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Opening Remarks

Martin Scheck

Chief Executive, ICMA

Welcome back, everybody. I very much hope that you enjoyed yesterday, both the conference and the gala evening, for those of you who were there, on the Ocean Diva. Thank you very much for joining again this morning. Today's conference is very varied. We start with a segment on China, and then we continue with a segment on green bonds. After coffee break, we welcome our keynote speaker, Steven Maijoor, who is Chairman of ESMA, before moving on to two panels. One of them is on the primary and secondary markets, and the final one is on secured financing, a very important topic. It really promises to be another interesting and relevant day.

Let us start with the segment on China. We are really delighted to be able to present this to you today. As many of you already know, ICMA started a representative office in Hong Kong two years ago, to focus on the developing capital markets in Asia-Pacific, which were attracting more and more cross-border issuance and investment, and playing a much larger and still increasing role in the international debt capital markets. Hence, these markets are no longer simply relevant for those living or working in the region, but of direct interest to all market participants wherever they are based, and, in addition, much of the expertise ICMA has built over many decades in the European markets is relevant to our members in Asia-Pacific. Already, our standards of best market practice are being increasingly used.

China is, of course, a particular focus for us, given its scale and potential, and our membership is growing and our activities increasing in China. We are very honoured to have three very senior representatives from key Chinese institutions here today: Shanghai Clearing House; NAFMII; and the People's Bank of China. The segment is going to be moderated by Spencer Lake, who will also deliver a few opening comments and introduce the speakers. Spencer is Group General Manager and Global Head of Capital Financing at HSBC. He has immense experience in Asia-Pacific. He is also a Board member of ICMA and was yesterday appointed Chairman, succeeding Cyrus Ardalan.

With that, I would like to hand over to you, please, Spencer. Thank you all.

China's Global Integration: Developments in China's Onshore RMB Market

Spencer Lake

Group General Manager and Global Head of Capital Financing, HSBC Bank plc

I. Preamble

Thank you, Martin. First, I just want to make sure that it is impressed upon people how lucky we are today. Yesterday, we had three very senior spokespeople on the topic of the capital markets union. Today, we have three of arguably the most senior and influential Chinese officials, who are going to give us insight that no one else is going to get, so let us make sure that we really enjoy the moment. I am particularly pleased to speak to you today on the topic – it is something that is very near and dear to my heart – of China's global integration. For us, it is probably the defining event of this century and it is clearly very important to ICMA's future.

II. Progress Towards Integration

China's globalisation presents an unprecedented opportunity for the world's business and capital markets community. As China continues to integrate with international markets and increasingly influences global policymaking, all will be profoundly affected. The opportunities presented by China's globalising fall into two broad categories: those arising from China going out into the rest of the world, and those from within China itself. Today, we are going to focus on what is going on within China itself. Both the Chinese Government and the international community share the same view: that, ultimately, both onshore and offshore markets will converge. We will hear later from our panellists how important and how strong is the level of dedication from the Chinese authorities to make this integration a great success.

The onshore capital markets need to make, and are making, rapid progress towards integration. The onshore bond market is already the third largest in the world, both in terms of bonds outstanding and in terms of volumes. The bond market, however, continues to be dominated by central government and policy banks, who represent the majority of issuers. This, however, rapidly changed this year. In 2000, 98% of issuers were from government or quasi-government bodies. Last year, this was down to 55%, as more and more corporates look to tap into the bond market. Rapidly changing dynamics such as this lead to some truly exciting opportunities, and I see five key areas that show real promise and require real action in China's onshore markets.

III. Areas of Promise

1. Corporate Bond Market

The first – and I just briefly touched on this – is the corporate bond market. There is an enormous strength of will from the Chinese authorities to continue to develop this market, to diversify credit risk currently concentrated in the banking system. Regulators continue to relax restrictions and simplify approvals to make it easier for corporates to issue debt, including this past January when the securities regulator issued new rules allowing all firms with a shareholding structure to issue corporate bonds. There remain key unresolved issues, however, including the fact that corporate bonds cannot be traded in the interbank market, by far China's largest bond market.

