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Assessment of Market Practice and Regulatory Policy

ICMA
International Capital Market Association

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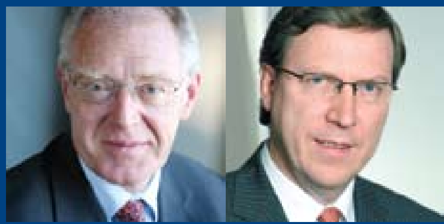
An integrated voice for the buy side



Foreword by Robert Parker and John Nugée

The global asset management industry is experiencing a period of unprecedented change on all fronts. The current deleveraging of the banking system is driving a major shift of assets to the buy side, which will have major implications for the way the industry will operate in future. There are also the continuing challenges of a more stringent regulatory regime and the possible inclusion of the activities of asset managers under any new initiatives designed to regulate shadow banking. The insurance sector is digesting the effect of the new Solvency II rules which, combined with historically low bond yields, will impact its ability to deliver returns; and pension funds are in addition facing the challenge of increased longevity.

In this environment there is an enhanced need for the international asset management industry to provide a more coordinated response to the authorities which is representative of the views of all its diverse components. The ICMA Asset Management and Investors Council (AMIC) aims to provide this integrated voice.

The AMIC has been in existence for four years and it has been successful in attracting high-level participation from a mix of companies which represent the diverse and dynamic nature of the modern asset management industry, including institutional asset managers, private banks, hedge funds, pension funds, insurance companies and sovereign wealth funds. It works primarily on market practice and regulatory issues which affect this broad range of international investor-led firms. The AMIC has from the outset taken an inclusive and international perspective; it respects the work of the various national associations and specialist industry bodies, and works with them on specific topics, but as the regulatory authorities increasingly seek all-industry and cross-border solutions to the challenges of the asset management industry, the AMIC believes that the traditionally fragmented representation of the industry needs to be supplemented by a dialogue that transcends both sectional and national interests, and this the AMIC seeks to provide.

Whilst the AMIC's specific remit is to represent the cross-border international asset management industry and to overcome some of the problems of its traditionally fragmented representation, it is also positioned to be complementary to other relevant national and international industry associations and actively cooperates with them on specific topics.

ICMA itself is a unique trade association in the European context, in that it is committed to representing both buy and sell side of the industry, as well as other key constituencies in the international capital market, and seeks to promote dialogue with all market participants including infrastructure providers. As a distinct community within ICMA, AMIC members have the benefit of access to ICMA's expertise, in particular on market practice as well as regulatory issues relating to the cross-border securities market. ICMA actively encourages constructive dialogue and discussion between its buy-side and sell-side members in pursuit of a common approach to market issues, whenever possible.

A number of working groups and councils – for example, the ETF Working Group, Solvency II Working Group, Private Banking Working Group and the Covered Bond Investor Council (CBIC) – meet regularly with the support of AMIC to produce regulatory responses and consider technical issues.

Amongst AMIC's most recent major initiatives are:

• *European Transparency Standards for Covered Bonds:* The CBIC has identified key information which covered bond investors require to make well-informed investment decisions, and has made public this new transparency standard after broad-based industry consultation.

- *The Private Banking Charter of Quality:* The proposed Charter of Quality represents an opportunity to explain to regulators and other interested parties the standards adopted by the private banking industry, drawing together in a single document the different regulatory requirements and best practices adopted by the private banking industry.
- *The Solvency II Reporting Project:* A Solvency II Working Group has been set up to discuss the impact of the regulatory developments on services delivered by asset managers to their clients in terms of data reporting requirements. The project will look at general principles at industry level regarding acceptable disclosure policies, and clarification regarding disclosure requirements (for instance the "look-through" approach proposed by European regulators).

In 2012, ICMA has redoubled its efforts to deliver integrated representation for the asset management community, introducing a new more flexible governance structure to allow the expansion of AMIC membership and to direct its activities. The AMIC Executive Committee will meet each quarter to define workflow and priorities following guidance from the wider Council membership and to steer the projects of the various working groups.

All ICMA members who have buy-side activities are encouraged to become involved in the AMIC and its activities. The AMIC Council will meet in London on 23 November 2012. For details of the agenda, please contact nathalie.aubry-stacey@icmagroup.org

Robert Parker (AMIC Chairman)
Head of Strategic Advisory Group, Credit Suisse

John Nugée
Senior Managing Director and Head of Official Institutions Group, State Street Global Advisors

Message from the Chief Executive

As most of you know, ICMA held its 44th AGM and Conference in Milan at the end of May. This is one of the highlights of the ICMA year and was again well attended with over 700 delegates. Not surprisingly the panel which aroused most interest was the one dealing with developments in the sovereign markets – which still dominate the daily news flow and market activity. ICMA's approach during this crisis has been to provide information and services which are of real practical benefit to our members and you will find summary details later in this Quarterly Report. We do not seek to add to the conjecture and speculation aired by many reporters and observers, but rather to focus on the impact on the securities markets of the various potential outcomes of this sovereign crisis. We note that members' usage of our legal helpdesk has grown significantly in recent months: we very much encourage members to use this service for guidance on market practice issues – and also to access the updated information on our website.

"Recent regulation is largely designed with crisis repair in mind, identifying and mitigating systemic risk.

The markets are changing rapidly and I want to highlight three current themes which are picked up in more detail inside this Quarterly Report.

First, the move towards secured funding rather than unsecured funding for financial institutions. A good example is the dramatic growth of the covered bond market over the last few years and covered bonds now play an increasingly significant role in bank financing. ICMA has an important investor-led initiative in this area to improve transparency through our Covered Bond Investor Council. At the short end, the trend is best illustrated by the increasing use of the repo market.

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There is increasing understanding that the OTC cash bonds segment will be irrevocably changed following the imposition of MiFID II and MiFIR.

This raises a number of issues. Is it an enduring trend? If so how far can it go? As a result there is a growing discussion on the cross-cutting issue of “appropriate” encumbrance levels. This topic is on the agenda of the authorities as well as issuers and investors, and ICMA is already, and intends to continue, engaging fully in this debate based on the input from our members.

The move to secured funding also emphasises the importance of collateral availability and reveals a growing shortage of high-quality collateral. This stems not only from an increase in covered bonds and repo but also from higher capital and liquidity requirements and new margining requirements for derivatives settled through CCPs. We address this in the ICMA European Repo Council and Committee as well as at the newly formed Collateral Initiatives Coordination Forum for which ICMA provides the secretariat.

Repo itself is coming under intense scrutiny in the context of shadow banking, and we remain vigilant to ensure that any changes to this vital and robust market proposed by regulators do not erode its efficiency and result in even more high-quality collateral being withdrawn.

Another important area where prediction is difficult is the outlook for retail involvement in the debt capital markets. Recent regulation is largely designed with crisis repair in mind, identifying and mitigating systemic risk. However, the focus on consumer protection is intense, whether through more disclosure, tighter regulation of intermediaries’ conduct or through outright bans on certain instruments deemed unsuitable for retail investors. The recent increase in the minimum denominations of debt securities which can be offered to investors without a fully passported and Prospectus Directive-compliant prospectus (which is increasingly rare) is a case in point. The impact is that the range of choices left for retail investors in the fixed income markets is becoming more constrained, and for example the majority of relatively easy-to-understand investment-grade fixed income securities is simply not directly available to retail investors. It is a paradox that the equity of a company is often available to retail investors in small lots, and yet has no fixed redemption date, discretionary dividends and ranks at the bottom of the pile in a liquidation scenario, whilst higher ranking senior debt of that same company, with a defined maturity date and fixed coupons, is not. If retail investors are to play a meaningful role in the fixed income markets in future, I suspect that the balance between the various types of regulation will need to adjust, with greater emphasis placed on code of conduct and disclosure to intermediaries rather than upon disclosure to retail end-investors.

The last theme is secondary market structure and liquidity. There is increasing understanding that the OTC cash bonds segment will be irrevocably changed following the imposition of MiFID II and MiFIR. Whilst the precise shape of the market is not yet clear, it appears likely that much of the OTC cash bond market will migrate to the new categories of organised trading facilities and/or systematic internalisers, and it will be critical for the industry to engage heavily in proposing the optimal design of these if liquidity is going to be preserved. We are running a series of seminars in various countries on this topic, and working collaboratively with other associations on the implications of MiFID II/MiFIR and the new CSD proposals. Secondary liquidity has been severely compromised during the crisis and remains under threat; regrettably, a consequence of much of the planned regulation may be to erode it further. We are already seeing a shift in the relationship between the primary and secondary markets with increased focus on primary market investment.

The above themes are amongst many that ICMA is addressing on a continual basis through our committees and councils, to ensure that the markets of the future are not only robust but efficient.

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Quarterly Assessment
by Paul Richards

The euro crisis and cross-border markets

This Quarterly Assessment, which covers the period until the end of June 2012, considers the impact of the euro crisis on cross-border financial markets, and the steps that the euro-area authorities have been discussing to help resolve the euro crisis and restore the role of cross-border markets in promoting the growth of the economy, both in Europe and more widely.

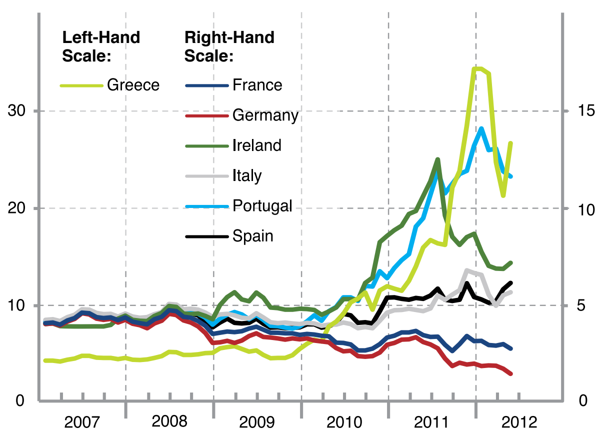
Since the crisis began, financial integration in the euro area has gone into reverse:

- Some markets have fragmented. Banks have increasingly retreated within national boundaries by matching their borrowing and lending at national level.
- Cross-border flows in the euro area have increasingly been intermediated by the ECB: not only through its longer-term refinancing operations (LTROs), but also through short-term financing to provide liquidity to banks, particularly those on the periphery of the euro area which have lost deposits.
- New bond issues by governments on the periphery have increasingly been purchased by their national banks, partially funded by the LTROs, rather than by investors across borders.
- The interdependence between national banks and their governments has intensified as a result.
- Five euro-area governments – Greece (twice), Ireland, Portugal, Spain and Cyprus – have now received, or asked for, official bail-outs from the euro-area authorities, either to support the governments themselves or their banks, or both.
- As markets have become more risk-averse, a higher proportion of bank assets have been encumbered. Secured financing has been extensively used in preference to unsecured. Some banks have become dependent on financing from the ECB, which only lends against eligible collateral.
- Owing to dysfunctional markets, the ECB's own transmission mechanism for official interest rates has been impaired, with different short-term euro interest rates prevailing in different national markets.

To some extent, developments in the euro area reflect developments in the international financial crisis generally. But they have been complicated by two problems specific to the euro area:

- One is that sovereign debt in the euro area is no longer regarded by the market as risk-free. It has always been explicit in the EU Treaty that one participating Member State in the euro area will not stand behind another's debts. But from the launch of the euro until the crisis began in 2007/08, government bond yields in the euro area were almost identical. Since the crisis began, yields have increasingly diverged, and the Greek debt restructuring has demonstrated that sovereign debt is not risk-free. The euro-area authorities argue that Greece is a special case. But market concerns that sovereign debt is not risk-free are reflected in historically high government bond yield spreads over bunds (Chart 1); and the downgrading of sovereign credit, particularly on the periphery of the euro area, by rating agencies recognises this.
- The other is that the commitment to Economic and Monetary Union (EMU) among participating Member States is no longer regarded by the market as irreversible. The EU Treaty makes no provision for exit from the euro area. But exit from the euro area, initially by Greece, has increasingly been perceived in the market as a risk. The need for contingency planning has begun to be discussed openly by the authorities. Consequently, currency risk has been added to credit risk.

Chart 1: Euro-area 10-year sovereign bond yields (%).



Sources: Bloomberg; BIS calculations.

Greece

It appears that there are currently three main policy options in the case of Greece:

- The first is for Greece to implement the conditions of its second official bail-out. In economic terms, that may well prove to be difficult, and political opposition to doing so has been demonstrated in two elections. Since the second election, the new Greek Government has asked for the second official bail-out to be renegotiated.
- The second option is for the euro-area authorities and the IMF to soften the existing conditions on the second official bail-out (eg by giving Greece more time to meet them, extending repayment periods and reducing interest rates on loans), or to provide more funds through a third official bail-out, or both. It remains to be seen how far the euro-area authorities and the IMF are willing to change the terms of the second official bail-out. The alternative might be for Greece to default on its debts, a substantial proportion of which, following the restructuring of the Greek Government debt to the private sector, are now owed to official creditors. If the euro-area authorities and the IMF were to agree to change the terms of the second official bail-out in a significant way, there would clearly also be implications for the terms of the other official bail-outs (eg for Portugal and Ireland), and for any further bail-outs needed in future.
- The third option is for Greece to exit the euro area. If the bail-out conditions are not met, and the euro-area authorities do not significantly soften the conditions or provide new money, and if the ECB does not continue to support the Greek banking system – which the ECB would not be permitted to do if the Greek banking system were to become insolvent – the market's current assessment is that there would be a substantial risk that Greece would eventually leave the euro area, either through choice or because in practice it had no alternative.

As EMU was originally intended to be irreversible, and there are no official provisions in the EU Treaty for leaving the euro area (though there are provisions for leaving the EU), the task of determining how exit from the euro area would work is uncharted and potentially complex. For example, it would not be straightforward to determine which financial claims and liabilities would be redenominated into the new national currency and which would remain denominated in euro. This would be likely to be influenced by: the law governing the financial contract; the contractual currency of payment; the place of payment; and the place of any litigation. And exit would probably be accompanied by defaults, by restrictions on deposit withdrawals, and by capital and foreign exchange controls, in defiance of normal EU rules.

Risk of contagion

But the immediate issue, if Greece were to leave the euro area – or even if the market were to conclude that Greece might leave in the near future – would be the risk of contagion elsewhere. Offsetting the risk of contagion in a decisive and timely way is the key to restoring market confidence. The evidence from this crisis over the past five years is that confidence will not necessarily recover without official intervention. What can the authorities do, if necessary, to help? There are five main issues to address: bank liquidity; bank solvency; budget deficits; growth; and competitiveness. While the market's focus in each case has been on the euro area, the problems are not limited to the euro area, and the economic effects are being widely felt elsewhere.

Bank liquidity

The EFSF/ESM: First, if Greece were to leave, the market fears that the main liquidity risk would arise from a run on weak banks in the peripheral countries still within the euro area. The euro-area authorities would argue that the Greek case was exceptional and that the firewall around the rest of the euro area would be sufficient to prevent contagion. But the firewall is smaller – and has taken longer to put in place – than originally expected. The European Stability Mechanism (ESM) is limited to €500 billion, on top of the commitments already made by the European Financial Stability Facility (EFSF). Although the IMF has increased its resources, these are available to support all its members, not just the euro area. And some governments outside the euro area take the view that the euro area should be capable of sorting out its problems on its own.

Deposit guarantee schemes, financed by a levy on banks, are intended to prevent a bank run. But national deposit guarantee schemes would not be sufficient to prevent a bank run in a case in which depositors have lost confidence in the creditworthiness of their own government. A single euro-area deposit guarantee scheme could in principle overcome this through the use of mutual guarantees, including from AAA-rated governments. But in practice: (i) a euro-area scheme would take time to agree and implement; (ii) the amount guaranteed is currently limited to €100k in each individual case; and (iii) the scheme would not provide any guarantee against the risk of a national government leaving the euro area. There is also a question about how a euro-area deposit guarantee scheme would be financed: banks in surplus countries might be reluctant to finance a scheme the effect of which would be to help protect their competitors in deficit countries.

ECB liquidity: Much the most effective counter to the risk of contagion in the short term would be the provision of unlimited liquidity, accompanied if necessary by a further reduction from 1% in short-term interest rates, by the ECB. That is what the two ECB LTROs (in late December 2011 and late February 2012) provided to the banks. If the two LTROs prove not to be sufficient, a third LTRO may be necessary. The ECB has already announced that it will continue to provide short-term (up to three-month) liquidity to banks until the end of this year. But the ECB only lends to banks against eligible collateral. If further ECB intervention proved to be necessary in large amounts, there would be a risk of a shortage of eligible collateral, particularly among banks that would be most in need of liquidity from the ECB. In those circumstances, the ECB would again need to decide whether to

“ Sovereign debt in the euro area is no longer regarded by the market as risk-free, and the commitment to Monetary Union is no longer regarded as irreversible.

> **The most effective counter to the risk of contagion in the short term would be the provision of unlimited liquidity by the ECB, easing the terms of eligible collateral if necessary.**

ease the terms of eligible collateral, or to permit more emergency liquidity assistance by the national central banks in the Eurosystem. Before the LTROs come to be repaid, the banks that currently depend on ECB assistance will need to work out how to survive without it, but that is not an immediate problem.

Bank solvency

Capital requirements: Second, some banks, particularly on the periphery of the euro area, are not only short of liquidity, but the market has doubts about their solvency. These banks have been under pressure as a result of holding, on their balance sheets, large amounts of sovereign risk as well as bad loans to the private sector (eg on property); they have high rollover requirements as a result of dependence on short-term funding in wholesale markets; and they need to meet higher capital requirements. In particular, they have had to meet the European Banking Authority's requirement for a 9% core Tier 1 capital ratio by the end of June.

Bank recapitalisation: In response to difficult market conditions and higher capital requirements, banks in general have been reducing their balance-sheet size by deleveraging (ie reducing their lending and selling securities and non-core assets). But some banks have not been able to meet their new capital requirements by deleveraging alone. Raising external capital in current market conditions would be difficult and expensive for them. In those circumstances, official support may be the only option.

Should a government in the euro area not be sufficiently creditworthy to provide capital to its banks at national level, the EFSF/ESM would be willing to do so at euro-area level, provided that it has sufficient resources, and subject to conditions. Up to €100 billion is to be provided in this way by the EFSF/ESM to recapitalise banks in Spain. In principle, there are two potential routes: through an official bail-out by the euro-area authorities to provide the government concerned with the resources to bail out its national banks; or through direct ESM intervention to recapitalise the banks concerned. The second option is due to be introduced before the end of this year, initially for the benefit of banks in Spain, but with equivalent terms for banks in Ireland and in other cases. This approach could help to break the link of interdependence between sovereigns and their national banks.

Bank resolution: One of the main problems with resolving banks that fail is where the burden of failure in future should fall. If a joint bank resolution mechanism were to be introduced at euro-area level, there would be three key issues about burden-sharing:

- One concerns whether the burden on taxpayers should fall exclusively at national level – because banks are "international in life, but national in death" – or whether the burden in the euro area can and should be shared at euro-area level.
- The second concerns the distribution of the burden between shareholders, creditors and taxpayers. If financial instruments are involved that can be "bailed in" (ie they can be written down or converted, in the case of resolution, to help recapitalise a financial institution), that may reduce the cost to taxpayers but it may also have implications for the cost of bank financing in future.
- The third and related question is whether any additional steps should be taken – eg to separate banks' wholesale from their retail activities – in an attempt to reduce the potential burden on taxpayers in future of banks being "too important to fail", and whether these would be cost-effective.

