b> .....	European Stability Mechanism	<b>MiFIR</b> .....	Proposed Markets in Financial Instruments Regulation
<b>BRRD</b> .....	Bank Recovery and Resolution Directive	<b>ESRB</b> .....	European Systemic Risk Board	<b>MMCG</b> .....	ECB Money Market Contact Group
<b>CAC</b> .....	Collective action clause	<b>ETF</b> .....	Exchange-traded fund	<b>MMF</b> .....	Money market fund
<b>CBIC</b> .....	ICMA Covered Bond Investor Council	<b>EURIBOR</b> .....	Euro Interbank Offered Rate	<b>MOU</b> .....	Memorandum of Understanding
<b>CCBM2</b> .....	Collateral Central Bank Management	<b>Eurosystem</b> .....	ECB and participating national central banks in the euro area	<b>NAV</b> .....	Net asset value
<b>CCP</b> .....	Central counterparty	<b>FAQ</b> .....	Frequently Asked Questions	<b>MTF</b> .....	Multilateral Trading Facility
<b>CDS</b> .....	Credit default swap	<b>FASB</b> .....	Financial Accounting Standards Board	<b>NAFMII</b> .....	National Association of Financial Market Institutional Investors
<b>CFTC</b> .....	US Commodity Futures Trading Commission	<b>FATCA</b> .....	US Foreign Account Tax Compliance Act	<b>NCA</b> .....	National Competent Authority
<b>CGFS</b> .....	Committee on the Global Financial System	<b>FCA</b> .....	UK Financial Conduct Authority	<b>NDRC</b> .....	National Development and Reform Commission
<b>CICF</b> .....	Collateral Initiatives Coordination Forum	<b>FIIF</b> .....	ICMA Financial Institution Issuer Forum	<b>NSFR</b> .....	Net Stable Funding Ratio (or Requirement)
<b>CIF</b> .....	ICMA Corporate Issuer Forum	<b>FMI</b> .....	Financial market infrastructure	<b>OTC</b> .....	Over-the-counter
<b>CoCo</b> .....	Contingent convertible	<b>FPC</b> .....	UK Financial Policy Committee	<b>OTF</b> .....	Organised Trading Facility
<b>COGESI</b> .....	Contact Group on Euro Securities Infrastructures	<b>FRN</b> .....	Floating-rate note	<b>OJ</b> .....	<i>Official Journal of the European Union</i>
<b>COREPER</b> .....	Committee of Permanent Representatives (in the EU)	<b>FSB</b> .....	Financial Stability Board	<b>OMTs</b> .....	Outright Monetary Transactions
<b>CPSS</b> .....	Committee on Payments and Settlement Systems	<b>FSOC</b> .....	Financial Stability Oversight Council	<b>PD</b> .....	EU Prospectus Directive
<b>CRA</b> .....	Credit Rating Agency	<b>FTT</b> .....	Financial Transaction Tax	<b>PD II</b> .....	Amended Prospectus Directive
<b>CRD</b> .....	Capital Requirements Directive	<b>G20</b> .....	Group of Twenty	<b>PMPC</b> .....	ICMA Primary Market Practices Committee
<b>CRR</b> .....	Capital Requirements Regulation	<b>GDP</b> .....	Gross Domestic Product	<b>PP</b> .....	Private Placement
<b>CSD</b> .....	Central Securities Depository	<b>GMRA</b> .....	Global Master Repurchase Agreement	<b>PRA</b> .....	UK Prudential Regulation Authority
<b>CSDR</b> .....	Central Securities Depository Regulation	<b>G-SIBs</b> .....	Global systemically important banks	<b>PRIPs</b> .....	Packaged Retail Investment Products
<b>DMO</b> .....	Debt Management Office	<b>G-SIFIs</b> .....	Global systemically important financial institutions	<b>PSI</b> .....	Private Sector Involvement
<b>D-SIBs</b> .....	Domestic systemically important banks	<b>G-SIFIs</b> .....	Global systemically important financial institutions	<b>PSIF</b> .....	Public Sector Issuer Forum
<b>DVP</b> .....	Delivery-versus-payment	<b>G-SIFIs</b> .....	Global systemically important insurers	<b>QMV</b> .....	Qualified majority voting
<b>EACH</b> .....	European Association of CCP Clearing Houses	<b>HFT</b> .....	High frequency trading	<b>RFQ</b> .....	Request for quote
<b>EBA</b> .....	European Banking Authority	<b>HMT</b> .....	HM Treasury	<b>RM</b> .....	Regulated Market
<b>EBRD</b> .....	European Bank for Reconstruction and Redevelopment	<b>IAIS</b> .....	International Association of Insurance Supervisors	<b>RMB</b> .....	Chinese renminbi
<b>ECB</b> .....	European Central Bank	<b>IASB</b> .....	International Accounting Standards Board	<b>RPC</b> .....	ICMA Regulatory Policy Committee
<b>ECJ</b> .....	European Court of Justice	<b>ICMA</b> .....	International Capital Market Association	<b>RTS</b> .....	Regulatory Technical Standards
<b>ECPC</b> .....	ICMA Euro Commercial Paper Committee	<b>ICSA</b> .....	International Council of Securities Associations	<b>SEC</b> .....	US Securities and Exchange Commission
<b>ECOFIN</b> .....	Economic and Financial Affairs Council (of the EU)	<b>ICSDs</b> .....	International Central Securities Depositories	<b>SFT</b> .....	Securities financing transaction
<b>ECON</b> .....	Economic and Monetary Affairs Committee of the European Parliament	<b>IFRS</b> .....	International Financial Reporting Standards	<b>SGP</b> .....	Stability and Growth Pact
<b>ECP</b> .....	Euro Commercial Paper	<b>IMMFA</b> .....	International Money Market Funds Association	<b>SI</b> .....	Systematic Internaliser
<b>EEA</b> .....	European Economic Area	<b>IMF</b> .....	International Monetary Fund	<b>SLL</b> .....	Securities Law Legislation
<b>EFAMA</b> .....	European Fund and Asset Management Association	<b>IOSCO</b> .....	International Organization of Securities Commissions	<b>SME</b> .....	Small and medium-sized enterprise
		<b>IRS</b> .....	Interest rate swap	<b>SMPC</b> .....	ICMA Secondary Market Practices Committee
		<b>ISDA</b> .....	International Swaps and Derivatives Association	<b>SPV</b> .....	Special purpose vehicle
		<b>ISLA</b> .....	International Securities Lending Association	<b>SRO</b> .....	Self-regulatory organisation
		<b>ITS</b> .....	Implementing Technical Standards	<b>SSAs</b> .....	Sovereigns, supranationals and agencies
		<b>KfW</b> .....	Kreditanstalt für Wiederaufbau	<b>SSM</b> .....	Single Supervisory Mechanism
		<b>KID</b> .....	Key information document	<b>SSR</b> .....	EU Short Selling Regulation
				<b>T+2</b> .....	Trade date plus two working days
				<b>T2S</b> .....	TARGET2-Securities
				<b>TD</b> .....	EU Transparency Directive
				<b>TFEU</b> .....	Treaty on the Functioning of the European Union
				<b>TRs</b> .....	Trade repositories
				<b>UKLA</b> .....	UK Listing Authority



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

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