2. Municipal Bond Market

The second area of development is the municipal bond market. Some believe this more than others, but the rationale is quite simple: China needs to solve its local government debt issues. This year, local governments were given a CNY 600 billion quota for bond issuance. We also saw recently an enormous debt-swap programme, through which local governments' bank loans were swapped for bonds, an unprecedented exercise to create continuity within the market. This scheme included a crucial development that local government bonds are now eligible for repo collateral. The effect of this is that banks can obtain cheaper funding and local government debt has become increasingly attractive. Jiangsu province kicked off the new municipal bond programme last month, completing a landmark bond sale of more than CNY 52 billion, with a very attractive cost of funding. We are sure we could see many more issues in the future.

3. Infrastructure and Sustainable Financing

The third area relates to infrastructure and sustainable financing, a bit theme here also in Europe. Internationally, the Chinese Government has made some powerful signals about how seriously it takes infrastructure, profoundly demonstrated by its establishment of the Asian Infrastructure Investment Bank and attempts to develop a new Silk Road, opening new land and sea trading routes. These initiatives will further integrate China's financial markets with the rest of the world.

China's rapid economic development has meant that it urgently needs solutions to the pressing environment challenges that this development has contributed to. For China to achieve the low-carbon, green economy that it needs for sustainable growth, it will require a huge amount of infrastructure and crucial funding. The Development Research Center of the State Council has recently estimated that green investment and green development in China will require an annual investment of CNY 2 trillion. I believe that green bonds have great potential to help close the investment gap and raise critical finance for sustainable infrastructure projects. Around $8 billion of outstanding Chinese corporate bonds today already have links to green themes, and we are set to see significant growth in this sector. Our prediction is that, within China, if CNY 100 billion is raised this year, probably CNY 60-75 billion will be from Chinese issuers.

ICMA has been working hard on the development of the green bond market and the critical publication of a set of green bond principles, and more is needed. At the same time, China has been hard at work, setting the foundations for sustainable green finance markets domestically. We have seen green credit guidelines from the banking regulator, guidelines for energy-efficient lending and, recently, the establishment of a special green taskforce within the PBSC. Interestingly, the taskforce will look at incentive structures, including tax measures and possible RWA exemptions to encourage a green bond market. This makes China the first country in the world to link incentive structures with green bonds and is something that we can learn from here.

The opportunities here are not just limited to green bonds. There is also great potential for green lending, green securitisation and the possible set-up of its own China Green Investment Bank, as we have in the UK, linked with the AAIB to support the country's ongoing infrastructure needs and help drive the latest One Belt, One Road national initiative.

4. Asset-Backed Securities

This brings me to the fourth opportunity, asset-backed securities. The ABS market in China is absolutely surging. Last year, it expanded from CNY 13 billion to CNY 285 billion, and it is expected to continue to expand from here. There is significant regulatory support for this market, as there is here in Europe, with recently simplifications in the approval process and greater participation from new types of issuers. The authorities are keen to give lenders an enhanced toolkit to help them to dynamically manage their balance sheet. ABS allows them to efficiently manage their assets, while minimising the need for new liabilities. We have seen rapid growth in this market, because there is increasing acceptance among domestic issuers and investors, but also greater participation from foreign investors, in the various Q schemes that we have heard about. We were the first foreign bank to issue China ABS, and we look forward to seeing this blossoming market develop further.

5. Onshore Equity

My fifth and final opportunity is the onshore equity market, perhaps less of a focus for the audience today, but very important for us to appreciate. Actually, in the audience, we have the Shanghai Stock Exchange, who can speak on this quite eloquently. The current total market capitalisation for China A shares is $4 trillion. We believe this will expand to $10 trillion within the next three years. The market has remained bullish, even during the relative economic slowdown, and new cross-border channels look to encourage demand further. In November last year, we saw the Shanghai-Hong Kong Stock Connect, through which we have seen steady flows from Hong Kong to the mainland. Flows from the mainland back into Hong Kong, though, remain subdued, up until the last month, when the mutual fund industry went through also some reform. We expect this to continue to pick up, as domestic investors in China become more familiar with the new investment opportunities.