Bank supervision: An integrated system for the supervision of banks in the euro area could help to oversee the recapitalisation of banks and a joint bank resolution mechanism. The euro-area authorities decided at the end of June that proposals should be considered before the end of this year, without the need for a change in the EU Treaty, for a "single supervisory mechanism" for banks in the euro area, involving the ECB. Agreement on these proposals is a condition for direct ESM recapitalisation of euro-area banks. The range of banks to be directly supervised by the ECB, its powers and the relationship between the ECB's role in the euro area and the European Banking Authority, which regulates banks across the EU as a whole, need to be worked out first.

Budget deficits

The Fiscal Compact: Third, some euro-area governments, particularly on the periphery, have budget deficits – and also contingent liabilities if their banks are weighed down by bad lending – which the market considers are not sustainable. This is reflected in their high government bond yield spreads over bunds. The Fiscal Compact – limiting budget deficits in the constitutions of national governments in the euro area to a maximum of 3% of GDP – is intended to address this problem. The question is how the Fiscal Compact will be enforced. It is unlikely to be any easier to enforce this time than the original Stability and Growth Pact was last time, especially as a number of Member States are currently a long way from meeting the target levels for budget deficits set. Even if the Fiscal Compact is enforced, it is not clear that controlling the level of budget deficits will address the problem which has occurred in Spain and Ireland. Before the crisis, they both had low government budget deficits, but large-scale property lending to the private sector, much of which has subsequently gone bad. This has led to the recapitalisation of some banks by the national governments concerned, and at euro-area level by the EFSF/ESM.

The ECB's Securities Market Programme: The immediate problem is not just how to bring down budget deficits, but how to finance them at a sustainable cost. In the absence of sufficient confidence in the market to finance them at sustainable rates, the Securities Market Programme of the ECB would help to do so, if there was agreement that secondary market intervention by the ECB on a sufficient scale was compatible with the EU Treaty. But there has not recently been agreement on this, and in the first half of 2012 the Programme has been wound down (in favour of ECB lending at sufficiently long term to the banks). Alternatively, the EFSF/ESM would have the powers to buy government bonds in the primary market or in the secondary market, subject to conditions, and using the ECB as its agent. But the EFSF/ESM would have only limited resources, which would have to be raised in the market, assuming that it was not granted a banking licence to borrow from the ECB.

As the ECB is in practice a preferred creditor, there is an additional concern in the market that secondary market purchases of government bonds by the ECB have the effect of subordinating the creditor status of private sector bondholders. Similar concerns have been raised about any decision to grant preferred creditor status to the ESM. The euro-area authorities

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Where banks cannot meet their new capital requirements by deleveraging alone, or raise capital in the market, official support may be the only option, if necessary from the ESM.

Is austerity the quickest way to achieve a return to growth, or is there an alternative?

have stated that the financial assistance to be provided by the EFSF to recapitalise Spanish banks, until the ESM becomes available, will not gain seniority status when transferred to the ESM.

Eurobonds: A potential alternative would be for the governments of the euro area to issue Stability Bonds (ie "eurobonds") with joint and several (or at least joint) guarantees, either for all or a proportion of new or existing euro-area government bills and bonds. If eurobonds were to be issued, governments with high credit ratings would stand behind those with low credit ratings. Proponents argue that the issue of eurobonds would give those with low ratings renewed access to financial markets at an acceptable cost. Opponents argue that this would increase debt service costs for those with high ratings, unless the costs were offset in some way; that pressure on those with low ratings to reform would be reduced; and that a change in the EU Treaty would be required. Although eurobonds have been proposed by the new French President, among others, the German Government has not so far been prepared to accept them, at least until a full fiscal union has been implemented across the euro area

Growth

The Growth Pact: Fourth, many countries in the euro area (and outside) have been suffering a long period of low or negative real growth. Since the crisis began, eight governments in Europe have so far fallen in response to a popular revolt against austerity. Everyone agrees that a return to growth is the only way to make government debt service sustainable in the medium term. The question is whether austerity (eg via the Fiscal Compact) is the quickest way to achieve a return to growth, or whether there is an alternative (eg a Growth Pact), and if so what form this should take and whether the Fiscal and Growth Pacts would be consistent with one another. Following the election of the new French President, the EU has agreed a Compact for Growth and Jobs, involving more cross-border infrastructure spending, financed by "project bonds", an increase in the capital of the EIB to support cross-border lending, and steps to encourage structural reform and innovation. However, the size of the measures proposed is not very large in relative terms and, if it were, there would be a risk that it might damage the credibility of the Fiscal Compact. As it is, the European Commission has already given the Spanish Government more time to meet the target for its budget deficit.

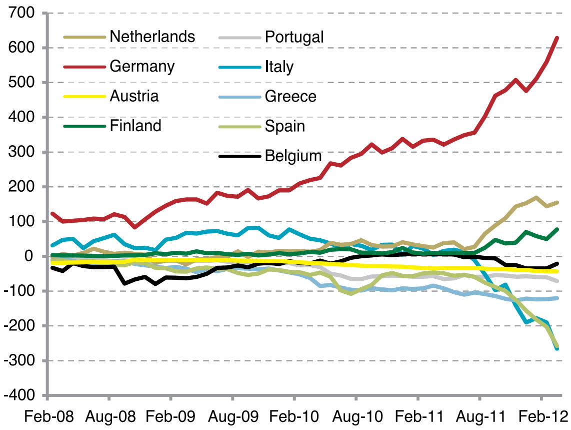
Competitiveness

Internal devaluation: Fifth, since the launch of the euro, the periphery of the euro area has lost competitiveness in relation to the core. Imbalances in the current account of the balance of payments reflect this; and TARGET2 shows a substantial increase in the imbalances within the Eurosystem between euro-area creditors (mainly Germany) and debtors (mainly on the periphery) (Chart 2). Weakness in the euro exchange rate against third currencies (like the US dollar) helps to improve the external competitiveness of the euro area as a whole, but not the imbalance within the euro area itself. External devaluation by a participating Member State is not an option without leaving the euro area. But internal devaluation is difficult to achieve (eg because it involves reducing wages and pensions and increasing unemployment). It also takes time to work. The question is whether the core – and in particular Germany – is prepared to increase internal demand in response, even at the cost of accepting a slightly higher level of inflation for a time, so that the competitiveness of the periphery can recover. There are doubts in the market, not just about whether this is likely to happen, but also about how long it would take to have a sufficient impact.

External devaluation: If Greece were to leave the euro area, the new national currency introduced in place of the euro would then depreciate sharply and substantially in euro terms. The aim would be to regain competitiveness as a result of external devaluation more quickly than would be possible through internal devaluation. That would depend on whether the Greek authorities were able to prevent the development of an inflationary spiral. If they were successful, the Greek economy might return to growth more quickly outside the euro area than it would have done if it stayed in. Should it return to growth relatively quickly after leaving the euro area, it might also act as a potential model for other countries still on the euro-area periphery. But this outcome would be far from guaranteed.

Chart 2:

TARGET2 imbalances in the Eurosystem (€ billion).



Source: Bloomberg

Integration versus disintegration

The resolution of these five problems is likely either to lead to more fiscal and financial integration in the euro area – through some form of fiscal and banking union – or to increase the risk of disintegration. In the former case, a "road map" is to be presented to the European Council before the end of this year, with an interim report in October. In the latter case, one or more departures on the periphery of the euro area might result in a more integrated core. There are several considerations here:

- First, in some cases integration involves the *mutualisation of debt.* A considerable amount of debt mutualisation in the euro area has taken place already: eg as a result of ECB intervention and the use of official bail-out funds. If there were to be more ECB intervention – either through more lending to the banks or further purchases of government debt in the secondary market – and if the ESM were to be used to bail out more governments and to recapitalise their banks, and if a euro-area deposit guarantee scheme were to be introduced for retail deposits and a joint resolution mechanism for failing banks, the result would be to increase the level of debt mutualisation much further, even without the issue of eurobonds.
- Second, although it is clear that the national authorities in the euro area would be in favour of further integration in principle, they have so far found it difficult in practice to agree on the *terms of integration:* for example, what form a fiscal union should take (eg the central control of the budget deficits of national governments in the euro area by a euro-area finance minister or equivalent); and whether fiscal union should precede further mutualisation of debt managed by a euro-area debt agency or the other way round, or whether the two should proceed in tandem in some way.
- Third, *time* is a critical factor. A number of the measures already proposed, or in prospect, to create a euro-area banking union and a euro-area fiscal union will take a considerable period of time to implement, particularly as some may require a change in the EU Treaty. While euro-area agreement on longer-term objectives may help, a full restoration of market confidence is likely to require action by the euro-area authorities much more quickly.

There are also wider issues to consider about the implications of greater euro-area integration:

- *The democratic deficit:* More integration at euro-area level raises questions about the extent to which there is support in the euro area for political union at national level. In particular, would there be political support in the core countries for large-scale fiscal transfers from the core to the periphery on a continuing basis? There were large-scale fiscal transfers from West to East Germany following unification, but would there also be political support for fiscal transfers in the euro area between different nations?

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Internal devaluation will be difficult and take time to work. External devaluation would involve leaving the euro area.

- *A widening gap between the euro area and the rest of the EU:* If the euro area were to become more integrated, the gap between the euro area and the rest of the EU would be likely to become wider. Not only monetary policy, but fiscal policy, bail-out funding, banking supervision, deposit guarantees, bank resolution and crisis management would all be determined for the euro area at euro-area level rather than at national level. As euro-area governments would effectively have a qualified majority on Single Market measures, there is a question about where this would leave the rest of the EU.
- *Regulatory arbitrage:* To prevent regulatory arbitrage and preserve a level playing-field for competition, the current and future euro-area frameworks for supervision, regulation and crisis management would also need to be consistent with global standards.

Role of the international capital market

As banks reduce their leverage and bank capital requirements increase, cross-border market-based finance – provided by investors and asset managers through the international capital market – could grow in relative importance to fill the gap and help finance the economic recovery. But a precondition is a resolution of the euro crisis and the restoration of market confidence.

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The resolution of these problems is likely either to lead to more fiscal and financial integration in the euro area or to increase the risk of disintegration.

In brief

- Developments in the euro area have been complicated by two specific problems. One is that sovereign debt is no longer regarded by the market as risk-free. The other is that the commitment to Monetary Union among participating Member States is no longer regarded by the market as irreversible.
- If Greece were to leave the euro area, the market fears that the main liquidity risk would arise from a run on weak banks in the other peripheral countries. The most effective counter to the risk of contagion in the short term would be the provision of unlimited liquidity by the ECB, easing the terms of eligible collateral if necessary.
- Some banks, particularly on the periphery of the euro area, are not only short of liquidity, but the market has doubts about their solvency. Where they cannot meet their new capital requirements by deleveraging alone, or raise capital in the market, official support may be the only option, if necessary from the ESM.
- Everyone agrees that a return to growth is the only way to make government debt service sustainable in the medium term. The question is whether austerity (via the Fiscal Compact) is the quickest way to achieve a return to growth, or whether there is an alternative (eg via a Growth Pact), and if so what form this should take, and whether the Fiscal and Growth Pacts would be consistent with one another.
- Since the launch of the euro, the periphery of the euro area has lost competitiveness in relation to the core. If the core is not prepared to increase internal demand, internal devaluation will be necessary on the periphery. This will be difficult to achieve and take time to work. External devaluation would involve leaving the euro area.
- The resolution of these problems is likely either to lead to more fiscal and financial integration in the euro area – through some form of fiscal and banking union – or to increase the risk of disintegration. More integration raises questions about the extent to which there is support for political union at national level; and is likely to lead to a widening gap between the euro area and the rest of the EU.

Recent practical initiatives by ICMA

Euro crisis

1. ICMA has provided information to members on the euro crisis in this, and previous, editions of the ICMA Quarterly Report, both in the Quarterly Assessment and in the section on the Regulatory Response to the Crisis. After the publication of each Quarterly Report, ICMA holds a teleconference call with members to discuss it, and answer members' questions.

2. ICMA has held a further teleconference call – involving three partners from Clifford Chance – to brief members on prudent contingency planning, in case of an exit from the euro area of a participating Member State, for the cash securities markets and for the documentation of bond issues. On the latest call, 340 people joined the call from 115 ICMA member firms.

3. ICMA has provided relevant information, through its website, including links to relevant documents, international law firm briefings and important external websites.

4. ICMA members have discussed the implications of the euro crisis in the relevant Market Practice and Regulatory Policy Committees (eg the ICMA European Repo Committee and the ICMA Legal & Documentation Committee).

5. Earlier in the year, ICMA organised, jointly with AFME, a roundtable teleconference call with economists on the euro crisis.

6. Following ICMA's earlier work on collective action clauses, ICMA arranged with Clifford Chance in May a seminar on collective action clauses, addressed by Philippe Mills, Chair of the EU Sovereign Debt Markets Group.

7. ICMA has continued to assess, discuss with members and, where appropriate, respond to relevant consultations on new regulations and proposals by the authorities in response to the crisis: eg on Stability Bonds ("eurobonds").

Short-term markets

8. ICMA's European Repo Council has responded to the European Commission Green Paper on *Shadow Banking* and to the FSB's Interim Report on *Shadow Banking*.

9. ICMA's European Repo Council has responded to the ESMA consultation on draft regulatory technical standards on risk mitigation techniques for OTC derivatives not cleared by a CCP under EMIR.

10. ICMA's European Repo Council has published an updated version of its margining best practices guideline.

11. ICMA has published the 2012 legal opinions on the Global Master Repurchase Agreement (GMRA), the standard agreement used for international repo transactions, together with the Guidance Notes and specific annexes to the GMRA 2011. The 2012 opinions support the use of the GMRA in more than 60 jurisdictions, including a brand new opinion for Qatar.

Primary markets

12. With guidance from the ICMA Legal & Documentation Committee, ICMA members have been preparing for the deadline of 1 July for the transposition of the Prospectus Directive into national law, following the recent review.

13. An ICMA Recommendation on *New Issue Processes*, together with a revised Explanatory Note on *Pre-sounding, Bookbuilding and Allocations*, have been agreed, in consultation with the ICMA Primary Market Practices Committee, and published.

14. Progress is being made in revising the ICMA Primary Market Handbook, in consultation with an expert Working Group set up by the ICMA Legal & Documentation Committee.

15. ICMA has submitted a response to the European Commission's consultation on the debt write-down tool, with contributions from a number of ICMA's Committees.

Secondary markets

16. ICMA has been consulting its Secondary Market Practices Committee on changes likely to be required to ICMA's Secondary Market Rules and Recommendations (eg on settlement fails and penalties) as a result of the European Commission's proposal for a CSD Regulation.

Asset management

17. The ICMA Covered Bond Investor Council has published its latest feedback statement showing investors' comments on its proposed transparency standard. The transparency standard was discussed at a covered bond investor conference in Frankfurt in May.

18. The ICMA Asset Management and Investors Council (AMIC) has responded, in relation to issues relating to the buy side, to the European Commission Green Paper on *Shadow Banking*.

Meetings with regulators

19. ICMA has continued to lead delegations of members on both the sell side and the buy side for meetings with central banks and regulators over the past quarter.

Regulatory Response to the Crisis

by David Hiscock

G20 financial regulatory reforms

On 17 April 2012, in her opening address at an IMF/CFP Policy Roundtable, the IMF's Managing Director, Christine Lagarde spoke on the *Future of Financial Regulation*. Amongst the comments she made are the following statements:

- "Simply put strengthening financial regulation is key to achieving durable global stability and growth."
- "In our view, the world is best-served by an internationally harmonized set of standards that are consistently implemented across countries, so as to avoid competitive distortions."
- "While policymakers have made progress, they still need to complete the reform agenda and ensure that the new standards are implemented in a way that is consistent across countries."
- "We also need timetables to be coherent so as not to undermine the resilience of the global financial system."
- "The reform momentum must be maintained. This means better, and more coordinated, regulation and in some cases deeper integration."

On 20 April 2012, the FSB Chairman, Mark Carney, reported to the G20 Finance Ministers and Central Bank Governors on progress in the financial regulatory reform programme. In a letter sent to the G20 ahead of their meeting, the FSB Chairman reported on the progress being made in the following priority reform areas: (i) building resilient financial institutions; (ii) ending "too big to fail"; (iii) strengthening the oversight and regulation of shadow banking activities; (iv) completing OTC derivatives and other reforms to create core continuous markets; and (v) implementing agreed G20 reforms in a timely and consistent manner. There are three reports published in support of this letter:

(i) Report on progress in extending the framework for global systemically important financial institutions (G-SIFIs) to domestic systemically important banks (D-SIBs): the principles for D-SIBs which are being considered seek to establish a minimum framework that would ensure compatibility with the G-SIB framework, address the cross-border externalities that the failure of a domestic systemic institution may nonetheless pose, and preserve a level playing field within and across jurisdictions.

(ii) Report on progress in strengthening the oversight and regulation of the shadow banking system – based on the initial recommendations and work-plans set out in the October 2011 Report, five workstreams have been launched to advance the work to develop proposed policy recommendations in the following five areas: (i) banks' interactions with shadow banking entities; (ii) money market funds (MMFs); (iii) other shadow banking entities; (iv) securitisation; and (v) securities lending and repos. The first, second and fourth of these workstreams are due to prepare their recommendations by July 2012. The recommendations from the other shadow banking entities workstream are expected by September 2012, while the securities lending/repo workstream is to prepare recommendations by the end of 2012.

(iii) Joint report from the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) on their progress in converging their standards, together with a report on enhancements to the governance of the IASB.

At their 20 April 2012 meeting, the G20 Finance Ministers and Central Bank Governors reaffirmed their commitment to common global standards by pursuing the financial regulatory reform agenda according to their agreed timetable in an internationally consistent and non-discriminatory manner.

Point 7 of the final communiqué from the 19-20 April 2012 Washington meeting of G20 Finance Ministers and Central Bank Governors directly concerns financial regulatory reform. Progress was assessed on the implementation of the G20 financial regulatory reform agenda, as outlined in the February 2012 communiqué, in order to deliver on commitments looking ahead to the Los Cabos Leaders' Summit.

The paragraph on *Global Collaboration* found within the communiqué of the 25th meeting of the International Monetary and Financial Committee, held in Washington on 21 April 2012, says: "It is also crucial to press ahead cooperatively in strengthening financial systems by completing and implementing the agreed international financial reform agenda in an internationally consistent and non-discriminatory manner, including in the area of Basel standards, derivatives, and cross-border resolution of financial institutions. In addition, fostering and protecting investment is crucial for the global recovery. We reaffirm our collective responsibility to avoid protectionism in all its forms." Other documents available in relation to this meeting include the Managing Director's action plan and official statements given.

The FSB met on 29-30 May 2012 in Hong Kong. At the meeting, the FSB discussed vulnerabilities currently affecting the global financial system and the progress in authorities' ongoing work to strengthen global financial regulation, including on:

- *Systemically important financial institutions (SIFIs):* the FSB reviewed the ongoing work to develop further the SIFI framework, including extending it to domestic systemically important banks and establishing a process to ensure consistent implementation of the policy measures, in particular for resolvability, that apply to global SIFIs. The FSB endorsed the IAIS consultation paper, which sets out a proposed methodology for assessing the global systemic importance of insurance companies. The FSB also evaluated progress in implementing its *Key Attributes of Effective Resolution Regimes for Financial Institutions* and welcomed progress of its *Data Gaps Initiative*, which will collect and share among authorities information on the common exposures and financial interlinkages of global systemically important banks.
- *OTC derivatives:* the FSB reviewed the steps being taken to implement OTC derivatives reforms, on which it will shortly issue its third progress report. The FSB noted in particular the substantial progress that has been made in the four safeguards for a resilient and efficient global framework for central clearing. In the coming weeks, standard setters will issue consultation papers on margining requirements for bilaterally-cleared derivatives transactions and on resolution of central counterparties (CCPs) and other financial market infrastructures.
- *Shadow banking:* members reviewed the ongoing workstreams to strengthen the oversight and regulation of shadow banking. The FSB will publish by end-2012 an initial integrated set of policy recommendations to strengthen regulation of shadow banking. The FSB also launched its second annual monitoring exercise of the global shadow banking system, which includes all FSB member jurisdictions.
- *Legal entity identifier (LEI):* the FSB approved recommendations, for submission to the Los Cabos Summit, to support the establishment of a global LEI system that will provide a unique global identifier for parties to financial transactions. The proposals for the initial reference data and LEI code are in line with the ISO 17442:2012 standard published 30 May 2012. The recommended implementation plan targets launch of the global LEI system on a self-standing basis by March 2013.

On 3 April 2012, the BCBS published its second progress report on Basel III implementation, which tracks the implementation of Basel II, Basel 2.5 and Basel III by BCBS member countries. The BCBS has also commenced a programme of peer reviews to assess whether its members' national rules and regulations are consistent with the globally agreed minimum standards. The methodology used by the BCBS to conduct these consistency reviews was also published on 3 April 2012. The final component of the BCBS's implementation programme entails a review of the results delivered by national rules to determine whether the outcomes are consistent across banks and jurisdictions. The BCBS's initial focus is on the calculation of risk-weighted assets in both the banking book and the trading book. These reviews started at the beginning of 2012, and initial findings are expected to be presented to the BCBS before the end of the year.

On 3 May 2012, the BCBS issued a consultative document on the fundamental review of trading book capital requirements. These proposals (as described more fully on page 43 of this Quarterly Report) will strengthen capital standards for market risk.

Then, on 11 June 2012, the BCBS published its report to the G20 Leaders on the implementation of its banking standards across member countries. The BCBS's implementation review process includes three levels of review: Level 1, ensuring the timely adoption of Basel III; level 2, ensuring regulatory consistency with Basel III; and Level 3, ensuring the consistency of outcomes.

The Leaders of the G20 met, as planned, for their latest Summit, in Los Cabos, Mexico on 18-19 June 2012, following which a declaration was published. From the financial regulatory perspective the most pertinent section of the declaration is that headed *Reforming the Financial Sector and Fostering Financial Inclusion* (paragraphs 36-54). Amongst the points to be found here, the G20 Leaders:

- welcomed the progress report by the FSB on taking forward the G20 commitments for strengthening financial stability;
- welcomed the publication of the traffic lights scoreboard to track progress in the implementation of financial reform recommendations;
- recognized the substantial progress to date in the priority reform areas identified by the FSB's Coordination Framework for Implementation Monitoring (CFIM): the Basel capital and liquidity framework; the framework for global systemically important financial institutions (G-SIFIs), resolution regimes, over-the-counter (OTC) derivatives reforms and shadow banking;
- reaffirmed the commitment that all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012, OTC derivative contracts should be reported to trade repositories and non-centrally cleared contracts should be subject to higher capital requirements;
- welcomed progress in implementing Basel II, 2.5 and III and urged jurisdictions to fully implement the standards according to the agreed timelines; and welcomed the Basel Committee's consultative proposals for a fundamental review of the market risk framework;
- reiterated their commitment to make national resolution regimes consistent with the FSB *Key Attributes of Effective Resolution Regimes* so that no bank or other financial institution is "too big to fail";
- welcomed progress on developing a set of principles as a common framework for the identification of, and policy measures relating to, domestic systemically important banks (D-SIBs);
- supported continuing work for the strengthening of the oversight and regulation of the shadow banking system;
- called for accelerated progress by national authorities and standard setting bodies in ending the mechanistic reliance on credit ratings;
- endorsed the FSB recommendations regarding the framework for development of a global legal entity identifier (LEI) system for parties to financial transactions;
- endorsed the recommendations and the revised FSB Charter for placing the FSB on an enduring organizational footing, with legal personality, strengthened governance, greater financial autonomy and enhanced capacity to coordinate the development and implementation of financial regulatory policies; and
- welcomed the ongoing work by the FSB on adherence to supervisory and regulatory information exchange and cooperation standards.

A table of G20 members' policy commitments, including some on financial sector policy, was also published. As from 1 December 2012, Russia will start chairing the G20 and the next Leaders' Summit will therefore be convened in St. Petersburg.

Alongside of this, the FSB issued a 19 June 2012 press release which includes a link to a 13 June 2012 letter to the G20 Leaders, in which Mark Carney, the FSB Chair, set out the key elements of recent progress on the reform programme and next steps.

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IOSCO 2012

Dated 22 May 2012, IOSCO released a final communiqué on its 37th Annual Conference, held in Beijing. In brief, this covers:

- *increased need for IOSCO's role:* economic turmoil highlights the need for securities regulators to work together to identify emerging risks, coordinate regulatory reform across jurisdictions, enhance regulatory and supervisory cooperation, and thereby seek ways to provide a stable and efficient securities market environment, which is a necessary foundation for economic growth. This underscores the importance of IOSCO as both a standard setter and a platform for regulators from both emerging and developed economies to meet the challenges ahead.
- *progress on policy issues:* discussions focused on a series of ongoing projects that respond to the wide-ranging initiatives on international regulatory reform and financial stability identified by the G20 and the FSB. Technical Committee (TC) members also noted and discussed progress on a number of other work streams undertaken at the initiative of IOSCO.
- *G20/FSB-related issues:* the TC considered updates on money market funds, various work streams on the identification methodologies for SIFIs (including systemically important market intermediaries) and IOSCO's contribution to other FSB work streams on market-based financing. The TC progressed a draft consultation paper on *Global Developments in Securitization Regulation*, addressing issues about risk retention, transparency and standardization; approved a report prepared by the OTC Derivatives Task Force on Derivatives Market Intermediary Oversight; and noted progress on reports to be made to the G20 meetings in Mexico on Price Reporting Agencies, CDS markets and market integrity. The TC also reviewed joint work streams by CPSS and IOSCO on Financial Markets Infrastructures and OTC derivatives reforms.

The final communiqué also covers: Other Policy Initiatives; Emerging Markets Committee Initiatives; the importance of implementation and the Assessment Committee; the continuing importance of the IOSCO MMoU; Initiative to Raise Standards of Cross-Border Cooperation; and Structural Changes and Operational Issues.

The SRO Consultative Committee (SROCC) exchanged views and information among its members on a number of emerging regulatory issues facing SROs, including matters related to corporate governance, high frequency trading, risks when intermediary firms outsource back office functions, and cooperation among regulatory bodies. The SROCC also discussed possible ways for SROs to more effectively contribute to the IOSCO's core work. Jose Carlos H. Doherty, Brazilian Association of Financial and Capital Markets Institutions (ANBIMA), was elected as the next SROCC Chairman.

The public sessions of IOSCO's 2012 Annual Conference focused on the themes of a new financial architecture for the post-crisis era, financial market infrastructures and market integrity, capital markets development in emerging markets, and regulation of commodity futures and financial derivatives. The public conference came at the conclusion of IOSCO's private meetings in which important steps were taken to ensure that IOSCO, as the international standard setter for securities markets regulation:

- is structured and positioned to continue providing the lead in the development of regulatory standards for capital markets;
- has the resources needed to engage in the identification of emerging securities markets risks;
- possesses the capacity to meet the needs of its members; and
- is prepared to respond to requests for project work by the G20 and the Financial Stability Board (FSB).

Further details relating to this can be found in the press release, *IOSCO Prepares for the Regulatory and Financial Challenges Ahead*. A new transitional IOSCO Board was constituted to subsume the functions of the Technical Committee (TC), the Executive Committee (EC) and the Emerging Markets Committee (EMC) Advisory Board. Masamichi Kono, the Vice Commissioner for International Affairs at the Financial Services Agency of Japan (JFSA), was appointed as Chairman of the new IOSCO Board. Mr Kono will step down from this position in March 2013 at the Board meeting in Sydney, from when Greg Medcraft, the Chairman of the Australian Securities & Investment Commission (ASIC), will assume the position of Chair until the meeting of the Board at the IOSCO Annual Conference in September 2014 in Rio de Janeiro. Dr. Vedat Akgiray, Chairman of the Capital Markets Board (CMB) of Turkey, and Ethiopis Tafara, the Director of the Office of International Affairs at the US Securities and Exchange Commission, were appointed as Vice Chairs. Additionally, pursuant to a prior consultation with members, IOSCO merged the policy and standard-setting work of the TC Standing Committees and the EMC Working Groups; and a Task Force has been formed to define the role of the future EMC within the new IOSCO architecture.

Four IOSCO members signed the IOSCO Multilateral Memorandum of Understanding (MMoU – the latest version of which is a text dated May 2012) during a ceremony in Beijing, bringing to 86 the total number of signatories. Together these participants cover about 95% of the world's securities markets. IOSCO also approved a resolution allowing it to take tougher measures to encourage compliance by members who have not yet signed the MMoU. The new resolution is designed to assist these non-signatories in overcoming the obstacles they often encounter in securing support from their governments or legislatures for implementing the legal and regulatory changes required for compliance with the MMoU, which marked its 10th anniversary at this conference.

IOSCO will hold its 38th Annual Conference in Luxembourg on 15-19 September 2013.

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Are the current and ongoing regulatory reforms sufficient to ensure a stable and efficient banking system and avoid systemic crises?

European financial regulatory reforms

On 3 May 2012, the European Commission initiated a short consultation by the High-level Expert Group on reforming the structure of the EU banking sector. The Group was set up in February 2012 and has the mandate to consider in depth whether there is a need for structural reforms of the EU banking sector or not and to make any relevant proposals as appropriate. The Group should present its final report to the Commission by the end of summer 2012 and solicited responses to this consultation by 1 June 2012. The consultation posed questions to banks, to corporate customers and to retail customers. The questions to banks were:

- to what extent are the current and ongoing regulatory reforms sufficient to ensure a stable and efficient banking system and avoid systemic crises?
- which structural reforms would improve the safety and efficiency of the banking system in the EU in the near term? In the long term?
- what are your views on the structural reform proposals to date (e.g. US Volcker Rule, UK ICB proposal)? What would be the implications of these proposals on your institution and the financial system as a whole?
- what are the main challenges of your financial institution as regards resolvability? Are you implementing structural changes to your institution in the framework of your recovery and resolution planning?

Published on 7 May 2012, ESMA’s annual regulatory programme aims to provide information on the planned technical standards, technical advice and guidelines and recommendations to be issued by ESMA in 2012. The regulatory work programme is based on the ESMA 2012 Work Programme published on 4 January 2012, but provides a more detailed outline of the individual workstreams. The 2012 regulatory programme lists 77 items, most of which are mandatory and all of which are stated to be subject to consultation, related to SSR, EMIR, MiFID, AIFMD, UCITS, TD, PD and Omnibus I.

Following a vote, adopted by 44 votes in favour with no abstentions or votes against, the European Parliament’s ECON issued a 14 May 2012 press release stating that “Bank capital requirements must be strengthened to make banks more risk-resilient and the risk weighting of loans to small firms must be reduced to facilitate lending to the real economy”. Then, as announced on 15 May 2012, the Council (at a meeting of ECOFIN) unanimously agreed a general approach on two proposals – the so called “CRD 4” package – amending the EU’s rules on capital requirements for banks and investment firms, with a view to negotiations with the European Parliament (these developments were also commented on by Commissioner Barnier and by the Danish EU Presidency). The proposals set out to amend and replace the existing Capital Requirement Directives by two new legislative instruments: a *Regulation* establishing prudential requirements that institutions need to respect and a *Directive* governing access to deposit-taking activities. Negotiations with the European Parliament aim for adoption of the package at first reading, with agreement in July now targeted if at all possible.

On 6 June 2012, the European Commission adopted a legislative proposal for bank recovery and resolution (as further discussed later in this Quarterly Report). The proposal lays out a comprehensive set of measures which aim to ensure that:

- national authorities are equipped with the necessary tools to intervene in a troubled institution at a sufficiently early stage to address developing problems;
- firms and authorities make adequate preparation for crises;
- national authorities have harmonised resolution tools and powers (including unsecured debt bail-in) to take rapid and effective action when bank failure cannot be avoided; and
- authorities cooperate effectively when dealing with the failure of a cross-border bank.

Following the normal EU legislative process, the proposal will now be worked on by the European Council and the European Parliament.

Whilst the proposal is a necessary first step to improve efficiency and cohesion in ensuring that failing banks in the EU Single Market can be resolved in a way which preserves financial stability and minimises costs for taxpayers, the *Reflection Towards a More Integrated Banking Union* is an essential subsequent step. It will look into key measures which need to be taken to ensure closer integration. Such a banking union will rest on the following four pillars:

- a single EU deposit guarantee scheme covering all EU banks;
- a common resolution authority and a common resolution fund for the resolution of, at least, systemic and cross-border banks;
- a single EU supervisor with ultimate decision-making powers, in relation to systemic and cross-border banks; and
- a uniform single rulebook for the prudential supervision of all banks.

The European banking union is not a new legal instrument to be drafted, instead it is a political vision for more EU integration – which will build on recent major steps to strengthen the regulation of the banking sector. The President of the European Council presented a report in close collaboration with the President of the European Commission, the Chair of the Eurogroup and the President of the European Central Bank to the European Council (28-29 June 2012). An update on the topic of the banking union was issued by the European Commission on 22 June 2012.

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Macro-prudential regulation

Central Bank Independence and Macro-prudential Regulation, an IMF working paper authorised for distribution on 1 April 2012, considers the optimality of various institutional arrangements for agencies that conduct macro-prudential regulation and monetary policy. When a central bank is in charge of price and financial stability, a new time inconsistency problem may arise. *Ex ante*, the central bank chooses the socially optimal level of inflation. *Ex post*, however, the central bank chooses inflation above the social optimum to reduce the real value of private debt. This inefficient outcome arises when macro-prudential policies cannot be adjusted as frequently as monetary. Importantly, this result arises even when the central bank is politically independent. The paper then considers the role of political pressures. It is shown that, if either the macro-prudential regulator or the central bank (or both) are not politically independent, separation of price and financial stability objectives does not deliver the social optimum.

On 2 April 2012, the ESRB published a letter aimed at helping EU legislators to further develop the legal basis, within the current proposals for CRD/CRR, for policies to address future threats to financial stability in the EU. The ESRB considers it essential from a macro-prudential perspective that these rules can be tightened temporarily, by both EU and Member State authorities, in order to tackle future threats to the financial system and to the flow of credit to the economies of the EU. The ESRB has identified three principles to underpin this macro-prudential framework: flexibility to undertake a broad range of actions; scope to act early and effectively; and efficient coordination of actions by Member States.

On 10-11 April 2012 the BIS, together with the Bank of Korea and the IMF held a joint conference on *Macro-financial Linkages: Implications for Monetary and Financial Stability Policies.* The conference programme included the presentation and discussion of research on banks, shadow banks and the macro-economy; bank liquidity regulation; the macro-economic impact of regulatory measures; macro-prudential policies in theory and in practice; and monetary policy and financial stability. The conference concluded with a panel discussion focused on the lessons or guideposts for the formulation and implementation of macro-prudential and monetary policies; and there was a discussion of weaknesses in the understanding of macro-financial linkages.

Separately, on 11 April 2012, the BIS published a new working paper, *Systemic Risks in Global Banking: What Can Available Data Tell Us and What More Data Are Needed?* As systemic risk analysis is severely hampered by the lack of consistent data that capture the international dimensions of finance, supervisors and other agencies need more and better data to construct even rudimentary measures of risks in the international financial system. Similarly, market participants need better information on aggregate positions and linkages to appropriately monitor and price risks. On-going initiatives that will help close data gaps include the *G20 Data Gaps* Initiative and enhancements to the BIS international banking statistics.

The final products of the BCBS's Research Task Force Transmission Channel project are two working papers that summarise the findings of the many individual research projects that were undertaken and discussed in the course of the project. The first, *The Policy Implications of Transmission Channels Between the Financial System and the Real Economy*, analyses the link between the real economy and the financial sector, and channels through which the financial system may transmit instability to the real economy. The second, *Models and Tools for Macro-prudential Analysis*, focuses on the methodological progress and modelling advancements aimed at improving financial stability monitoring and the identification of systemic risk potential.

On 24-25 May 2012, the BIS was the venue for a joint workshop, *Banks – How Big is Big Enough?*, which was hosted by the BCBS, the Centre for Economic Policy Research, and the *Journal of Financial Intermediation*. The two-day agenda largely consisted of the presentation of a series of papers broadly linking to the overall theme. And then on 26-27 April 2012 the BIS held a conference, hosted by the Central Bank of Brazil in Rio de Janeiro, on *Financial Stability, Financial Regulation and Monetary Policy,* the third under the auspices of the BIS Consultative Council for the Americas. This involved researchers from the central banking community in the region and distinguished academics.

On 31 May 2012, the ESRB released its Annual Report 2011. The foreword is provided by Mario Draghi, ESRB Chair, and is followed by an executive summary. Section 1 of the report then elaborates on the role and functioning of the ESRB, considering its establishment, tasks and institutional set-up. Section 2 then describes ESRB activities since its inception in December 2010. Finally section 3 provides a focus on topical systemic issues. The report was introduced by Mario Draghi at a hearing on the ESRB before the European Parliament's ECON. His 31 May 2012 introductory statement includes an assessment of systemic risks in the EU financial system; observations on a sound macro-prudential framework for the EU; and a brief review of structural developments in the EU financial system.

Whilst it is now generally accepted that there needs to be a macro-prudential approach to financial regulation, the fundamental rationale behind macro-prudential policies is not always clearly articulated. In this context *Externalities and Macro-Prudential Policy*, an IMF staff discussion note published on 7 June 2012, lays out the key sources of market failures that can justify macro-prudential regulation. It explains how externalities associated with the activity of financial intermediaries can lead to systemic risk, and thus require specific policies to mitigate such risk.

On 21 June 2012, the General Board of the ESRB held its sixth regular meeting. The ESRB noted that from the macro-prudential perspective the fundamental challenges remain limiting contagion between Member States across the EU; and promoting a macroeconomic strategy that supports growth and fiscal consolidation. The ESRB goes on to state that addressing these challenges requires measures to tackle vulnerabilities at their source that lie beyond the remit of the ESRB and European System of Financial Supervision. Within this broader context, and from a macro-prudential point of view, the ESRB encourages authorities to:

- support credible mechanisms for the recapitalisation and restructuring of the banking sector based on: increased consistent valuation and transparency about banks' asset quality; the imposition of strong conditionality on the relevant banks with regard to the use of any publicly funded recapitalisation; and the resolution of non-viable institutions;
- continue with measures to build resilience among banks generally by: requiring capital levels accumulated so far to be maintained and encouraging banks to assume their responsibilities in financing the real economy; and ensuring a focus on banks' leverage as well as risk-sensitive capital adequacy measures for improving resilience;
- exchange information and, when necessary, coordinate actions at the ESRB so as to ensure the efficiency of macro-prudential measures, including those mentioned above.