Recent developments on Hong Kong-China mutual fund recognition and the FTSE launches of two transitional indexes are just other examples of how this will progress. We will also see other exchanges connect, and we are very much looking forward to seeing bond connect, commodities connect, derivatives connect and also major connections made to this time zone, whether it be to London, to Paris, to Frankfurt, to Canada.

IV. Remaining Barriers

1. Credit Ratings

These are all fantastic opportunities, but there remain risks and significant barriers. The Chinese Government, though, has shown great dedication to liberalisation of its financial markets, and we have only seen these pick up over the last year or two. There are clearly challenges with any structural issues, and we can debate endlessly what we can do to try and overcome them. What are the areas that we think require further attention? The first is credit ratings. We think they are an important area. Only 32% of onshore bonds currently have a credit rating and the market is dominated by domestic rating agencies. There is no international influence. Ratings are critical to give investors accurate information about potential new assets, and, if ratings do not accurately reflect an issuer's quality, then how can they accurately reflect their price? Better rating information will attract new investors and greater trust within the global markets.

2. Default Mechanism

A second key area is the lack of a comprehensive default mechanism, similar to Europe, actually. There remains an implicit state guarantee, which protects investors in the short term but is detrimental to the long-term development of China's capital markets. Investors are drawn to high-yielding products, without carrying out significant due diligence. This disadvantages high-quality issuers that deserve lower yields. It also exposes investors to risk, should it transpire that these guarantees do not materialise.

3. Investment Choices

The final area is the lack of investment choices and still fairly restricted access for the onshore market. ICMA and NAFMII have a working group that is making progress on how we can close the gap between the Chinese market and the offshore markets, but much more work needs to get done. It is a bit of a chicken and egg situation, and we are leading to try to break that ice. Greater participation from foreign institutions will help spur this on, and more cross-border issuance and investment channels will further add to the momentum.

V. Concluding Remarks

I think these challenges, though, will be corrected, as more market discipline enters China's financial system. ICMA members have considerable knowledge and expertise in China that we will continue to work on. Of course, HSBC has been leading this initiative and continues to inspire and be at the forefront of China's journey, which I hope everybody in the room could actively explore, be involved in and get to know better, as we will find out on our panel. There will clearly be bumps along the road. This is a directional journey that does not happen overnight, but we feel quite confident that we will be able to progress.

With that, I am going to pass it over to Madam Liu, who is the Deputy Secretary General of NAFMII. She will then pass it over to Chairman Xu, Chairman of the Shanghai Clearing House. Then I will ask Ming Bao a couple of questions on the stage. Thank you very much.

China's Financial Markets and the Work of NAFMII

Jianhong Liu

Deputy Secretary General, NAFMII

I. Preamble

Ladies, gentlemen, friends, good morning. Thanks for the invitation from ICMA. I am very glad to be at the ICMA 2015 conference. Thanks also to ICMA for preparing special arrangements so that I and my colleagues have the opportunity to introduce the latest developments in China's financial market dynamics.

II. Financial Market Situation

First of all, I will outline the overall situation of China's financial markets, accompanied by the process of the economic reform that is being gradually developed. Although the development time has not been long, these developments have achieved remarkable success. At present, China has formed markets including money market, bond market, stock market, insurance market, gold market, foreign exchange and financial derivatives and other such markets. These are relatively comprehensive, multi-layer financial market systems.

In the currency markets in 2014, the lending and bond repo markets alone amounted to CNY 226 trillion in total. In 2014, stock market capitalisation was about CNY 37 trillion. The figures have already risen to CNY 74 trillion. According to the World Federation of Exchanges in 2014, China is already second after the United States. The interbank foreign exchange trading volume reached CNY 8.9 trillion, with two consecutive years of double-digit growth. In the gold markets, China's gold futures trading volume has been ranked second in the world, first in Asia. In 2014, the Shanghai Gold Exchange established an international board to further promote China's gold markets, aligning with international markets. In the commodity futures market in 2014, Shanghai Shenzhen 300 stock index futures and bond futures had a total turnover to CNY 292 trillion. The financial derivatives market has developed four categories of products, including interest rate bonds, currency and credit derivatives, and is developing rapidly.