On 22 June 2012, the ESRB issued its first occasional paper, *Money Market Funds in Europe and Financial Stability.*

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OTC (derivatives) regulatory developments

Leaders and senior representatives from key authorities with responsibility for the regulation of the OTC derivatives markets in their respective jurisdictions met on 1 May 2012 in Toronto. At the meeting, the authorities discussed a range of implementation issues, including pre- and post-trade transparency, margin for uncleared derivatives, coordination of clearing mandates, access to data in trade repositories, and cross-border clearing house crisis management. The participants welcomed the opportunity for continued discussion and sharing of information on implementation of OTC derivatives reform, with a view to further align regulatory requirements where possible; and the authorities committed to continue to engage in bilateral discussions as necessary in their efforts to implement new requirements for OTC derivatives.

As announced in its 15 June 2012 press release, the FSB has published its third six-monthly progress report on implementation of OTC derivatives market reforms. The report notes that, since the previous FSB progress report in October 2011, encouraging progress has been made in setting international standards, the advancement of national legislation and regulation by a number of jurisdictions; and practical implementation of reforms to market infrastructures and activities. But much remains to be completed by the end-2012 deadline. Broadly speaking, the jurisdictions with the largest markets in OTC derivatives – the EU, Japan and the US – are the most advanced in structuring their legislative and regulatory frameworks. They expect to have regulatory frameworks in place by end-2012 and practical implementation within their markets is well underway. Other jurisdictions are generally less advanced.

Since the October 2011 progress report, standard setting bodies have made significant progress in developing the international policies that are key to advancing OTC derivatives reform implementation across jurisdictions, notably:

- CPSS and IOSCO issued in April 2012 *Principles for Financial Market Infrastructures* (PFMIs), which are an important milestone in the global development of a sound basis for central clearing of all standardised OTC derivatives.
- IOSCO published in February 2012 recommendations on requirements for mandatory central clearing.
- CPSS and IOSCO in January 2012 outlined OTC derivatives data reporting and aggregation requirements, recommending that trade repositories implement measures to provide authorities with effective and practical access.
- IOSCO in June 2012 published standards for the regulation of OTC derivatives market intermediaries.

Also, in January 2012, the FSB responded to the request from some jurisdictions for guidance to help them make informed decisions about the form of CCPs to use in order to meet the G20 commitment on central clearing by identifying four safeguards for a resilient and efficient global framework for central clearing. With international standard setting and policy guidance now largely complete, jurisdictions need to promptly develop and implement legislative and regulatory frameworks.

Given the importance of practical implementation, the FSB will focus increasingly on monitoring not only the legislative and regulatory steps that have been achieved but also the concrete implementation that has taken place. In the next progress report, to be published before the November G20 Finance Ministers and Central Bank Governors

"Encouraging progress has been made in setting international standards, the advancement of national legislation and regulation, but much remains to be completed by the end-2012 deadline.

> Existing empirical evidence on many aspects of the CDS market tends to be mixed, although the CDS market is found to have an important role in the price discovery process.

meeting, the FSB intends to put additional focus on the readiness of infrastructures to provide central clearing, platform trading and reporting of OTC derivatives, the practical ability of industry to meet the requirements, and the remaining steps for industry to take.

The EBA launched an open consultation on 15 June 2012, on Draft Regulatory Technical Standards (RTS) on the capital requirements for CCPs, with comments requested by 31 July 2012. The EMIR Regulation requires CCPs to collect margins, to maintain a pre-funded default fund and to maintain dedicated own resources to cover their losses upon the default of one of their clearing members. Additional capital is also required under Article 16 to mitigate, on the one hand, against market risk, credit risk and counterparty credit risk arising from non-covered activities and, on the other hand, against operational risk arising from all activities of a CCP. The draft RTS developed by the EBA are intended to specify these additional capital requirements. The proposed consultation paper is based on the EMIR texts as adopted by the European Parliament on 29 March 2012 and by the European Council on 11 April 2012. The two texts are now being reconciled by jurist linguists and the final EMIR text will be signed and made available before August. The final draft RTS will be submitted to the EU Commission for endorsement by 30 September 2012.

On 16 June 2012, IOSCO published a report on the credit default swap (CDS) market, which seeks to inform the ongoing regulatory debate on CDS and highlight some of the key policy issues involving these financial swap agreements. The report was mandated by the G20 leading industrialized and emerging nations at the Cannes Summit in November 2011, where IOSCO was called on "to assess the functioning of CDS markets and the role of those markets in price formation of underlying assets". The report addresses the issues mentioned in the Cannes declaration and discusses the recent changes and current trends in the CDS markets. It also provides information from recent literature about the trading, pricing and clearing of CDS, while covering the following areas:

- basic functioning of CDS contracts and market size;
- features of the CDS market; and
- the impact of CDS on the bond market-CDS impact on credit spreads and creditor incentives; CDS impact on the secondary market of underlying bonds; and CDS role in the price discovery process.

Among the report's conclusions is that existing empirical evidence on many aspects of the CDS market tends to be mixed, such as on the impact of CDS on the orderly functioning of the primary and secondary markets of the underlying bonds and on creditor incentives, although the CDS market is found to have an important role in the price discovery process.

On 25 June 2012 ESMA launched a consultation which includes the Regulatory and Implementing Technical Standards ESMA is required to draft under EMIR, with comments requested by 5 August 2012. The consultation covers implementing measures for the application of the clearing obligation for risk mitigation techniques, exemptions for non-financial counterparties and intra-group transactions, requirements for CCPs and reporting and disclosure obligations for trade repositories. An open hearing will take place on 12 July 2012. The consultation paper is based on the EMIR texts as adopted by the European Parliament on 29 March 2012 and by the Council on 11 April 2012. The final draft standards are intended to be submitted to the EU Commission for endorsement by 30 September 2012.

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Credit rating agencies

As reported in the ICMA Quarterly Report for the Second Quarter, on 15 March 2012 ESMA announced that it considers the regulatory frameworks for credit rating agencies (CRAs) of the United States of America, Canada, Hong Kong and Singapore to be in line with EU rules. On 18 April 2012, ESMA made a further announcement stating that it considers the regulatory frameworks for CRAs of Argentina and Mexico to be in line with EU rules. This allows EU financial institutions to continue using for regulatory purposes credit ratings issued in these two further countries after 30 April 2012.

ESMA also published its (positive) technical advice to the European Commission on the equivalence of the regulatory regimes for CRAs in the USA, Canada and Australia. Once the Commission has declared a third-country regime to be equivalent to the EU regime, CRAs which are only established in that specific country can submit their application to ESMA to be certified in the EU in accordance with the CRA Regulation. This will allow for their ratings to be directly used by EU financial institutions.

Subsequently, on 27 April 2012 ESMA also announced that it considers the regulatory framework for CRAs of Brazil to be in line with EU rules. This allows EU financial institutions to continue using credit ratings issued in Brazil for regulatory purposes after 30 April 2012. Following the endorsement decisions already adopted by ESMA, concerning Japan, the USA, Canada, Australia, Hong Kong, Singapore, Mexico, and Argentina, the majority of non-EU issued credit ratings are now recognised by ESMA to be subject to EU-equivalent regulation.

However, there remain a number of jurisdictions whose legal framework does not currently meet EU requirements. Accordingly ESMA advises EU financial institutions, when using credit ratings for regulatory purposes after 30 April 2012, to pay particular attention to identify EU-endorsed ratings among those credit ratings that are issued outside the EU. In doing so, EU financial institutions should carefully consider all information made available by CRAs regarding the endorsement status of their credit ratings. It should be noted that the European Commission has recently clarified that "credit ratings are not considered to be used for regulatory purposes under the IRB Approach (with the exception of the RBA and IAA for securitisations) and credit ratings issued in non-endorsable countries could continue to be used after 30 April 2012 eg as benchmarks in IRB models (excluding RBA and IAA for securitisations)".

As announced on 21 May 2012, the Permanent Representatives Committee agreed the European Council's position on two proposals amending the EU's rules on CRAs (CRA 3), with a view to negotiations with the European Parliament (this was also noted by the Danish EU Presidency). It mandated the presidency to start negotiations with the Parliament, on the basis of the Council's general approach, so as to enable adoption of the texts at first reading. The proposals for a directive and a regulation set out to amend existing legislation on CRAs in order to reduce investors' over-reliance on external credit ratings, mitigate the risk of conflicts of interest in credit rating activities and increase transparency and competition in the sector.

On 19 June 2012, the European Parliament's ECON adopted the report of its *rapporteur*, Leonardo Domenici, thereby allowing that negotiations can be opened with the European Council. The press release following this debate focuses on the regulation of sovereign debt ratings. MEPs also decided to take the first step towards developing an internal public rating capacity at EU level. It is proposed that the task of creating an independent EU creditworthiness assessment will be entrusted to the existing EU institutions.

On 25 May 2012, the Technical Committee of IOSCO published a consultation report, *Credit Rating Agencies: Internal Controls Designed to Ensure the Integrity of the Credit Rating Process and Procedures to Manage Conflicts of Interest.* This report, on which comments are sought by 9 July 2012, describes certain internal controls and procedures that CRAs use to promote the integrity of the credit rating process and address conflicts of interest, with a view to promoting a better understanding of these practices. The report seeks to describe the operational practices of the CRAs that are designed to give effect to the relevant provisions of the IOSCO Code of Conduct Fundamentals for CRAs, which was published in December 2004 and revised in May 2008.

On 30 May 2012, four Commission Delegated Regulations establishing regulatory technical standards for CRAs were published in the EU's *Official Journal*. These technical standards set out: (i) the information to be provided by a CRA in its application for registration to ESMA; (ii) the presentation of the information to be disclosed by CRAs in a central repository (CEREP) so investors can compare the performance of different CRAs in different rating segments; (iii) how ESMA will assess rating methodologies; and (iv) the information CRAs have to submit to ESMA and at what time intervals in order to supervise compliance. The four standards, which complement the current European regulatory framework for credit rating agencies, were developed by ESMA and endorsed by the European Commission on 21 March 2012.

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Taxation

Based on a report prepared by *rapporteur* Anni Podimata, a resolution adopted (with 33 votes for and 11 votes against) on 25 April 2012 by the European Parliament's ECON says that the proposed financial transaction tax (FTT) should be better designed to capture more traders and to make evading it unprofitable. The resolution also says the tax should go ahead even if only some Member States opt for it. The European Parliament has been calling for a FTT for close to two years and the European Commission tabled a legislative proposal for one late in 2011.

To further elaborate on its original impact assessment, on 4 May 2012 the European Commission services published seven explanatory notes that provide the results of further analysis and clarifications on how the FTT would work in practice. Then on 23 May 2012 the full European Parliament adopted an opinion (approved with 487 votes in favour, 152 against and 46 abstentions) supporting the Commission's proposal on FTT, as welcomed in a statement issued by Commissioner Šemeta. Whilst the Parliament's opinion has no legislative status and need not be acted on by the European Commission, it does provide political support for the FTT's proponents.

A new study by Oxera reviews the European Commission's explanatory notes as well as their new economic model that assesses the macroeconomic impact of the tax. Oxera considers that many of shortcomings of the original September 2011 impact assessment (as set out in Oxera's previous report) remain. Also, the European Commission's new analysis underestimates the impact of the FTT by more than the September impact assessment. Oxera further concludes that, even based on the European Commission's own assumptions, the tax would remain an inefficient way to raise public funds.

Meanwhile the actual decision making on the adoption of FTT remains in the hands of Europe's Finance Ministers. A series of Council meetings have been held, with detailed discussion of the proposal and its impact assessment. FTT requires unanimity to proceed as an EU measure and it appears that this will not be achieved. This has prompted some discussion of alternatives, including proceeding with a narrower tax (more akin to the UK's equities' stamp tax regime); proceeding on the basis of cooperation amongst a sub-group of EU members (but even at the level of the euro Member States it appears no agreement can be found for this); or pursuing other tax measures, such as financial activities tax (FAT) or bank levies. Most recently, at their 21-22 June 2012 meeting in Luxembourg, EU Finance Ministers held an orientation debate on the basis of a Presidency progress report concerning the FTT proposal, to determine the next steps in taking this project forward at EU level. The way forward now appears to be for a block of, at least nine, Member States to proceed with a proposal on the basis of enhanced cooperation..

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"The European Commission's new analysis underestimates the impact of the FTT by more than the September impact. The tax would remain an inefficient way to raise public funds.

Sovereign Bond Markets

Collective action clauses

As reported in the ICMA Quarterly Report for the Second Quarter, the EFC's EU Sovereign Debt Markets Group (SDMG) has published the agreed text of the model collective action clauses (CACs) for the euro area, together with some explanatory notes. As of 1 January 2013, these model CACs are to be included in all new euro-area government securities (save for some retail savings bonds), with maturities above one year, in such a way that their legal impact is identical. In order to preserve the liquidity of securities issued without CACs before January 2013, each euro-area Member State may tap securities existing before that date (ie without CACs), in an amount equal per year to an agreed percentage of the total issuance of debt securities by that Member State in that year. The transition has been designed in order to allow a smooth and gradual decline in the maximum amount of securities existing prior to January 2013 which can be tapped.

The objective underlying the introduction of these CACs is, where necessary, to facilitate agreement between the sovereign and its private sector creditors in the context of potential private sector involvement. Their inclusion does not entail a higher probability of default or restructuring for securities; and the same level of seniority will exist between pre-2013 and post-2013 euro-area sovereign bonds. These model CACs are based on New York and English law sovereign CACs. Whilst they will be applied to a broad range of securities under different legal systems, harmonisation of these CACs across Member States will ensure that the legal impact of the CACs is identical under all euro-area jurisdictions.

The model CACs establish quorum requirements for meetings and thresholds for approval, which vary depending on whether the proposed modification is a reserved matter or not. For reserved matters, which covers a wide range of topics, the quorum for a meeting and for an adjourned meeting is set at 66 2/3% of the principal outstanding; and the threshold for the approval of a modification is set at 75% of the votes represented at a meeting (or 66 2/3% of the principal outstanding in the case of a written procedure). Consequently, the modification of a reserved matter requires the approval of investors representing at least 50% of the principal outstanding. For non-reserved matters the quorum for a meeting is set at 50% of the principal outstanding, and at 25% for an adjourned meeting; and the threshold for the approval of a modification is set at 50% of the votes represented at a meeting (or 50% of the principal outstanding in the case of a written procedure).

For cross-series modifications, the threshold for approval is set at 66 2/3 % of the votes represented at separate meetings (50% of the principal outstanding in the case of a written procedure) for each series *and* 75% of the total aggregate of all series (66 2/3% of the principal outstanding in the case of a written procedure). In case a cross-series modification is not approved, a partial cross-series modification can still be approved if the proposed modification would have been adopted by a subset of the series covered by the proposed modification. Prior to the record date, the issuer must publicly notify the bondholders of the conditions for the approval of a partial cross-series modification.

For a bond providing for the accrual of interest (typical fixed bullet security), the voting rights of an investor are equal to the face amount of the bonds. Since it would not be fair to allocate the same voting rights for zero coupon bonds (which do not bear interest) or for index-linked bonds (whose face value does not reflect an accrued value that can be significant), the model CAC provides specific methods to calculate such bonds' voting rights.

The only holders of bonds allowed to vote on a proposed modification are those who benefit from autonomy of decision and are required to act independently of instructions given by the issuer. Hence the issuer itself and governmental bodies (ministries, departments, agencies, etc.) are disenfranchised from the vote, but autonomous central banks may vote.

In order to ensure consistency of implementation at national levels, each Member State will be required to deliver a legal opinion from the highest Member State authority competent for such matters, confirming that the model CAC will be legal, valid, binding and enforceable in accordance with its terms under the laws of that Member State. The SDMG expects to publish a report on the implementation of the model CAC prior to January 2013.

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Principles for fair debt restructuring

Dated 22 November 2004, the Institute of International Finance (IIF) and the International Primary Market Association (IPMA) issued a statement of *Principles for Stable Capital Flows and Fair Debt Restructuring*. Since then, application of these principles has been routinely monitored and reported on, most recently in the 2011 *Report on Implementation* by the Principles Consultative Group; and in 2009, the ECB published a related occasional paper. On 7 June 2012, the IIF announced the formation of a special Joint Committee on the Strengthening of the Framework for Sovereign Debt Crisis Prevention and Resolution, under the auspices of the Group of Trustees of the Principles for Stable Capital Flows and Fair Debt Restructuring. This new Joint Committee will discuss and draw lessons from recent episodes of sovereign debt crises both in Europe and elsewhere; and discuss measures to strengthen the guidelines provided by the Principles to keep them relevant and useful to address today's challenges in sovereign crisis prevention and resolution. ICMA's President, René Karsenti, is amongst the members appointed to this Joint Committee.

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Stability Bonds

As reported in the ICMA Quarterly Report for the First Quarter (page 23), the European Commission's Green Paper on the *Feasibility of Introducing Stability Bonds* was published on 23 November 2011. Following from this, on 4 May 2012 the European Commission issued a report on the public consultation; and has subsequently made available the consultation responses (including ICMA's 6 January 2012 submission). The results of the public consultation following the Green Paper show a clear majority in favour of Stability Bonds (or "eurobonds"), and most of them in favour of the Green Paper's Approach 2 (ie partial substitution of Stability Bond issuance for national issuance, with joint and several guarantees). It appears that the main challenge in reassuring opponents remains how to ensure a full respect of fiscal rules and avoid moral hazard. The feedback to the public consultation revealed several additional issues not addressed in the Green Paper which must be further analysed.

In the meantime the European Parliament's ECON has been preparing a report on the feasibility of introducing Stability Bonds, guided by its *rapporteur,* Sylvie Goulard. This considers a "roadmap" which links all progress towards Stability Bonds with an imperative parallel process of budgetary stabilisation and economic convergence. It anticipates a four phase approach:

- immediate measures to exit the crisis: (i) setting up of a temporary European redemption fund to reduce debt to sustainable levels at affordable interest rates; and (ii) introducing eurobills to protect Member States from illiquidity runs;
- in the short term, a blue bond proposal: yearly allocated debt ≤ 60 % of GDP to be issued in common without a Treaty change;
- in the medium term, common issuance of national debt involving a Treaty change; and
- in the long term, common issuance of a genuine European debt.

Dated 18 June, the European Parliament issued a press release, *Eurobonds and Other Tools for Debt Solidarity*, following from ECON's consideration of this draft report.

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ICMA is continuing its own efforts to promote improved transparency regarding the terms and conditions of all sovereign debt issuance.

Sovereign transparency

Steven Maijoor, the Chair of ESMA, gave a speech – on *The Sovereign Debt Crisis and the EU Single Market: Where is Further Work Needed from a Securities Markets Perspective?* – at the high level Conference on Financial Integration and Stability at the ECB in Frankfurt on 26 April. In his speech, Steven Maijoor talked about three subjects:

- the institutions needed for a Single Market in the securities area;
- how the financial crisis has affected economic integration in securities markets; and
- three policy areas where further progress is needed to foster economic integration in securities markets, namely: (i) transparency related to sovereign debt issuers; (ii) financial planning of private households; and (iii) the balance between loan-based intermediation and market-based intermediation.

On the subject of transparency related to sovereign debt issuers, he stated that “while initially not sufficient, the transparency and financial reporting by listed companies holding sovereign debt has improved. However, the transparency of issuers of sovereign debt is lagging behind.” He then went on to say: “A first area where we should progress is financial reporting by governments.” ICMA is pleased to see further official acknowledgement of the potential for improvements in this area and is continuing its own efforts to promote improved transparency regarding the terms and conditions of all sovereign debt issuance.