The stock of China's bond market has reached CNY 35 trillion, about $5.7 trillion. Government bonds, financial bonds and corporate credit bonds each accounted for one third. Among them, the size of the market in corporate credit bonds reached CNY 11 trillion, ranking second in the world after the United States. In 2014, full-year cash bond and repo trading volume totalled CNY 358 trillion. Since 2008, the interbank bond market has been booming, with NAFMII and other debt financing instruments rapidly growing year after year, registering an amount of CNY 16.1 trillion at the end of 2014. It is 80.8% of the Chinese companies' credit bonds. The total issue size is CNY 15 trillion and the stock size is CNY 7 trillion. The ratio is 59%.

III. Interbank Market System

1. Basic Products

Secondly, I would like to highlight China's interbank market system construction and secondary market transactions. Interbank traffic flow and the varieties available for trading are constantly increasing. In terms of the basic products, varieties and types of bond lending streams among the banks have been optimised. Among them, the main government bond products, including various types of government-like credit agencies, financial institutions and non-financial corporations, and other products with different time limits, play an important role in supporting the real economy.

2. Derivatives

In the derivatives area, long-term interest rate bonds, interest rate swaps, forward rate agreements, foreign exchange forwards, foreign exchange swaps, currency swaps, foreign currency exchange rate derivatives and credit derivatives constitute a complete primary sequence. The emergence of some online product transactions, netting, wash transactions and other trading mechanisms further improve the operational efficiency of the market, strengthen risk control and enhance operational stability.

3. Market Volumes

The interbank bond market in 2014 had grown more than 400-fold compared to 1997. On China's interbank derivative markets, the notional principal of interest rate derivatives trading in 2014 almost reached CNY 3 trillion. On the investor base, after more than 10 years of construction, the interbank market participants group, which consisted of just 16 commercial banks at its inception in 1997, has developed a wide range of insurance, securities finance and other financial institutions, insurance agency and other trust products, and investments from non-financial and overseas institutions, especially given the accelerating pace of opening up to foreign investment in recent years.

4. Foreign Investors

More renminbi-qualified foreign institutional investors have been entering the interbank market for trading operations in recent years. Up to 26 March 2015, the State Administration of Foreign Exchange has approved an investment quota of a total of CNY 72 trillion from 267 qualified foreign institutional investors. The active participation of foreign institutions in China's interbank market has further enriched the variety of investment entities, creating a positive effect and improving market liquidity.

5. Trading Systems

Fuelled by the infrastructure and system construction, China's exchange trading centre, the trading front office, provides trading systems for financial institutions, the interbank market and corporations, and organises transactions, as well as providing the market with straight-through processing services. At present, in the back office, the central depository trust and clearing and the interbank market clearing house provide bond registration and custody for market participants. They provide market participants with individual full settlement services for DVP. At present, it is quite a modern payment system, and these processes improved efficiency, transparency and security. However, there is still a big difference with market-mature economies. The types of investors are still not rich enough and the number of types of foreign investors needs to be improved. In 2014, the trading volume accounted for only 4% of the spot market trading volume, but the continuous development of the market will improve this.

IV. The Work of NAFMII

1. Formation

Thirdly, I would like to detail the effort made by NAFMII in promoting continuous development of the interbank market. In 2007, the self-disciplined organisation, NAFMII, was voluntarily formed by the market participants. At this time, NAFMII established some regulations for implicit guarantee. It works to promote distribution, trading and information disclosure.

2. Product Toolbox

In recent years, with a focus on the real economy, NAFMII has been fully integrating the market resources and actively carrying out innovative work, and has formed a multilevel, fully compatible and innovative product toolbox. We have added different types of short-term financing bills, short-term convertible notes and other financing notes, as well as structured credit, embedded options, floating interest rate, multicurrency design and other technologies, to ensure a meticulous operation in the basic and innovative products and to create innovative combinations to meet the diverse needs of the investors and the issuers. In order to actively implement the policy of the central authority, NAFMII has been promoting the issuance of renminbi debt financing instruments. In March 2014, we successfully developed several new products.

V. Outlook

Last, I want to talk about NAFMII and the outlook for China's interbank markets. China's economic development has taken a new normal path, with the goal of upgrading the economic transition; restructuring and resolving the excess capacity; orderly, continuous improvement of the self-disciplined system of the market interest-rate pricing mechanism; and constantly increasing capital account convertibility. The consequence will be the steady development of the financial market in a broader, deeper, more open way. Derivative product innovation, while it is vigorously promoted, will be controlled on the premise of risk.

VI. Concluding Remarks

Opening up and market orientation mean that exchanges between China and the world's financial institutions will continue to deepen and both sides will get more opportunities. As an interbank market self-regulating organisation, NAFMII will continue to uphold the purpose of self-disciplined innovation and service, and practise the concept of market-oriented development, while continuing to promote the development of China's interbank market. On the one hand, we will continue to deepen the communication with the main bodies of the foreign financial markets, regulators and international financial organisations, to enhance understanding. On the other hand, we will deepen cooperation and further enrich the variety of China's financial market participants, expanding investment and financing channels for the international market and providing a better stage for market participants at home and abroad. I believe that, with the joint efforts of all parties, we will be able to establish a highly efficient, stable international capital market and promote global financial stability and world economic development. Thank you.

The Chinese Corporate Credit Bond Market: Broad Prospects for Development

Dr Zhen Xu

Chairman, Shanghai Clearing House

I. Preamble

Dear Mr Martin Scheck, Mr Spencer Lake, distinguished guests, ladies and gentlemen, good morning. I am very pleased to attend this meeting. This is the first time that the Shanghai Clearing House has participated in the ICMA Conference. We hope to enhance our understanding of and cooperation with the international market through influential industrial associations such as ICMA and this meeting. This meeting has arranged a special session for China's bond markets, which indicates that, against the background of renminbi internationalisation and capital account liberalisation, international financial institutions are increasingly interested in China's markets. Just now, the Deputy Secretary General of NAFMII, Ms Liu Jianhong, has delivered a very excellent presentation on China's bond markets from the perspective of a self-disciplined organisation. Now I would like to share with you some understanding of China's corporate credit bond market.

I think that there is a broad space for the development of China's corporate credit bond market. Over the past 10 years, China's corporate credit bond market has experienced rapid growth. In 2004, the outstanding balance of corporate credit bonds was CNY 115.4 billion, accounting for only 1.91% of the outstanding balance of CNY 6.03 trillion in the bond market that year. 10 years later, the outstanding balance of corporate credit bonds is CNY 11 trillion, accounting for 30% of the total outstanding balance CNY 35.58 trillion in the bond markets. It is 96 times what it was 10 years ago. At present, China's corporate credit bond market ranks second in the world, measured by the outstanding balance.

II. Factors in Growth

1. GDP Growth

The rapid growth of China's corporate credit bond market mainly benefits from the rapid growth in the economy, the changes in social financing structure and the market-oriented reforms. These factors will continue to support the development of China's corporate credit bond market over the next 10 years.

First of all, the rapid growth of China's economy supports the expansion of the bond markets. Over the past 10 years, China's GDP has increased from CNY 13.65 trillion to CNY 63.65 trillion, with an average annual growth rate of 10%, directly leading to the demand for debt financing and becoming the main supporter for the rapid development of the bond market. At present, China's economy has taken the new normal path, whose key features are steady growth, restructuring, reinforced promotion and risk prevention. The expected GDP growth rate will remain around 7% at this stage. The aforementioned growth ranks ahead from a global perspective and will continue to support the expansion of China's bond market.

As for the percentage that the bond market accounts for in GDP, it is only 55% in China, while, in the developed economies, it has commonly surpassed 100%, some of which even exceeded 200%. Therefore, China's bond market still has significant prospects for improvement. Corporate credit bonds will be the dominant component in the development of China's bond market in the next stage.

2. Financing Structure

Secondly, the transition of the social financing structure effectively promotes the development of corporate credit bonds. Over the past 10 years, China's social financing structure has changed gradually, and the proportion of direct financing increased from 4% in 2004 to 18% in 2014. Specifically, the proportion for corporate credit bond financing increased from 1.6% to 14.5%.