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Public Sector Issuer Forum

After its inaugural session in Paris in February, the Public Sector Issuer Forum (PSIF) met for its first full session end-March at the headquarters of KfW in Frankfurt. The meeting confirmed at the outset the Forum’s Steering Committee with three senior representatives representing each key constituency of the SSA sector (sovereigns, supranationals and agencies). The members of the Steering Committee are Madelyn Antoncic of the World Bank, Frank Czichowski of KfW, and Anne Leclercq of the Belgian Debt Agency.

The current format of discussions of the Forum is for a member to address an agreed topic of concern, with an external market participant also providing its view. In Frankfurt, the presentations focused on the impact of regulatory developments, especially CRD IV and Basel III, on derivatives pricing and on related risk mitigation strategies.

As the invited speaker, Barclays Capital elaborated on the overall increase post-crisis of funding and counterparty risk costs for derivatives. On the regulatory front, Basel III is expected to add considerably to counterparty risk costs through a Credit Value Adjustment add-on charge (CVA Capital Charge). For the SSA sector, the question is whether it will be exempt in line with its favourable risk weighting treatment under Basel II. In the meanwhile, market counterparties are generally seeking to obtain two-way Credit Support Annex (CSA) agreements from SSAs in order to mitigate higher costs, relieve liquidity issues and avoid pricing hikes.

KfW’s presentation focused on experience to date in mitigating the trend of the rising cost of derivatives, and managing the related requests from counterparties for collateral and credit support. The ensuing discussions highlighted the diversity of experience of SSAs in responding to these issues, and the lack of a “one size fits all” solution.

Generally, PSIF members’ contributions at the Forum confirmed its strong focus on the regulatory outlook in Europe and the US. Besides the difficulty of monitoring and evaluating the multiplicity of regulatory initiatives under way, the concern is with their still unforeseeable combined impact, as well as the risk of unintended consequences such as simply displacing systemic risk to a new set of institutions, or aggravating existing market dysfunction resulting from the crisis. This could be particularly problematic if the current regulatory drive indirectly leads to an aggravation of the credit and liquidity drought already observed in the market. These concerns will be a central topic for discussion at subsequent PSIF meetings.

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by David Hiscock

Short-Term Markets

European repo market

Repo margin practices: Consistent with its commitment to promoting best practice in the repo market, the ICMA European Repo Council (ERC) has published a revised and updated edition of its *Repo Margining Best Practices.* This new guidance, released on 25 May 2012, replaces that previously published on 15 September 2005. Recommendations in this guidance include: which transactions are included in the calculation of exposures; what price to use to value collateral; when margin should be called; margin call thresholds; deadlines for making a margin call; substitution of margin securities; and what happens if margin is not delivered. The guidance has been revised to take into account changes in market practice resulting from the publication of the latest version of the Global Master Repurchase Agreement (GMRA), the most widely used documentation for international repo market transactions, in 2011. In particular, changes are now recommended to:

- provide that margin calculations be based, where possible, on actual rather than assumed settlement;
- ensure mutual agreement on whether to use initial margins or haircuts, since the GMRA 2011 now embraces two alternatives; and
- encourage migration towards same-day settlement of margin calls.

The ERC believes that these incremental changes will significantly assist in embedding the most up-to-date margin risk management practices across the repo market.

Bank recovery and resolution: On 6 June 2012, the European Commission adopted a legislative proposal for bank recovery and resolution. Following the normal EU legislative process, the proposal will now be worked on by the European Council and the European Parliament. Within this proposal, there are two topics of particular note for repo:

- *Bail-in:* Amongst the proposed resolution tools it is generally proposed that the resolution authorities should have the power to bail in all the liabilities of the institution. There are, however, some liabilities which it is proposed would be excluded ex ante, including secured liabilities. Secured liabilities are defined to include “liabilities arising from repurchase transactions and other title transfer collateral arrangements” (Article 2(58)). The proposed exclusion of secured debt from bail-in is covered by Recital 47 and Article 38.2. Note that it is proposed that bail-in powers will apply to “any part of a secured liability or a liability for which collateral has been pledged that exceeds the value of the assets, pledge, lien or collateral against which it is secured.”

“The ERC believes that these incremental changes will significantly assist in embedding the most up-to-date margin risk management practices across the repo market.

- *Temporary stays:* A power is proposed to allow resolution authorities to impose a temporary stay on the exercise by creditors and counterparties of rights to enforce claims and close out, accelerate or otherwise terminate contracts against a failing institution. Such a temporary suspension would last no longer than until 5.00 pm on the next business day. This is intended to give the authorities a period of time to identify and value those contracts that need to be transferred to a solvent third party, under the safeguard that linked arrangements must either all be transferred, or not at all (see Recitals 59-61 and Articles 62, 63, 68-70 and 77).

Shadow banking: On 27 April 2012, the FSB published the Interim Report of its Workstream on Securities Lending and Repos. The Workstream has reviewed current market practices through discussions with market participants, and classified the markets into four main, interlinked segments: (i) securities lending; (ii) leveraged investment fund financing and securities borrowing; (iii) inter-dealer repo; and (iv) repo financing.

The Workstream views the following aspects of securities financing markets as constituting potentially important elements of the shadow banking system, as defined by the FSB:

- repo financing by non-bank entities to create short-term, money-like liabilities, typically collateralised by longer-term securities;
- leveraged investment fund financing that may lead to further leverage and maturity transformation;
- securities lending cash collateral reinvestment by which the cash proceeds from short sales are used to collateralise securities borrowing and then reinvested by securities lenders into longer-term assets, thus constituting a long credit intermediation chain with maturity transformation; and
- collateral swaps (also known as collateral downgrade/upgrade transactions) that can further lengthen transaction chains or allow banks to meet liquidity requirements.

From its review of market practices and regulatory frameworks, the Workstream has preliminarily identified seven issues arising from the securities financing markets that might pose risks to financial stability and/or need further investigation by the Workstream: (i) lack of transparency; (ii) procyclicality of system leverage and interconnectedness; (iii) other potential financial stability issues associated with collateral re-use; (iv) potential risks arising from the fire-sale of collateral assets; (v) potential risks arising from agent lender practices; (vi) securities lending cash collateral reinvestment; and (vii) insufficient rigour in collateral valuation and management practices.

These financial stability issues will form the basis for the next stage of the Workstream’s work, which is to develop appropriate policy measures to address risks, where necessary, by the end of 2012. The FSB invited comments on this report, by 25 May 2012, in particular on the issues arising from the securities lending and repo markets that might pose risks to financial stability, and the ERC subsequently provided a response letter.

As reported in the ICMA Quarterly Report for the Second Quarter, on 19 March 2012 the European Commission published its Green Paper on *Shadow Banking*. The ERC submitted its letter of response in accordance with the originally stated 1 June deadline.

As forewarned, in her speech at the European Commission’s Conference on Shadow Banking on 27 April 2012, Sharon Bowles (MEP and Chair of the EU Parliament’s Economic and Monetary

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Financial stability issues will form the basis for the next stage of the Workstream’s work, which is to develop appropriate policy measures to address risks, where necessary, by the end of 2012.

Affairs (ECON) Committee) sought to use the currently proposed EU Capital Requirements Regulation (CRR) as a vehicle for swiftly introducing repo reporting requirements. Accordingly, ECON compromises for the CRR included:

“Article 95a: additional reporting requirements:

- Institutions shall report the level, at least in aggregate terms, of repurchase agreements, securities lending and all forms of encumbrance or clawback arrangements.
- Such information should be reported to a trade repository or a Central Securities Depositary to enable access, *inter alia,* by EBA, ESMA, relevant competent authorities, the ESRB and relevant central banks and the ESCB.
- In liquidation proceedings unregistered clawback arrangements shall not have legal effect.”

This new entry into the CRR Article 95 (Reporting on Own Funds Requirements) appears inappropriate, as that is arguably neither the place to legislate such repo reporting requirements nor has there been a proper debate and assessment in respect of the requirement for, and implications of, any such reporting requirements. Nevertheless, it seems likely that some form of repo reporting requirements are inevitably on the way (also considering the ECB’s call, at the same conference, for a euro repo database).

Published at the beginning of May 2012, *Shadow Banking in the Euro Area: An Overview,* is an ECB occasional paper which presents a first investigation of the size and the structure of shadow banking within the euro area, using the statistical data sources available to the ECB/Eurosystem. Section 3 of this paper describes the main components of shadow banking, with section 3.3 (pages 16-17) covering the repo market. Notwithstanding the difficulties in collecting relevant information, the paper indicates that the analysis carried out allows some tentative conclusions to be drawn to contribute to the regulatory debate. First, as regards direct regulation, it would be important to undertake a preliminary assessment of the specific entities or activities within the shadow banking sector that have large leverage or maturity mismatches. Second, as regards possible indirect regulation, a key finding concerns the growing interlinkages between the euro-area regulated banking sector and the shadow banking system. And finally, the data seem to suggest that the importance of shadow banking entities differs across euro-area countries.

Commission work programme 2012: At the beginning of April, the European Commission published an updated table showing actions expected to be adopted during the remainder of 2012. Two items of particular note from the standpoint of the ERC are:

- *Close-out Netting Directive, December 2012:* close-out netting is an important risk mitigation tool to reduce counterparty credit risk because it gives priority over unsecured creditors to the non-defaulting counterparty in case of insolvency. The objective is to increase legal certainty and safety of bi- and multilateral netting agreements, but also, as part of an EU framework for crisis management in the financial sector, to empower national authorities to impose a temporary stay on the rights to close-out netting; and
- *Securities Law Directive, fourth quarter 2012:* the main objective of the measure is to reduce the divergence between national laws on book-entry securities and therefore to make a substantive contribution to the simplification of financial markets operations and to their legal safety.

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Building and sustaining the European repo market

Given the significant, on-going programme of regulatory reform, within which there is an increasingly crucial role for collateral to play, this is a particularly pertinent time at which to take stock of the work which the ICMA European Repo Council (ERC) has done over the years to contribute to the establishment of a robust infrastructure to underpin the European repo market. This article summarises a position paper which appears in full as an appendix to the ERC's recent shadow banking response.

Introduction: The ERC was established by ICMA in December 1999, to represent the cross-border repo market in Europe. It is composed of practitioners in this market, who meet regularly to discuss market developments in order to ensure that practical day-to-day issues are fully understood and dealt with adequately. Membership of the ERC is open to ICMA members who transact repo business in Europe and the twice yearly ICMA ERC General Meetings are widely attended.

Documentation: ICMA has been and continues to be an active force in standardising repo documentation. The Global Master Repurchase Agreement (GMRA) is the most widely used standard documentation for the cross-border repo market. It is supported by associated legal opinions obtained by ICMA in more than 60 jurisdictions. Besides these formal legal underpinnings for the market, the ERC has promulgated a number of trading guidelines and recommendations.

Education: Supported by the ERC, ICMA's commitment to provide high-quality education is concretely extended in the repo market context through specialist courses on Securities Lending & Borrowing; and on Collateral Management, as well as through targeted seminars providing market participants with the education they need in respect of the GMRA.

Transparency: To provide market transparency, the ICMA ERC instigated surveys which have become the only authoritative source of data on the size and composition of the European repo market. These surveys are conducted by the ICMA Centre at the University of Reading in the UK. For the most recent survey, the twenty-second consecutive semi-annual survey the baseline figure for market size stood at €6.2 trillion.

Market efficiency: The ERC has contributed to many initiatives to improve market efficiency, both at its own instigation and in support of the efforts of others. A significant recent ERC contribution came with the July 2010 publication of a White Paper on the European repo market, including the role of short selling, the problem of settlement failures and the need for reform of the market infrastructure. Efforts in support of others have included prolonged involvement in market-wide expert groups, such as the European Commission's CESAME and the ECB's COGESI.

Collateral initiatives: The importance of collateral has accelerated significantly since the advent of the financial crisis in mid-2007 and it is widely perceived that collateral demands will significantly outstrip supply. With a view to improving the efficient utilisation of collateral, by bringing together separate pools of liquidity, the ERC is discussing triparty settlement interoperability between the ICSDs (and eventually CSDs); and at the same time the ERC is seeking to increase the supply of high-quality collateral assets, by advancing a project to support the use of credit claims as acceptable bilateral repo market collateral. More broadly, the ERC is supporting the ICMA's 2012 initiative on the Collateral Initiatives Coordination Forum (CICF).

Regulation: Over the years the ERC has contributed to a wide range of regulatory debates, both through its participation in numerous meetings and through written submissions, in respect of consultation papers, regulatory proposals and other similar official papers. Many instances of the ERC's work in this regard are publicly available. The ERC also seeks to produce papers at its own initiative, in order to better inform deliberations about necessary and appropriate regulatory interventions, one such example being a report on the role of central and commercial bank money in European clearing and settlement.

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ECP market

Bank recovery and resolution: On 6 June 2012, the European Commission adopted a legislative proposal for bank recovery and resolution. Within this proposal there is a particular point of note for banks' own issues of paper of greater than one month maturity. Amongst the proposed resolution tools it is generally proposed that the resolution authorities should have the power to bail in all the liabilities of the institution. There are, however, some liabilities that it is proposed would be excluded *ex ante,* including short-term liabilities. The proposed exclusion of liabilities with an original maturity of less than one month is covered by Article 38.2(d) (note that this contradicts the reference to "residual" maturity which is included on page 13 of the provisional text). It remains to be seen whether this exception, including its one month cut-off point, is adopted in the final legislative text, which will emerge in time from the normal EU legislative process involving both the European Council and the European Parliament. The bail-in part of this proposal is only intended to come into effect as from 1 January 2018.

Shadow banking: Dated 16 April 2012, the FSB published a progress report, *Strengthening the Oversight and Regulation of Shadow Banking.* A number of elements of this work are likely to prove pertinent to ECP, particularly through measures directly impacting ABCP and indirectly through measures impacting money market funds. Related developments in these areas follow below.

ABCP: On 7 June 2012, IOSCO published a consultation report on *Global Developments in Securitization Regulation,* which seeks public comment (by 6 August) on policy issues arising from the work of its Task Force on Unregulated Markets and Products (TFUMP). This responds to a request from the FSB as part of its work to strengthen oversight and regulation of the shadow banking system. The FSB asked IOSCO, in coordination with the Basel Committee on Banking Supervision, to conduct a stock-taking exercise on the requirements for risk retention and measures enhancing transparency and standardization of securitization products, and to develop policy recommendations as necessary. The FSB's request followed earlier IOSCO and Joint Forum work aimed at regulatory initiatives to support recovery of securitization markets.

Money market funds (MMFs): Although MMFs did not cause the crisis, regulators consider that the performance of MMFs during the financial turmoil highlighted their potential to spread or even amplify a crisis. In this regard, the FSB asked IOSCO to undertake a review of potential regulatory reforms of MMFs that would mitigate their susceptibility to runs and other systemic risks and to develop policy recommendations by July 2012. The FSB's mandate indicated that a key issue to be considered by such a review is whether the regulatory approach to MMFs needs to choose between: (i) encouraging/requiring shifts to Variable Net Asset Value (VNAV) arrangements; (ii) imposing capital and liquidity requirements on MMFs which continue to promise investors Constant NAV (CNAV); and/or (iii) whether there are other possible approaches. Consequently, on 27 April 2012, the Technical Committee of IOSCO published a consultation report, *Money Market Fund Systemic Risk Analysis and Reform Options,* which provides a preliminary analysis of the possible risks that MMFs could pose to systemic stability and consults on an exhaustive range of policy options to address those risks. Following an official extension, the closing date for comments was 29 June.

Speaking at the European Commission's Shadow Banking Conference on 27 April 2012, Paul Tucker, the Bank of England's Deputy Governor for Financial Stability discussed the topic of MMFs. Amongst his comments he stated that, in case the US fails to act further on MMFs, "authorities in Europe and elsewhere will need to think through what if any measures we could sensibly take to make our part of the global financial system more resilient to the faultline that the money fund industry currently represents." Going on he then said: "one possibility would be for bank supervisors to limit the extent to which banks could fund themselves short-term from US money funds and from other fragile/flighty sources, including CNAV money funds domiciled elsewhere."

A note dated 11 June 2012 on *Money Market Funds and Systemic Risk,* posted by the New York Fed, briefly revisits the ongoing concerns underlying the sentiment that action is needed to further assure the stability of MMFs. However, despite much continued speculation, the process of MMF reform in the US remains seemingly deadlocked.

On 22 June 2012, the ESRB issued its first occasional paper, *Money Market Funds in Europe and Financial Stability.* This provides an overview of the current EU landscape; discusses sources of risk from a financial stability perspective; describes channels of contagion; and identifies avenues to explore further. Based on this paper, the ESRB may conduct more in-depth analysis, taking account of the discussions at the international level. Accordingly, this paper should not be viewed as offering any final recommendations, but simply as listing some of the main options available and the factors that need to be considered.

ICMA ECP Committee will continue to collaborate closely with IMMFA to fully understand any more definitive proposals for the regulation of MMFs.

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Basel III liquidity monitoring exercise

by Serena Vecchiato

In April 2012, the European Banking Authority published the results of its Basel III monitoring exercise on the data submitted by 156 European banks in mid-2011. The exercise aimed at outlining the ability of banks to comply with the new liquidity measures, should these provisions have been implemented on the date for which the data were submitted.

As for the liquidity coverage ratio (LCR), the exercise showed an average value of 71% for internationally-active banks with Tier 1 capital in excess of €3 billion (Group 1); and 70% for all the remaining banks (Group 2). In aggregate, 53 banks met the minimum requirement (Chart 1), while a shortfall of liquid assets of €1.15 trillion was registered for the remaining 66% of banks (Chart 2), assuming that no change was made to their liquidity risk profile. Banks that are below the 100% minimum required have until 2015 to meet the minimum standard by: (i) reducing their exposure to activities which are most vulnerable to a significant short-term liquidity shock; (ii) lengthening the term of their funding beyond 30 days; or (iii) increasing their holdings of liquid assets.

Turning to the second standard, the average net stable funding ratio (NSFR) was 89% and 90% for Group 1 and Group 2 banks respectively. In this case, the requirement was met by 58 banks (Chart 3), and the aggregate shortfall of stable funding was €1.93 trillion for the remaining 62% of banks, assuming that no change was made to their liquidity maturity mismatch. Banks that are below the 100% minimum required have until 2018 to meet the standard. Measures that can be taken by banks are: (i) lengthening the term of their funding; or (ii) reducing their maturity mismatch.

However, it is worth noting that the shortfalls highlighted in the exercise are calculated based on the banks' balance sheets as of 30 June 2011, without taking into account any planned management actions to comply with the new Basel III provisions. Accordingly, the costs of meeting the new liquidity requirements remain unclear. This uncertainty is heightened by the fact that both liquidity standards are currently subject to an observation period which includes a review clause to address any unintended consequences prior to their respective implementation dates. Moreover, the interaction between capital and liquidity requirements should be considered. As stated by the Basel Committee in its report in August 2010: "Banks' efforts to meet the capital requirements are likely to reduce the adjustments the banks will need to make to meet the liquidity requirements, and vice versa".