It is observed that the pace of current transition from indirect financing to direct financing is gradually accelerating. The proportion of direct financing in the entire financing structure in developed economies can reach up to 40-50%, and the proportion of corporate credit bonds in the entire financing structure can surpass 25% apparently. In the upcoming decades, the function of China's corporate credit bond markets to meet the social financing demands will be further enhanced and widely expanded.

3. Administration

Thirdly, streamlined administration, decentralisation of power and market-oriented reform have promoted the development of corporate credit bond markets. Since 2004, the People's Bank of China and the securities regulator have been making efforts to streamline the administration and push forward market-oriented reform. By promoting the innovation of bond products and establishing market-based restriction mechanisms for credit rating, credit enhancement and credit disclosure, and improving the construction of bond market infrastructures, China's corporate credit bond market has realised leap-forward development. At present, with the goal of allowing the market to play a material role in resource allocation, the new Chinese Government is trying to greatly promote market-oriented reform and simplify administrative approval. Therefore, the corporate credit bond market faces new opportunities for rapid development.

Initial statistics show that, since this year, China's relevant authorities have issued 10 policies or documents on corporate credit bonds, and the content of those policies or documents is mainly relaxing the constraints for issuers and investors; developing institutional investors; optimising the mechanisms of issuance, trading and claim; and expanding the opening up of the bond market. I believe that these measures will effectively improve the demand and supply of the corporate credit bond market and enhance the scale of the market.

4. New Developments

Besides this, some new elements will effectively support the development of corporate credit bond markets. China's One Belt, One Road strategy is in progress. The capital market is very active and the financing demands have greatly increased. China's stock market has expanded by 125% since last August, and it rose by 303% compared to last year, ranking the first in the world. Equity financing effectively increases the equity capital scale, decreases the leverage ratio and provides room for expanding the scale of corporate credit bonds markets. Beside the implementation and deepening of One Belt, One Road, development strategies will definitely bring massive financing demand for corporate credit bonds.

Financial reform and the opening up of the capital market will promote the development of corporate credit bonds. Renminbi interest-rate liberalisation is speeding up and the deposit insurance system has been established since May 2015, after years of discussion. On 10 May 2015, the PBOC adjusted financial institutions' deposit interest rate cap to 1.5 times the benchmark interest rate, indicating that the market-based reform of interest rates is close to the end.

The internationalisation of renminbi and the opening up of the capital market received extensive attention from the world. According to SWIFT, renminbi has become the world's fifth largest settlement currency. In November 2014, the Shanghai-Hong Kong Stock Connect programme was launched, and, in the next phase, the Shenzhen-Hong Kong Stock Connect programme is expected to be implemented. This series of reform and opening-up measures that have been or about to be implemented include the international cooperation of the Shanghai Stock Exchange, China Financial Futures Exchange and Deutsche Börse. The acceleration of construction of the cross-border renminbi clearance system, the establishment of the international financial markets trading platform in China, the free-trade zone very clearly show that China's capital market is facing a new opportunity for development, and China's corporate credit bond market will possibly become a global financial asset allocation platform.

5. Foreign Institutional Investors

It can be observed that, in the developing economies, overseas investors can hold up to about one third of the entire corporate credit bonds. In 2014, by contrast, all kinds of foreign institutional investors in China held less than $100 billion; that is CNY 600 billion, accounting for only 1.67% of the total market volume. The corporate credit bond holdings by overseas investors did not exceed $14 billion. These figures reflect that, on the one hand, international investors are not familiar with China's corporate credit bond market, and that, on the other hand, China's corporate credit bond market will have huge growth potential in the future.

III. Shanghai Clearing House

1. Overview

Shanghai Clearing House is China's CSD of corporate credit bonds and the CCP of OTC bonds, interest rates, foreign exchange and commodity transactions, as designated by the Central Bank of China. In 2014, Shanghai Clearing House provided registration and custody services for newly issued corporate credit bonds, with a total face value of CNY 4.18 trillion, which accounted for 77% of the total face value of corporate credit bonds issued that year. At year-end of 2014, bonds with face value of CNY 4.77 trillion were deposited at Shanghai Clearing House, with a year-on-year growth of 43%.

Shanghai Clearing House also provides central counterparty clearing services for spot and repo bonds, interest-rate swaps, foreign exchange spot forward and swaps, as well as commodity derivatives. In 2014, transactions with notional principal of CNY 44 trillion were centrally cleared, with year-on-year growth of 93%. The registration, custody, central counterparty clearing, collateral management, corporate credit bond index and valuation services provided by Shanghai Clearing House effectively support the expansion of corporate credit bonds and enhance market liquidity. Therefore, Shanghai Clearing House is becoming the asset and liability management, and risk management, platform for corporate credit bond issuers and investors, both at home and abroad.

2. Priorities

a. Free-trade zone

In the future, Shanghai Clearing House will take full advantage of favourable conditions for the opening up of China's capital markets. First, we will make full use of the Shanghai free-trade-zone policy and infrastructures, through the free-trade zone separate accounting units and a free trade account, to introduce more foreign issuers and investors in corporate credit bonds, and support the cross-border transactions for renminbi bond assets.

b. Central counterparty clearing

Secondly, we will continue to promote the central counterparty clearing for corporate credit bonds, both spot and repo transactions. We are also trying to use more high-grade corporate bonds as collateral and to cooperate with our international counterparts to launch cross-border collateral management services. Meanwhile, we are trying to develop corporate credit bond index funds or bonds and ETFs with other financial institutions, in order to expand the use of corporate bond indices and enhance the liquidity of credit corporate bonds in both onshore and offshore renminbi markets.

c. OTC products

Thirdly, we will provide CCP clearing for more OTC products, including interest rate, foreign exchange credit and commodity products. We are trying to expand the range of cleared products, maturity and participants, to ensure that the issuers and investors could use more derivatives to manage and mitigate risks and to further promote the sound development of China's bond markets.

IV. Concluding Remarks

Ladies and gentlemen, the history of credit is much longer than that of the industrial and banking industries, and even the corn industry. The history of economic development is also the history of the credit industry. I believe, with the steady growth of China's economy and the integration of international financial markets, there will be a very broad space for the development of China's corporate credit bond market. Shanghai Clearing House hopes to enhance communication and cooperation with international issuers and investors, and international financial institutions and infrastructures, to complement each other's strengths and promote mutual developments. To end, I would like, on behalf of the Shanghai Clearing House, to invite all of you to come to China. Thank you.

Conversation with Mingyou Bao

Speakers:

Mingyou Bao, Chief Representative, People's Bank of China Representative, Office for Europe

Spencer Lake, Group General Manager and Global Head of Capital Financing, HSBC Bank plc

Spencer Lake

I want to spend the next 10 or 15 minutes with Mr Bao, who is, as I mentioned before, the Chief Rep of the PBOC in Europe. He is also been the Chief Rep of the PBOC in the Americas. He is a Mason Fellow at Harvard, so quite a distinguished member of the Government. Just to pick up a little bit on Dr Xu's comment about the new economic reform in China, which has a lot of profound implications – and it is not obvious that people understand exactly what it means – maybe you could expand on that a little bit and also touch on what it means for the financial market reform, which is also quite a big topic.

Mingyou Bao

Thank you very much, Spencer. It is a great pleasure to join you for this discussion. Also, I would like to congratulate you on being elected as the Chairman of ICMA. It is the right time to lead such an important institution. It is a very important question. A lot of people are talking about China entering what we call a new economic normal, but not like everything else. Everything is made in China nowadays, but not this term. The new normal was actually created in the United States by some economists and scholars after the financial crisis. At that time, they said that the economy would be entering a period of low growth, high unemployment and high volatility in financial markets. If you take a look at the US economy nowadays, you can see that is really the new normal. Unemployment is very high. Although the official figure is 5.5%, with about 3-4% of people withdrawing from the labour market, there is about a 9% unemployment rate. In the second quarter, the newest figure for the USA is a contraction of 0.7% of the economy, so it is really a new normal.

China is different. For China, the new normal is that we will be moving to more sustainable economic growth, with improved economic restructuring. To achieve that broad target, Spencer, you are quite right that we need to do a lot of work in the financial sector by reforming the financial system. For example, we need to take bold actions to complete the final task of interest-rate reform, to make a breakthrough in capital account convertibility and to the increase the flexibility of the exchange rate system. We also need to shift the economy towards a more sustainable model, which relies less on resource input, and more on innovation, technology and efficiency of the economy, including a more efficient financial system, which means we need to develop more direct financing for the economy.