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Chart 1
Liquidity Coverage Ratio Compliance

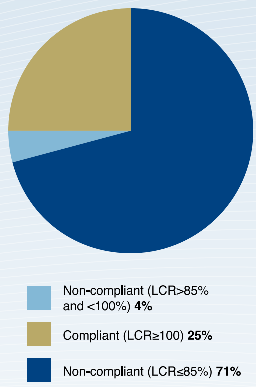


Chart 2
Liquidity Coverage Ratio - Shortfall of liquid assets

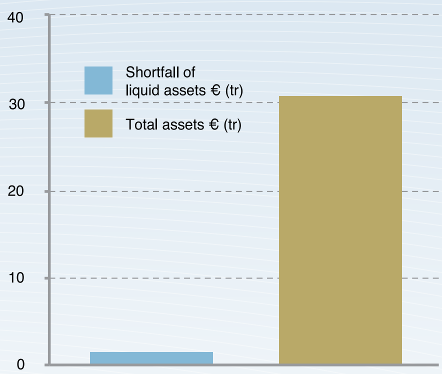
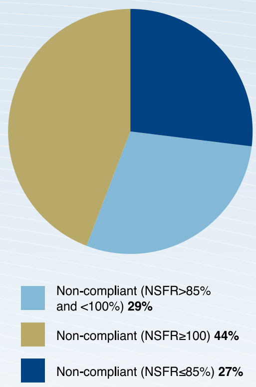


Chart 3
Net Stable Funding Ratio Compliance



Source: EBA.

by Ruari Ewing

Primary Markets

Prospectus Directive revision

At *Level 1*, transposition of the 2010 PD amending Directive into national law and regulation has continued. ICMA is not proactively monitoring national transposition, but it seemed, at the time of writing, that at least some EEA Member States would not meet the 1 July deadline – ICMA is aware of a Belgian FSMA Communication regarding the position in Belgium from 1 July pending full transposition. Otherwise ICMA is aware most recently of a Transposition Bill in Spain and, following an earlier policy statement, the final Prospectus Regulations 2012 in the UK (see previous editions of this report for prior developments). Of particular interest will be whether any variations between transposition at national level impact the operational mechanics of pan-EU offerings (including "opt-down" mechanics, in relation to the "qualified investor" concept).

At *Level 2,* a first amending Regulation EU/486/2012 to the PD Implementing Regulation (PR) has been published in the EU *Official Journal,* covering the format of final terms and summaries (as well as proportional disclosure regimes that ICMA has not been focusing on). Prospectuses and base prospectuses approved before 1 July are grandfathered in relation to relevant provisions of the Regulation. The Regulation generally follows ESMA's preceding advice delivered in October 2011, including concerning the prescriptive "A/B/C" categorisations (in terms of permissibility for final terms) of individual PR information items (also noting that final terms may give effect to options relating to all three categories of information), the prescribed information for summaries and the issue-specific summary concept. However, the Regulation is silent on, has differed from or added to some aspects of the advice. For example, the Regulation details seven items of additional information allowed in final terms, prescribes the order of the individual items within each section heading of the summary and requires advertisements to mention when no prospectus is required. The Regulation is substantially the same as a preceding Commission proposal.

A Commission proposal for a second amending Regulation has also been published, generally following ESMA's preceding advice delivered in February and notably covering the mechanics for "general" and "individual" consent to third party prospectus use. The proposed Regulation also covers a few other aspects of the PR, namely issuer "own" indices (including related indices) and auditor reviews of profit forecasts/estimates. Prospectuses and base prospectuses approved before 1 July are grandfathered in relation to the entirety of the proposed Regulation. It appears that the EU *Official Journal* publication of the adopted final text will not be until after the summer for procedural reasons (transmission of the proposal to the European Parliament too late for it formally to adopt a waiver of its three month objection period).

The specific provisions of the first amending Regulation and proposed second amending Regulation are complex and have been the subject of quite detailed briefings by various law firms. The

Commission has published an impact assessment concerning its proposed Level 2 measures.

ESMA has published a consultation (with a 20 August deadline) that may in due course result in further ESMA advice and a further amending Regulation. As this seems to address primarily aspects relating to securities that are convertible and exchangeable into equity, it may be that no ICMA response will be submitted.

At *Level 3,* ESMA has published a 14th updated version of its *Questions and Answers on Prospectuses.* This set out three new entries relevant to bond issues, namely on:

- base prospectuses disclosing tax information for all passported jurisdictions (which seems to go beyond the PR requirement for disclosure just of taxes "withheld at source");
- PR category "B" information eligible for inclusion in final terms "placeholders" being limited to "amounts, currencies, dates, time periods, percentages, reference rates, screen pages, names and places" (hopefully this approach is distinct from the ability noted above for final terms to give effect to options relating to all three "A/B/C" categories of information);
- the disclosure of an index "description" to cover the "essential characteristics to enable an investor to fully understand the index and its dynamics and make an informed assessment" and address eight specific information points.

ICMA understands that ESMA has also been considering the permitted scope of supplements to prospectuses, but has not yet been able to make any public pronouncement in this regard. The use of supplements is likely to be particularly important now that the use of final terms will be so strictly prescribed. In a related development, ESMA has published a Peer Review Report on good practices in the prospectus approval process, noting regulators generally follow five practices: (i) establishment of approval precedents; (ii) internal review of approval decisions where appropriate; and focus on (iii) prospectus consistency, (iv) comprehensibility and (v) structure. The review did not report on a sixth practice, focusing on the completeness of financial information in prospectuses, as differing organisational structures preclude a consistent measurement standard.

ICMA is working to revise, further to the two initial amending Regulations mentioned above, the *pro forma* final terms currently in the ICMA Primary Market Handbook (available to ICMA members and to subscribers). The revision process may take some time on an iterative basis as regulator interpretations of the amended PD regime become apparent. ICMA has circulated an initial working draft of the low-denomination *pro forma* final terms to a working group of lead managers and law firms for consideration in the context of forthcoming transactions. ICMA is also seeking to engage regulators directly in the development of the revised *pro formas.*

The full impact of the amended PD regime will likely need some time to become clear as all parties familiarise themselves with its workings. Market participants may need to be somewhat flexible regarding transaction timelines during this transitional period. Despite a few improvements, some wonder whether the net effect of the new PD regime will be to disincentivise issuers from accessing EEA retail investors and even perhaps the EEA-regulated markets. Market participants are expecting to exchange views at Euromoney Legal Training's 3rd Prospectus Directive Conference in London on 26 and 27 September.

The Prospectus Directive (PD) regime: First implemented in 2005, the Prospectus Directive (PD) regime governs the content, approval and publication of prospectuses for (i) the admission of securities to trading on EEA-regulated markets and (ii) the non-exempt offering of securities in the EEA. It consists of the Level 1 Directive itself (transposed by EEA national laws) and a Level 2 PD Implementing Regulation (which is directly applicable under EEA national laws, without transposition). A first review of the PD regime has been under way since 2009 and is nearing completion.

> **Despite a few improvements, some wonder whether the net effect of the new PD regime will be to disincentivise issuers from accessing EEA retail investors and even perhaps the EEA-regulated markets.**

Separately, concerning *accounting standards,* the PR has been amended, by both the first amending Regulation EU/486/2012 mentioned above and Regulation EU/311/2012, to:

- add the Generally Accepted Accounting Principles (GAAP) of China, Canada, and South Korea to those of Japan and the United States as alternatives to IAS1-compliant IFRS and EU IFRS; and
- extend, for financial years beginning before 1 January 2015, the transitional regime applicable to Indian GAAP, for non-EEA issuers in presenting their financial statements in prospectuses requiring approval under the PD.

In terms of other FSAP regime reviews and regulatory developments, ICMA continues to monitor the reviews of the EEA Transparency (TD), Market Abuse (MAD/R) and (MiFID/R) insofar as they exclusively impact bond issuance. ICMA also continues to monitor the Commission's Packaged Retail Investment Products (PRIPs) initiative and other regulatory initiatives. In this respect, on 21 May, the Joint Associations Committee on retail structured products (of which ICMA is a member) submitted a response to the IOSCO consultation report on *Suitability Requirements with Respect to the Distribution of Complex Financial Products.*

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New issue processes

On 9 May, ICMA published ICMA Recommendation 1.32 on *New Issue Processes* and revised ICMA Explanatory Note XIII on *Pre-Sounding, Bookbuilding and Allocations,* as part of the ICMA Primary Market Handbook.

The purpose of the Recommendation is to promote further accessibility, including consistency of disclosure, of the bookbuilding process by recognising and memorialising good market practices in the Primary Market Handbook. This follows additional feedback, from discussions between investors, issuers and lead managers during 2011, set out in the 2011 Fourth Quarter edition of this Quarterly Report.

The purpose of the Explanatory Note is to provide some practical information on pre-sounding, bookbuilding and allocation processes, as often used in the prevalent "pot" context of the European cross-border syndicated institutional primary debt markets.

As market practices are continually evolving and individual transactions are structured according to their specific circumstances, the Explanatory Note is not intended to prescribe or endorse particular structures or practices. Rather, it is intended to be a document designed to both enhance transparency for, and serve as a helpful point of reference to, bookrunners when explaining their working practices to colleagues, issuers and investors. It sets out common practices relating to pre-sounding, bookbuilding and allocation, noting some that issuers, intermediaries and investors may find this useful in the context of their participation in individual bond issuance transactions.

The Explanatory Note was revised to reflect the feedback from the investor, issuer and lead manager discussions noted above – notably in relation to investor meetings, intermediate price discovery, order book and distribution disclosure and public dissemination.

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Review of the ICMA Primary Market Handbook

by Lalitha Colaco-Henry

The syndicated issuance of international debt securities is an important part of the capital markets. ICMA's work in this area is based on a strong legacy from the International Primary Market Association (IPMA), one of ICMA's predecessor organisations. IPMA launched the IPMA Handbook (now called the "ICMA Primary Market Handbook") in 1985. When it was launched, the Handbook consisted of a few short pages that covered the issuance of straight Eurobonds. The Handbook has since evolved into a comprehensive document covering a broad range of international securities. Generally, the Handbook is intended to apply to cross-border issues of securities lead-managed by ICMA members, who are presumed (except as stated to the contrary) to be applying the relevant ICMA Recommendations.

The Handbook is very much a "live" document that has been continuously updated to respond to market developments when guidance or standardisation has been required.

However, in the light of its 25 year history, during which time the markets and the process by which international debt securities are syndicated have evolved considerably, it has been decided to undertake a top-to-bottom review of the Handbook to ensure that it continues to remain a definitive statement of good market practice. Accordingly, an important focus of the review is to delete any obsolescence, amend other provisions to reflect changes in market practice and add new provisions, where necessary.

Notably, the past four or five years have seen a significant shift in the way syndicated issues are distributed. Historically, most syndicate arrangements were structured as "retention" deals where managers received an allotment of securities at the discretion of the Lead Manager, which the managers then sold directly to their clients. However, the market has subsequently shifted so that the "pot" system now predominates. In its simplest form (100% pot with no retention) the whole of the issue is set aside to be allocated to investors out of a central order book run by one or more of the bookrunners for the issue. Other syndicate members contribute orders to the pot but do not control the final allocation or distribution of securities. Therefore, one of the aims of the review is to ensure that the Handbook clearly identifies those Recommendations that apply to retention deals, pot deals and transactions entailing a mix of both methods.

A further aim of the review is to reorganise the material in the Handbook. As the Handbook has evolved gradually over many years the provisions do not follow a logical order. In addition, the lack of an index makes locating provisions within the Handbook difficult and time-consuming. Accordingly, the Handbook is being revised so that the order of the provisions generally follows the timeline of a deal – roughly: pre-announcement, announcement, launch, pricing, signing, closing and settlement. A new index will also be included. The new structure should also make it easier to incorporate any future amendments. A final aspect of the review will be to ensure that the Handbook continues to be consistent with all relevant EU Directives, including those that relate to competition law.

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EBA consultation on own funds

On 4 April 2012, the European Banking Authority (EBA) launched a consultation on *Draft Regulatory Technical Standards (RTS) on Own Funds (Part One).* The EBA has developed the draft RTS in accordance with the mandate contained in the different articles of the Capital Requirements Regulation (CRR) on the basis of the European Commission's proposals.

The consultation includes a wide range of measures to ensure a single rulebook for institutions (although some of the requirements are directed at competent authorities) with the aim of enhancing regulatory harmonisation in Europe and at strengthening the quality of capital in the area of own funds. The measures require, among other things, a specification of the characteristics of the instruments that could affect the condition of an institution in periods of market stress, and the limitations that the institution should be able to apply to the operation of these instruments to restore the capital structure of the institution.

The consultation groups 14 RTS covering, among others, areas such as: Common Equity Tier 1; Additional Tier 1; deductions from Common Equity Tier 1 and from own funds in general; and transitional provisions on grandfathering.

ICMA has formed a small Working Group from among members of the Financial Institution Issuer Forum (FIIF) with the aim of presenting a well informed, broadly based view of the proposals from the relevant perspective and compiling a response to the proposals with regard to the characteristics and operation of write-up/write-down feature of Additional Tier 1 instruments – in particular, the prohibition on distributions on a temporary write-down; the fact that distributions may still be paid on common equity and Additional Tier 1 instruments with a permanent write-down; the restriction on write-up to current year profits; the proportionally lower rate of write-up on a temporarily written-down instrument; and certain observations on the point of non-viability and the tax treatment of the instruments. The consultation period runs until 4 July 2012, after which time the ICMA response will be available at www.icmagroup.org.

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Bank recovery and resolution

In March 2012, the European Commission published a *Discussion Paper on the Debt Write-down Tool – Bail-in.* The paper was not a consultation document and the Commission was not specifically seeking input other than from a few key stakeholders. Nevertheless, ICMA was keen to have a voice in this important discussion, and so submitted a response on 20 April 2012, which presented a balanced view of ICMA member firms on both the issuer and the investor side.

In brief, the bail-in proposals are intended to facilitate recapitalisation through the write-down of liabilities and/or their conversion to equity, which would allow the institution to continue as a going concern, avoid the disruption to the financial system that would be caused by stopping or interrupting its critical services, and give the authorities time to reorganise it or wind down parts of its business in an orderly manner.

On 6 June 2012, the Commission adopted a *legislative proposal* for *Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms.* The proposal builds upon and strengthens national resolution systems in key respects and sets out the necessary steps and powers to ensure that bank failures across the EU are managed in a way which avoids financial instability and minimises costs for taxpayers. The proposed tools are divided into powers of "prevention", "early intervention" and "resolution", with intervention by the authorities becoming more intrusive as the situation deteriorates. In particular, the proposals set out details on the following resolution tools: (i) sale of business; (ii) bridge institutions; (iii) asset separation; and (iv) bail-in. Decisive powers are delegated in the proposals to the EBA to develop regulatory technical standards and guidelines in areas where harmonisation and consistency in rules and practices is key.

ICMA is reviewing the proposals in detail, in particular the provisions relating to bail-in, in the light of the aforementioned response, including the proposed list of instruments which are excluded from the scope of bail-in, the operation of Member States' discretion as to other excluded liabilities and minimum holdings of bail-inable debt, and the hierarchy of claims. ICMA will be entering into discussions with interested members, including the Financial Institution Issuer Forum (FIIF) and the Asset Management and Investors Council (AMIC), to assess the impact of the proposals and agree upon any necessary further actions.

In terms of timing, the transposition of the proposed Directive is set at 31 December 2014. However, the provisions on the bail-in tool are subject to a longer transposition period and should be applied as from 1 January 2018 to all newly-issued debt, with anything outstanding at that date being "grandfathered". This provides the relevant institutions the opportunity to observe maturity cycles of existing debt while structuring funding and maturity profiles accordingly. Resolution authorities can use this time to ensure required levels of eligible liabilities.

Following the normal EU legislative process, the proposals will now form part of the workstream of the European Council and the European Parliament.

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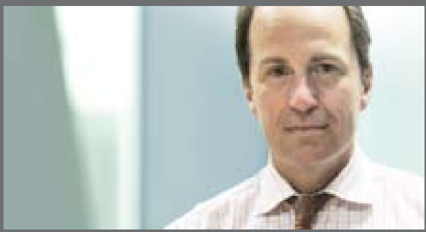

The US JOBS Act: one small step for global convergence

by Lee Goss

On 5 April 2012, the Jumpstart Our Business Startups Act (JOBS Act) was signed into law by President Obama. The JOBS Act was passed by Congress in response to concerns that certain features of US regulation of public offerings and private placements of securities were discouraging entrepreneurs and small businesses from obtaining access to financial markets and as a result limiting these businesses' ability to expand and create much needed new jobs in a difficult economy. Moreover, from a much broader perspective, it eliminates an inconsistency and achieves a greater degree of global convergence with the relevant regulatory regimes in the major capital markets outside the US.

The JOBS Act liberalises a number of the requirements for a US public offering or private placement by an issuer that falls within the JOBS Act's definition of "Emerging Growth Companies", issuers that have no more than $1 billion of total annual revenues and meet certain other criteria. While aimed mainly at US issuers and IPOs, certain parts of the JOBS Act may also be taken advantage of by non-US "foreign private issuers" as well as for SEC-registered public offerings and private placements of debt securities to both Accredited Investors and Qualified Institutional Buyers (QIBs) under SEC Rule 144A.

The "gag rule": One of the significant changes brought about by the JOBS Act is the relaxation of the prohibition on "general solicitation" in connection with private offerings in the US by eligible US or non US issuers. This long standing "gag rule," largely unique to the US, was intended to ensure, *inter alia,* that private placements exempt from registration under the Securities Act of 1933 remained distinctly and ostensibly "private" in character and would not be deemed to be public offerings under US law. Consistent with the practice for SEC-registered offerings where no pre-offering publicity is permitted (and offers and sales are only to be made by means of a written prospectus), the marketing of private placements by US issuers traditionally has been permitted only over the telephone or in one-to-one meetings with eligible investors.

Trans-Atlantic disharmony: An important aspect of the prohibition on "general solicitation" in connection with a US private placement is that, even where actual sales are concluded only with eligible Accredited Investors or QIBs, an issuer or a lead manager may still violate US law if a general solicitation takes place, ie offers are more broadly made, regardless of the fact that the issuer and lead managers are careful to ensure that no sales are made to non-eligible persons. For many years this has caused practical difficulties for international transactions and market participants in the light of there being no comparable analogue to the US "gag rule" outside of the US, and in a world where globalised media, particularly via web based technology, affords almost instantaneous access to financial information irrespective of national jurisdictional borders.

For example, a non-US issuer conducting a multi-jurisdictional offering with a concurrent US private placement risks the loss of its Rule 144A exemption (and having to register an offering and other adverse consequences) if marketing publicity disseminated outside the US finds its way into the US and is thus deemed a "general solicitation" in violation of US rules. This has, not surprisingly, led commentators in the past to highlight and question this anomaly, as it logically begs the following question: How can a person lose money if they do not purchase anything? Put another way, if sales are concluded only with permitted eligible investors, what harm is caused by solicitation or marketing communications observed by non-purchasers?

This difficulty it is hoped has now been resolved, as the JOBS Act directs the SEC within 90 days to revise Rule 144A and Regulation D to now permit securities of eligible issuers under these provisions to be offered more broadly, including as a general solicitation or general advertising, provided that the securities are sold only to eligible Accredited Investors and QIBs. As a result, the risk of a private placement being deemed a public offering is greatly reduced or eliminated and the ability to conduct a cross-border transaction that includes a US private placement may be done on a more consistent and harmonised basis across the global capital markets.

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by John Serocold

Secondary Markets

MIFID II and MiFIR: the risks of reform

Timetable

As we reported last quarter, the EU legislators (Council, European Parliament, European Commission) aim to finalise the Markets in Financial Instruments Directive (MiFID) II and the accompanying Markets in Financial Instruments Regulation (MiFIR) by the end of 2012. Recent developments show a broad range of political views on technical issues, including the key priorities for the international capital market identified in previous ICMA Quarterly Reports. It remains to be seen how effectively these differences can be reconciled within the time available. While there are clear risks in hasty political compromises, policymakers are keen to complete their work on this proposal, not least because parts of it are required for European members of the G20 to meet the Pittsburgh commitments. A guiding principle must be for EU regulation to support well-functioning capital markets that serve issuers and investors.

The Danish Presidency of the Council has recently begun discussion of draft compromise amendments to the draft Directive and the draft Regulation to the Commission's original proposals for a Directive and a Regulation. Discussion will continue under the forthcoming Cypriot Presidency, which aims to reach agreement among Member States by the autumn. But it may be that the Irish, who assume the Presidency in the first half of 2013, will need to complete the work on these dossiers.

Meanwhile, in the European Parliament, following *rapporteur* Markus Ferber's draft report published in March 2012, other MEPs have tabled over 2,000

In brief

In this article, we report on the timetable and legislative process for MiFID II and MiFIR and highlight three important issues: the treatment of non-EU firms; bond market transparency; and the treatment of different forms of trading venue.

additional amendments. At the time of writing, discussions continue in the Parliament on possible compromise amendments. The Parliament aims to finalise its position by the late summer.

Once the Council and Parliament have finalised their stances, the trilogue between them and the Commission is scheduled to reconcile remaining differences by the end of the year.

As previously noted, once this Level 1 legislation is agreed, the important drafting of more detailed and technical Level 2 measures and European Securities Markets Authority (ESMA) binding technical standards will begin. This will be a crucial stage for ICMA and its members to ensure that the detail of EU laws and rules meshes well with the needs of fixed income investors and issuers and with valid market practices. It will be important that the broad principles established at Level 1 allow Level 2 to elaborate a workable framework. While the pace of the Level 2 legislative process is likely to remain brisk, there is a welcome recognition that detailed technical proposals benefit from discussion and consultation.

It will also be essential to ensure that enough time is allowed, after Level 2 is completed, for implementation by market participants, so that the transition to new requirements and systems is smooth and does not create systemic risk.

Third country (ie non-EU) firms

Because of the international nature of fixed income markets, ICMA has identified MIFID II's and MIFIR's regulation of third country (ie non-EU) firms as a priority issue. A wide range of approaches to the regulation of international participation in EU financial markets is currently proposed among the EU legislators. These differences are evident both among MEPs' proposed amendments, and between the distinct stances of the Commission, Council, and the range of views in the European Parliament.

The *Commission* has proposed to harmonise the currently diverse national regimes for third country firms. Firms dealing with retail clients would need to operate a branch authorised in the EU. Firms dealing with counterparties would need to register themselves with ESMA. In both cases, third country firms would enjoy a passport to provide services to clients and counterparties across the EU. But third country firms would be allowed access to EU markets only subject to a range of conditions; in particular, only if the Commission judged (with a four-year transition period) that the third country's regulation had "equivalent effect" to MIFID II and the Capital Adequacy Directives, and if the third country provided reciprocal recognition of the EU prudential regulatory framework. While a harmonised passporting regime is an important goal, the intricacies of the international market are such that the associated requirements, constraints, conditions, and exemptions need to be more carefully gauged to maintain Europe's important position in the global capital market.

In the *Council,* the Presidency's draft compromise suggests that the balance of Member State opinion is against radical change to the existing nationally-based regulatory regime for third country firms. There would be no new requirements for professional markets. There would be a new harmonised requirement for third country firms to establish a branch if providing services to retail clients, but such branches would not enjoy a passport to provide services across the EU, for which an authorised EU subsidiary would be required.

In the *European Parliament,* the *rapporteur* proposed broadly to retain the Commission's proposal, but with more practical transitional arrangements so that the new regime would not come into effect until after the Commission had made an equivalence decision in relation to any particular third country. Other MEPs' amendments cover a wide range. Some seek to intensify the constraints and authorisation or registration requirements for third country firms dealing with EU investors. Others seek to modify the requirements to make them more compatible with the open provision of financial services between EU and third country intermediaries and investors, for example by making equivalence requirements less rigorous, or by widening exemptions for third country firms that do not solicit EU clients or for services intermediated by EU-authorised firms.

ICMA's priority as the legislation develops will be to help the EU legislators ensure that the EU remains an open and integral part of the international capital market. The legislators' guiding principles should be to promote and encourage, by example, open and well-regulated markets worldwide, and to ensure that EU requirements (including new rules on market structure and transparency: *see below*) are optimal for responsible market interactions between EU and third country investors and issuers.

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ICMA's priority as the legislation develops will be to help the EU legislators ensure that the EU remains an open and integral part of the international capital market.

Market structure and transparency

The other priority issues identified by ICMA are MIFID II and MIFIR's rules on market structure and transparency. MIFID II and MIFIR will, for the first time at EU level for fixed income markets, introduce rules on pre-trade transparency (availability of information about trading opportunities), and post-trade publication to the market of completed trades. They also propose changes to the regulation of market structure, partly based on MIFID's existing regulation of equities markets. Taken together, these changes are widely expected to have a significant impact on how bonds are traded in Europe.

The *Commission* has proposed a new category of Organised Trading Facilities (OTFs), alongside Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs), to cover all systems that allow multiple investors to interact, including those where the system operator exercises discretion over the interaction. Whilst mainly designed to regulate systems specific to equity and derivatives markets, the OTF category would also affect a range of multilateral systems in fixed income markets, including those operated by single dealers and by inter-dealer brokers. The Commission has also proposed to extend the existing equity Systematic Internaliser (SI) regime, with some modifications, to fixed income markets, requiring dealers in certain circumstances to make and publish quotes to other clients when dealing bilaterally. One of the main motivations is to limit the scale of OTC trading beyond organised and transparent trading venues. For the same reason, the Commission proposed to extend MiFID's market transparency rules, which currently apply only to equities, to fixed income markets also. As well as the new obligations placed on SIs, there would be requirements to make public pre-trade information about trading opportunities on RMs, MTFs, and OTFs, and to publish the details of completed trades. Waivers or delays in publication would be allowed in some circumstances, for example for large trades. While the rationalisation of market structure regulation offers important opportunities to streamline the Single Market, and the Commission has tried in some respects to adapt the new requirements to the specific circumstances of the fixed income markets, there is significant concern that as drafted the SI and market transparency rules in particular may be too blunt and not well enough adapted to support the responsible operation of fixed income markets, in which a range of dedicated and well-functioning mechanisms have evolved to cater for investors' and issuers' needs.

The *Council* has responded to these concerns, in particular by focusing SI and market transparency obligations on the most liquid instruments and smaller size transactions, where regulation of market information can be most useful, and exempting or allowing waivers for illiquid instruments, and transactions in large scale, where a more sensitive recognition of the trade-off between liquidity provision and transparency is needed. The Council Presidency's draft compromise text also recognises the need for the rules to be better adapted to the particular circumstances of systems such as voice broking and request for quote systems. And it partly recognises the need for firms to be able to apply their own capital to provide liquidity to clients when dealing on an OTF in illiquid instruments (a practice that the Commission proposes to restrict to bilateral SI systems), though the Council compromise's current limitation of such assistance to "matched principal" transactions makes it less useful in the fixed income context.

In the *European Parliament* the amendments proposed cover a broad range. Some seek to remove or limit the new OTF category, instead driving fixed income trading as far as possible onto public markets or into the extended SI regime, with limitation of the waivers from market transparency.

Other amendments parallel the Council's draft compromise by limiting transparency to more liquid instruments and smaller trades, or allowing more discretion in SIs' management of their quotes. Further amendments seek to delete pre-trade transparency rules for fixed income, placing reliance instead on the post-trade reporting regime, or to allow reporting of aggregated trade information, or to phase in the new regime on a longer timescale.

ICMA's priority as the legislation develops will be to help EU legislators ensure that the new regime for market and transparency regulation is well adapted to fixed income markets. Many features of the fixed income market differ markedly from equities: the frequency and incidence of trading; the size of typical transactions; the types of investors and their motivation; the mechanisms by which trading interests are disclosed and transactions concluded. There are clear risks that merely replicating a regime that was originally designed for liquid equity markets will not be well adapted to the particular needs of fixed income issuers and investors. There are indications in all of the EU legislators' drafting that they recognise the need for adaptation and calibration. ICMA is keen to work with the legislators and ESMA, both in the Level 1 drafting and at subsequent stages of the process, to prepare rules that responsibly support Europe's role in the international capital market.

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Fundamental trading book review

On 3 May 2012, the Bank for International Settlements (BIS) published a consultation paper presenting the initial policy proposals emerging from the Basel Committee's fundamental review of trading book capital requirements. This proposes mandatory calculation of the standardised approach by all banks and considers introducing the standardised approach as a floor or surcharge to the models-based approach. There are two particular aspects of interest: the boundary between the trading book and the banking book; and revisions to the standardised and internal models-based approaches. Comments on the consultation paper are to be submitted by 7 September 2012.

The policy directions set out in the consultation paper form part of the Basel Committee's broader agenda of reforming bank regulatory standards to address the lessons of the financial crisis, and the Committee believes that the policy orientations with regard to the trading book are a vital element of the objective to achieve comparability of capital outcomes across banks, particularly those which are most systemically important.

The consultation paper sets out the key approaches under consideration by the Basel Committee to revise the market risk framework. The proposals, which build on the series of important reforms that the Basel Committee has already delivered through Basel III, are intended to strengthen capital standards for market risk and thereby contribute to a more resilient banking sector and reflect the Committee's increased focus on achieving a regulatory framework that can be implemented consistently by supervisors and which achieves comparable levels of capital across jurisdictions.

Key elements of the proposals include:

- a more objective boundary between the trading book and the banking book that materially reduces the scope for regulatory arbitrage;
- moving from value-at-risk to expected shortfall, a risk measure that better captures "tail risk";
- calibrating the revised framework in both the standardised and internal models-based approaches to a period of significant financial stress, consistent with the stressed value-at-risk approach adopted in Basel 2.5;
- comprehensively incorporating the risk of market illiquidity, again consistent with the direction taken in Basel 2.5;
- measures to reduce model risk in the internal models-based approach, including a more granular models approval process and constraints on diversification; and
- a revised standardised approach that is intended to be more risk-sensitive and act as a credible fallback to internal models.

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While the revisions to the models-based approach will be of interest primarily to a small number of internationally active banks, the revisions to the standardised approach will be of interest to a wider cross-section of the ICMA community.

The Basel Committee is also proposing to strengthen the relationship between the models-based and standardised approaches by establishing a closer link between the calibration of the two approaches, requiring mandatory calculation of the standardised approach by all banks, and considering the merits of introducing the standardised approach as a floor or surcharge to the models-based approach. Furthermore, the treatment of hedging and diversification will be more closely aligned between the two approaches.

A more objective boundary between the trading book and the banking book: The Basel Committee believes that there are two approaches that are most likely to meet the described objectives whilst addressing the issues of the current boundary. These approaches are:

- *a trading evidence-based boundary:* the trading evidence-based boundary is an enhanced version of the current intent-based boundary;.
- *a valuation-based boundary:* the core principle of the valuation-based boundary would move away from the concept of “trading intent” to construct instead a boundary that focuses on aligning the design and structure of regulatory capital charges with the risks posed by an instrument to the regulatory capital position of a bank. This approach would recognise the link between capital resources and capital requirements and attempt more fully to address the fact that market price changes in all instruments held at fair value immediately impact the solvency of banks.

Revisions to the standardised and internal models-based approaches: To address shortcomings of the current standardised measurement method, the Basel Committee proposes a “partial risk factor” approach as a revised standardised approach. This is based on applying risk weights to the market values of instruments, with enhancements prudently to reflect hedging and diversification. The Committee also invites feedback on a “fuller risk factor” approach as an alternative to the revised standardised approach. This measures risk based on the distribution of regulator-prescribed risk factors. It is the Committee’s intention to implement a single standardised approach for all banks.

The Committee’s objective for the models-based approach to calculating regulatory capital for the trading book is to estimate the amount of capital required to cover a potential loss in a period of stress from all sources of risk. The approach should in principle be based on the full capture and symmetric treatment of all risk factors, regardless of the contractual form or instrument category in which they are embedded.

While the revisions to the models-based approach will be of interest primarily to a small number of internationally active banks, the revisions to the standardised approach will be of interest to a wider cross-section of the ICMA community.

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Asset Management

by Nathalie Aubry-Stacey

AMIC response on shadow banking

The ICMA Asset Management and Investors Council (AMIC) responded to the European Commission Green Paper on *Shadow Banking*. The response explained the economic benefit offered by the shadow banking system, and the fact that it provided market participants and corporates alternative sources of funding and liquidity. However, the AMIC agreed that the financial crisis has also shown the shortcomings of the system, and explained that lack of transparency is a problem as this can hide risks to market participants. The overall level of risks should remain appropriate and adequately disclosed to prospective investors. Greater transparency within the structures themselves is required so that investors can make more informed decisions. The AMIC response stated that positive regulatory steps have been taken to address transparency.

The AMIC response also suggested that "shadow banking" contained pejorative connotations, and proposed "market finance" as an alternative term. The use of the "shadow banking" term reflects the fact that debate has been so far viewed through the lens of banking supervision and the prudential regulatory tool-kit. It also ignores the fact that many "shadow banking" entities and activities are already highly regulated under securities legislation.

The AMIC has been particularly interested in shadow banking in the light of the Basel III reforms and their direct impact on traditional banking structures, and indirectly on the asset management industry. A key step in the discussion on shadow banking is to clarify the type of activities understood under this term. Regulating different products in the same way in itself creates systemic risk. Moreover, the AMIC would like to ensure that recommendations on regulatory reform take into account current regulatory developments and their impact on the asset management industry, and avoid regulatory overlaps, considering the work also being conducted by the FSB and IOSCO. Problems may result from dual regulation, whether at an EU and/or global level. The AMIC recommends a global approach in the definition and identification of shadow banking issues rather than an EU-led project. Regulation should not result in the EU becoming uncompetitive. Measures may overlap or conflict with new regulations, thereby hindering the ability of the EU to respond to the critical need for growth and the ability of financial institutions to rebuild financial stability.

The AMIC is concerned that the European Commission may cast the net too wide and associate in the future the whole asset management industry with shadow banking. The central issue in the current shadow banking debate is in fact one of definition, and in the first place the definition of what exactly constitutes "shadow banking". In order to be effective, policy development will need to define clearly the entities and activities in scope. Any new policy recommendations should be mindful of the function of some market finance activities in protecting the end-investor. In fulfilling their fiduciary duty towards their clients, investment managers carefully manage their counterparty exposure to banks. This may entail, for example, increasing collateral haircuts in times of stress. Any limitation on the ability to do so would force end investors to be exposed to greater risk in times of market stress. Alternatively, investment managers could stop dealing with certain counterparties which would increase pro-cyclicality.

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Covered bond transparency

The Covered Bond Investor Council (CBIC) has been following closely the development of the European Covered Bond Council (ECBC) labelling project, and was particularly interested in the presentations of the Label Convention and Label Governance Structure made during the ECBC plenary meeting held in March 2012. Therefore CBIC members decided to contribute to the project with some comments that they hope will help the establishment of a strong European covered bond market.

The CBIC membership welcomes any market initiative, such as the ECBC Covered Bond Label Initiative, preventing further dilution of the quality of covered bonds. The CBIC mission statement makes a reference to its intent to promote "the high quality, simplicity and transparency of the product". The CBIC represents long-standing investors – who believe that only the most secure assets should be used in cover pools, and that covered bonds should remain a simple and strong product.

The CBIC notes that the ECBC Label Convention definition of covered bonds core features is quite broad, so that in fact all UCITS covered bonds can qualify for the label, including specialised ones. The CBIC understands that a broad definition will allow the label to reach more easily a critical mass, which is key to the success of the label. However, the broad criteria do not provide quality information about the labelled covered bonds to investors, even though it ensures that the demarcation between covered bonds and ABS/ABS-like products, and future possible "covered bonds" backed by other types of assets is clear. A label of "quality" as understood by investors will have to rest on the reporting of quality and comprehensive information, in a standardised manner.

In the light of this broad definition of the core features of covered bonds, transparency will therefore be key for investors. The CBIC European transparency standards provide a comprehensive template for disclosure and European-wide reporting standardisation. However, the template does also recognise national specificities and includes a qualitative section where national issuers are asked to agree on common national definitions and explain those. The CBIC transparency initiative has in fact deliberately started by accommodating national common definitions on key concepts instead of imposing European common definitions. The fragmented nature of the underlying national mortgage markets and legislation structures would not have made European definitions feasible in the short term. However, the CBIC believes that the label, by setting nationwide standardisation for transparency, is a precondition for any steps towards a European-wide agreement on definition, where it makes sense. Transparency will enhance investors' ability to analyse different covered bond programmes and compare standardised information at European level.

The CBIC believes that the limits to the comprehensiveness of the national transparency requirements may prove problematic for investors to assess the quality of covered bond programmes. The ECBC minimum transparency requirements are seen as the starting point and as part of a progression towards the CBIC transparency template. The CBIC would also encourage ECBC members to focus specifically on the standardisation of the reporting at European level – along the lines indicated in the CBIC template – to help investors to easily compare information.

The CBIC welcomes the infrastructure that the labelling project is putting in place for further strengthening of the European covered bond market. It relies rightly on dedicated national covered bond legislation and on the supervision on both the issuing credit institutions and the cover pool. Against this background, the label is an important, positive step. It has the merit of defining certain minimum requirements for covered bonds, if only at national level at this stage, which does not help the aim of making comparisons across European issuers. To achieve a high quality label and for investors to benefit fully from the label, the CBIC believes an enhanced transparency regime, converging with the CBIC European transparency standards, is key.

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Solvency II reporting requirements: an asset manager's view

The ICMA Solvency II Working Group has deep concerns regarding the "look-through" approach proposed by the regulator – which requires firms to list all underlying assets where an instrument is based on the performance of underlying assets. We believe the approach will profoundly affect operations, compliance and relationships between asset managers and insurance companies. This is particularly true for applying look-through requirements to funds of funds.

The Working Group is worried that insurance companies will amend and simplify their asset allocations policies to meet their reporting requirements. This means they could lose out on the benefits of economies of scale or investment returns from some products because of compliance issues. Moreover the look-through requirements will be a cost that will be passed on to insurance companies in the long-run.

Indeed asset managers feel that the look-through approach will have consequences for insurance companies' investment policies in the long-term.

> There is also a problem of treating all investors equally. Unlike private funds, mutual funds have more than one investor and all investors within a single mutual fund should have same access to the details of the fund. Hence, if holding details are shared with one investor for regulatory disclosure, this should be shared with all the other investors.

The challenges for funds of funds

Several insurers investing in a single mutual fund may demand different types of data and data formats, thus increasing costs for the mutual fund holders and going against the rationale of collective investment – that is to spread the cost over a large base of clients in order to profit from economies of scale. The increase in cost could prevent insurance companies investing in mutual funds in the future.

For smaller insurers, captives and those in run-off, cost effective investing necessitates the use of mutual funds. Current look-through proposals may detract from the cost effectiveness of this opportunity unfairly penalising those smaller insurers.

There is also a problem of treating all investors equally. Unlike private funds, mutual funds have more than one investor and all investors within a single mutual fund should have same access to the details of the fund. Hence, if holding details are shared with one investor for regulatory disclosure, this should be shared with all the other investors.

From a technical point of view the problems also stem from the fact that under Solvency II, insurers will require earlier reporting than is sometimes currently offered by the asset managers to their investors. If the information is public, there is no conflict of interest. If it is not, disclosure is forbidden because all investors are supposed be treated equally (ie to have the full composition of the portfolio available at the same time). The group would like to know if the regulator has given any thought to this conflict and how it proposes fund managers address it.

Currently there is no technical or procedural infrastructure to perform or provide any detailed reporting for mutual funds, and this is from an accountancy point of view as well as an interface one. Moreover this is not an easy infrastructure to build – it would be much more complex than that designed for the German *Spezialfonds* for instance, because it goes beyond a simple "one manager – one fund owner" relationship. Therefore it is expected that building such an infrastructure to comply with the look through requirements will take some time and would be very costly.

Breaching confidential agreements

From a compliance perspective, many fund managers have signed confidentiality agreements with third parties not to disclose information. This is especially true in relation to funds of funds where a number of investment managers are used. Such information is usually confidential in nature as it may reveal the proprietary trading strategies of the fund managers. Any disclosure, therefore, may significantly impact the ability of fund managers to trade in the market and may, in turn, impact the investment returns that insurers will receive.

Difficulty in obtaining data

During the QIS 5 exercise where insurers required a look-through for all their investments (to calculate their SCR), some had difficulty in obtaining the detailed information from some of their asset managers. The risk in such a context is that to overcome this barrier some insurers might decide to simplify their asset allocation and internalise the management of parts of their portfolio to ensure and control the data quality of their investments.

Complex investment environment

Finally the Working Group believes that the increasing complexity of cross-border security transactions and asset management is a barrier to the look-through approach given the difficulty of determining the location of the positions.

Reporting a look-through of the asset portfolio will be very problematic. Indeed having many third parties within the data chain means that to collate this kind of information may take weeks and sometimes months. To do this within the deadlines proposed by EIOPA will be a huge challenge.

The reporting on an ISIN level basis for investments, instead of providing data on an aggregate basis would risk dramatically increasing the costs already carried by the asset managers' clients.

Use of the data

At this stage of the regulatory process it is key for the ICMA Working Group to have a better understanding of how the regulator would review the end data. It would help asset managers to consider the level of granularity needed to meet regulatory requirements in a proportional manner. The working group believes that it should be possible to define a level of granularity that could be acceptable to both regulators and asset managers in assessing risk concerns, and that this level of granularity does not include delivery of ISIN level data – and take into full consideration the reality which asset managers and insurers face.

EIOPA and Allianz SE also contributed to the symposium and expressed views regarding the look-through.

This article first appeared as part of a symposium published on Solvency II wire.

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Forthcoming AMIC-related events

Private Wealth Management Workshop – 4 October 2012 in Luxembourg: The ICMA Private Banking Working Group was set up following the ICMA Asset Management and Investors Council meeting held on 9 September 2009. The private banking industry is a cross-border industry and it faces issues of a fragmented European regulatory landscape (for instance, in the case of different investor protection regimes for different products). Our pan-European Working Group provides a neutral forum to identify such issues and where appropriate to propose solutions to regulators. The Working Group has been drafting a Private Wealth Management Charter on behalf of its members. The workshop will be an opportunity to present the Charter to Luxembourg institutions. Jean Guill of the CSSF will make the keynote speech.

AMIC Council meeting – 23 November 2012 in London: In 2012 ICMA has introduced a new more flexible AMIC governance structure. The AMIC Executive Committee meets each quarter to define workflow and priorities following guidance from the wider Council membership and to steer the projects of the various working groups. The AMIC Council will meet in London on 23 November 2012 and will discuss the AMIC 2013 priorities as well as progress with existing and potential future working groups.

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by David Hiscock

Market Infrastructure

CPSS / IOSCO

On 16 April 2012, the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) published the final version of their new *Principles for Financial Market Infrastructures* (there is also an explanatory cover note and a summary note). This documents new and more demanding international standards (called "principles") applicable to all systemically important payment systems, central securities depositaries, securities settlement systems, central counterparties and trade repositories (collectively "financial market infrastructures" or "FMIs"). In general, the standards are principles-based in recognition that different FMIs may have different approaches to achieve a particular result. In some cases, however, the standards set out a specific minimum requirement to ensure a common minimum level of risk-management across FMIs and countries. CPSS and IOSCO members will strive to adopt the new standards by the end of 2012; and FMIs are expected to observe the standards as soon as possible.

CPSS and IOSCO have strengthened and harmonised the international standards for FMIs by raising minimum requirements, by providing more-detailed guidance and by broadening the scope of the standards to cover new risk-management topics and new types of FMIs. The 24 principles outlined in this report are categorised into nine broad categories: (i) general organisation; (ii) credit and liquidity risk management; (iii) settlement; (iv) CSDs and exchange-of-value settlement systems; (v) default management; (vi) general business and operational risk management; (vii) access; (viii) efficiency; and (ix) transparency. These broad categories encompass the major elements critical to the safe and efficient design and operation of FMIs. The report also includes revised responsibilities of relevant authorities in regulating, supervising and overseeing FMIs. Importantly, this report supports the G20 and FSB strategies with respect to cooperation, access and resolution.

The principles were issued for public consultation in March 2011; and the finalised principles now being issued have been revised in the light of the comments received (which included a contribution produced by ICMA's European Repo Council). They replace the three existing sets of international standards set out in the *Core Principles for Systemically Important Payment Systems* (CPSS, 2001); the *Recommendations for Securities Settlement Systems* (CPSS-IOSCO, 2001); and the *Recommendations for Central Counterparties* (CPSS-IOSCO, 2004).

At the same time as publishing this final version of the principles, CPSS and IOSCO have issued two related documents for public consultation, namely an assessment methodology and a disclosure framework for these new principles. The assessment methodology, which provides guidance for assessing and monitoring observance with the principles and responsibilities, is primarily intended for external assessors at the international level (in particular the IMF and the World Bank). It also provides a baseline for national authorities to assess observance of the principles by the FMIs under their oversight or supervision, or to self-assess the way they discharge their own responsibilities as regulators, supervisors, and overseers; and may also be used by FMIs for purposes of their own self-assessments of observance of the principles. The disclosure framework is intended to promote consistent disclosures of information by FMIs regarding rules and key procedures. Any comments on either of these papers were requested by 15 June 2012.

CPSS and IOSCO are also engaged in additional work on the resolution of FMIs, which aims to provide guidance for designing recovery and resolution regimes for FMIs consistent with the FSB's *Key Attributes of Effective Resolution Regimes for financial Institutions* while taking account of the special characteristics of FMIs.

ECB: TARGET2-Securities (T2S)

As announced in a press release, the ECB hosted an event on 8 May 2012 to mark the signing of the T2S Framework Agreement (T2S FA) by the Eurosystem and a first group of nine European CSDs: Bank of Greece Securities Settlement System – BOGS (Greece); Clearstream Banking AG (Germany); Depozitarul Central S.A. (Romania); Iberclear (Spain); LuxCSD S.A. (Luxembourg); Monte Titoli S.p.A. (Italy); National Bank of Belgium Securities Settlement System – NBB-SSS (Belgium); VP LUX S.á.r.l. (Luxembourg); VP Securities A/S (Denmark). The signing of the T2S FA, which governs the legal relationship between the Eurosystem and each CSD participating in T2S, is an important milestone in the T2S project. The CSDs that signed the contract account for around two-thirds of the settlement volumes in the euro area and other CSDs are expected to sign in June 2012. The T2S project is now more than halfway to delivery, with a go-live date set for 2015. The T2S FA is available on-line, along with other T2S key documents.

On 1 June, the *Spring 2012 issue of T2S OnLine* was published by the ECB. The last paragraph of the editorial summarises the content of this edition as follows: "This issue of *T2S OnLine* will primarily be dedicated to the signing event on 8 May. However, many other things have happened in the T2S project since our winter issue: hence, as usual, Helmut Wacket will bring us up to date on the latest T2S developments in his T2S Project Update. The Insight, by T2S team member Anna Nuzzolo, will offer an overview of the highlights of the 8 May event in the form of a "reportage", with particular focus on the messages conveyed by the Eurosystem and the CSDs in their speeches, presentations and interviews. In Bayle's View, Marc Bayle provides an overview of the next key milestones of the T2S project. Finally, the nine CSDs that have already signed the Framework Agreement are the subjects of the last article, entitled "Introducing the first CSDs of the T2S Community"."

A T2S "Info Session" was held on 18 April 2012 in Malta and a dedicated technical session, on "Implementing the relationship between Payment Banks and their clients in T2S", was held on 23 May in Amsterdam. The T2S Advisory Group (AG), which is an advisory body that reports directly to the ECB's decision making bodies on the T2S project, last met on 27 March 2012 (and next meets on 18-19 September). The T2S Harmonisation Steering Group (HSG), which is supporting the AG in formulating its harmonisation agenda, met on 25 June 2012.

The TFAX (Task Force on adaptation to cross-CSD settlement in T2S) was set up by the AG in its September 2011 meeting. TFAX met on 10-11 May 2012, to review the responses received (including that provided by the ICMA ERC Operations Group) for the first mini-consultation on issues 1 - 4 as well as decide on actions to take thereon; and to discuss the content of issues 5-8 and potential solutions. TFAX met again on 6 June, to finalise the discussion on issues 5-8 and focus on the questions to ask in view of the upcoming second mini-consultation (and next meets on 4-5 July 2012). The ERC Operations Working Group is meeting on 11 July 2012 in the presence of an ECB representative to further develop the TFAX issues relating to repo transactions.

ECB: Collateral Central Bank Management (CCBM2)

As publicly announced in a 15 June 2012 press release, the Governing Council of the ECB has decided to discontinue the preparations for the CCBM2 project in its current form. The existing Correspondent Central Banking Model (CCBM) for cross-border collateral management remains in place. In the immediate future, the Eurosystem will concentrate on implementing the previously announced enhancements to Eurosystem collateral management services, namely the removal of the repatriation requirement from the CCBM and the support of cross-border triparty collateral management services within the CCBM. Both enhancements will be introduced in the Eurosystem collateral management framework in the course of 2014. Furthermore, the Eurosystem will prepare for the support of T2S auto-collateralisation procedures. The Eurosystem will also continue assessing and developing its collateral management framework and practices, with an initial emphasis on harmonisation.

UNIDROIT: close-out netting

Following the approval by the UNIDROIT Governing Council at its 91st session in May 2012, UNIDROIT has convened a Committee of governmental experts to consider the draft Principles on the enforceability of close-out netting provisions established by the UNIDROIT Study Group. The first session of the Committee of governmental experts is scheduled for 1-5 October and will be held at the Headquarters of the Food and Agriculture Organization of the United Nations in Rome.

Global legal entity identification (LEI) numbers

On 8 June the FSB announced the publication of *"A Global Legal Entity Identifier for Financial Markets – FSB Report to the G20".* This FSB report, approved when the FSB met on 29-30 May in Hong Kong, responds to the mandate issued by the G20 at the Cannes Summit and was transmitted for consideration at the 18 - 19 June Los Cabos Summit. It sets out 35 recommendations for the development and implementation of the global LEI system. These recommendations are guided by a set of "High-Level Principles" which outline the objectives that a global LEI system should meet.

The FSB's recommendations draw extensively on advice from the FSB LEI Industry Advisory Panel and participants in public/private workshops. The proposals for the initial reference data and code are fully in line with the recently published standard for the LEI developed as an industry consensus solution by the International Organisation for Standardisation ISO 17442:2012.

Following endorsement of the Report by th G20, an FSB LEI Implementation Group will now undertake the necessary preparatory work with a wide range of private industry representatives to develop a central platform to facilitate the integration of local identification schemes into a logically centralised database of unique LEIs based on consistent standards, protocols, procedures etc. that appears seamless to users. An open invitation and solicitation of interest in joining the global industry LEI foundation consultative group will be made via a public announcement. The recommended implementation plan targets launch of the global LEI system on a self-standing basis by March 2013.

Collateral Initiatives Coordination Forum (CICF)

The CICF is more fully described in an article in issue 24 of ICMA Quarterly Report (pages 46–47). On 30 April 2012, the CICF held its second meeting at ICMA's offices; and agreed on a number of further steps to advance its efforts, including the drafting of a white paper, on the topic of "collateral fluidity", for potential future publication. Discussions also reviewed work already done on developing the CICF's website pages and on the drafting of a simple paper describing "Collateral Fundamentals". A further CICF meeting is anticipated in September 2012.

The CICF's collateral fundamentals paper is conceived as a primer to be published as a simple introduction to the concept of collateral. In just a few pages it seeks to describe what is collateral, who uses it, and what are its uses. A set of simple diagrams provide schematic illustrations of a series of basic transaction types in which collateral is utilised, including secured cash borrowing, repos and OTC derivatives.

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diary

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

10 JULY

MiFID II, MiFIR and CSD: the market perspective on regulatory developments
ICMA and SIX Swiss Exchange conference, Zurich, 10 July

MiFID II and its accompanying EU Regulation, MiFIR, will change the relationship of financial institutions with their customers, methods of trading, liquidity provision and costs of doing business. The proposed CSD Regulation has important implications for settlement of securities – including the introduction of settlement at T+2 for securities traded on regulated markets and new measures to address settlement fails.

This half-day conference will consider the implications of the proposed new measures, specifically for the OTC debt capital markets, with the focus on how the changes will impact activity in Switzerland.

Register here

14 SEP

Understanding the ICMA Primary Market Handbook (IPMA Handbook), London, 14 September

In response to recent increased demand from members for guidance on the use of some of our core resources, we are running workshops on ICMA's Primary Market Handbook for the issuance of international debt and debt-related instruments. The half-day session will give an overview of the scope and application of the recommendations and will also review recent developments and changes.

Understanding the ICMA Primary Market Handbook (IPMA Handbook) is an accredited workshop under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 2.5 hours CPD credit for their attendance at this workshop.

Register here

19-21 SEP

Global Master Agreements for Repo and Securities Lending workshop, Zurich, 19-21 September

ICMA and the International Securities Lending Association (ISLA) will be running a workshop on the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA). These two separate master agreements are the essential legal underpinnings for repo and securities lending markets respectively. The workshop will include a detailed review of both legal agreements and their application, together with case studies, the operational and basic legal characteristics of the repo and securities lending markets will also be covered. There will also be coverage of the GMRA 2011.

The Global Master Agreements for Repo and Securities Lending Workshop is an accredited course under the Solicitors Regulation Authority's (formerly The Law Society) CPD Scheme. Solicitors may claim 18 hours CPD credit for their attendance on the whole course.

Register here

20-21 NOV

ICMA Professional Repo and Collateral Management Course, London, 20-21 November

The ICMA European Repo Council course caters to the needs of professional repo market participants and is provided at subsidised rates to ICMA members, underlining the association's commitment to education and the development of this financing product. The course, which has run successfully for almost 10 years, becoming the market benchmark, features a blend of presentations from experienced practitioners who are actively involved in the repo market on day to day basis, together with a sound theoretical explanation of the principles involved in this type of financing from ICMA Centre academics. As well as covering the fundamentals of the repo product, the course will address the uses of repo and collateral by central banks, the impact of the crisis on the repo market and the latest developments in clearing and settlement.

The 2012 ICMA Professional Repo and Collateral Management Course is sponsored by Fitch Solutions.

Register here

Save the date for these ICMA events in the autumn

25 September
5th Annual ICMA BWF Conference, Frankfurt

27 September
ICMA European Repo Council Meeting, London

4 October
Private Banking Workshop, Luxembourg

18 October
NEW Regulatory Policy training workshop, London

23 November
ICMA AMIC Council meeting, London

*Over 700 delegates attended **the 44th ICMA AGM Conference** at the Palazzo Mezzanotte in Milan at the end of May. Speeches and presentations from the evert are available from the ICMA website.*

ICMA Executive Education in 2012

For full programme and details of all courses please see www.icmagroup.org/training-development

ICMA Executive Education has just produced its first newsletter. It is designed to give more in-depth insights into our programmes and the trainers who give them. It also features profiles of some successful certificate holders, who explain how they are applying the skills they have learnt through ICMA courses in their every day working lives. ICMA Centre academics have contributed features on "The credit crunch of 1294" and "Stress testing credit risk".

The ICMA Executive Education newsletter is available from the ICMA website.

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Introductory Programmes

Financial Markets Foundation Course (FMFC)
Luxembourg: 24-26 September
London: 26-28 November

Securities Operations Foundation Course (SOFC)
London: 24-26 September
Brussels: 12-14 November

Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Hong Kong: 26 August – 1 September
Sitges, Barcelona: 28 October – 3 November

Primary Market Certificate (PMC)
London: 19-23 November

Specialist Programmes

Collateral Management
London: 11-12 October

Corporate Actions – An Introduction
London: 16-17 October

Derivative Credit Risk
London: 30-31 October 2012

Fixed Income Portfolio Management
London: 22-23 November 2012

Global Custody
Dubai: 31 October – 1 November

Inflation-linked Bonds and Structures
London: 22-23 October

Securities Lending & Borrowing
Dubai: 28-29 October

Technical Analysis and Inter-Market Trading
London: 13-14 September 2012

Trading & Hedging Short-Term Interest Rate Risk
London: 5-6 November 2012

Trading the Yield Curve with Interest Rate Derivatives
London: 7-8 November 2012

ICMA Executive Education – Skills Courses

Mastering Mandates
London: 27-28 September 2012

Successful Sales
London: 8-9 November

Glossary

ABCP	Asset-Backed Commercial Paper
AFME	Association for Financial Markets in Europe
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CoCo	Contingent convertible
CPSS	Committee of Payments and Securities Settlement
CRA	Credit rating agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depositary
DMO	Debt Management Office
D-SIBs	Domestic systemically important banks
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN	Economic and Financial Ministers (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Stability Facility
EGMI	European Group on Market Infrastructures
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure regulation
ERC	ICMA European Repo Council
ESMA	European Securities and Markets Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
Eurosystem	ECB and participating national central banks in the euro area
FPC	UK Financial Policy Committee
FSA	UK Financial Services Authority
FSB	Financial Stability Board
FTT	Financial transactions tax
G20	Group of Twenty
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
HFT	High frequency trading
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositaries
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
LCR	Liquidity Coverage Ratio (or Requirement)
L&DC	ICMA Legal & Documentation Committee
LTRO	Longer-Term Refinancing Operation
MiFID	Markets in Financial Instruments Directive
MiFID II	Proposed revision of MiFID
MiFIR	Proposed Markets in Financial Instruments Regulation
MTF	Multilateral Trading Facility
NSFR	Net Stable Funding Ratio (or Requirement)
OTC	Over-the-counter
OTFs	Organised trading facilities
PD	EU Prospectus Directive
PR	PD Implementing Regulation
PMPC	ICMA Primary Market Practices Committee
PRIPs	Packaged Retail Investment Products
PSI	Private sector involvement
PSIF	Public Sector Issuer Forum
RM	Regulated Market
RPC	ICMA Regulatory Policy Committee
SBWG	ICMA Sovereign Bonds Working Group
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SMPC	ICMA Secondary Market Practices Committee
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSR	EU Short Selling Regulation
T2S	TARGET2-Securities
TD	EU Transparency Directive
TRs	Trade repositories

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

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