Just now, Mr Xu mentioned that, although we have made substantial progressing in raising the direct financing in the economy from about 4% to 18%, compared with other developed countries like the US, where direct financing accounts for 90% of the total financing, we still have a long way to go to catch up. Through this process of economic transformation, we will create huge opportunities for investors in China and investors from other countries. China has such a high level of savings, and the financial system needs to be more efficient, to offer better products and more choices for these high savings, both at home and in the foreign market.

Spencer Lake

As the economy goes through this new normal and as it transforms itself, the currency has been the point guard in making that happen. It is now the fifth most traded currency globally, and it is opening up to investment products both onshore and offshore for international investors through the various schemes. What are the next two or three big agenda items in your mind for the internationalisation of the currency as a mechanism?

Mingyou Bao

The internationalisation of the Chinese currency is quite a big topic nowadays in the international financial market. I agree with you, Spencer, that, over the past few years since the introduction of the so-called cross-border use of the Chinese currency, we have made substantial progress in this regard. For example, now, the overall deposit of the Chinese currency in overseas markets has already reached about CNY 2 trillion, and the central bank has signed swap agreements with about

28 or 29 central banks and monetary authorities in the world, in both the developed countries and the emerging market economies. We have established about 14 renminbi clearing centres across the world, in both the advanced and the emerging market economies.

Although we have made a lot of process in this regard, it is still not sufficient to meet the market demands and there are a lot of things we need to move forward. The first priority, in my view, is that we need to provide more convenience for international investors and financial markets in capital account transactions. I want to bring you to one fact, which is that, actually, the capital account convertibility or liberalisation has been put at the top of the Government's agenda. You may know that, every five years, China has a plan for broad economic development, which we call the five-year-period plan. In the last five-year-period plan, the Government said clearly in the statement that we will gradually achieve free convertible currency of the Chinese yuan. This year will be the last year for the 12th five-year-plan period, so I think major breakthroughs will be made this year concerning the capital account convertibility.

If you take the definition by the International Monetary Fund, among the 40 categories of capital account transactions, within China, only five are totally non-convertible. 35 are either convertible or partially convertible. The last mile in the capital account convertibility will be associated with freeing the investment by Chinese retail investors across the border to international markets, and also allowing non-resident international investors to issue financial instruments in the onshore market.

Just now, Ms Liu and Mr Xu touched on a lot of reform measures in this regard. For example, we just recently introduced the Shanghai-Hong Kong Stock Exchange Connect, and maybe we will have another stock exchange connect between Hong Kong and the Shenzhen market. We are also considering allowing qualified Chinese retail investors to invest abroad in the international markets. That is the programme that we call QDII 2; QDII 1 is for institutional investors. This programme will help retail investors make investments across the border. That is the priority. That is the top work for the financial regulators and policymakers in the Government.

Spencer Lake

One of the challenges has been, from an issuer perspective, that, on the investment side, there has been a lot of opening up both ways, and the schemes themselves have, for the most part, worked. Stock connect is a game-changer, because, all of the sudden, in a frictionless environment, you can access equities onshore, so getting that broad-banding of capital flows between other centres around the world is going to be quite helpful. This is maybe an unfair question, because it is actually more for Madam Liu, but offshore issuers coming into China have still found it difficult. When you are broadening out the asset base onshore to corporate credit, which is obviously a big topic, away from government credit, offshore credit still finds it very difficult to get onshore.

Mingyou Bao

I agree. That is why we need to move forward forcefully in reforming these areas. Even now, when international investors come to the Chinese market, they come mainly through two channels. The first is the interbank bond market, as Ms Liu has mentioned. Another one is our Renminbi-Qualified Foreign Institutional Investor programme. These are the two channels to access the onshore market. However, for the time being, we still have some regulatory approval, both for the qualification of the investor and the quota the investor is allow to invest in the onshore market, and that is something we need to do more on. For example, in the future, we might relax restrictions on the qualification review, even by moving from the ex-ante approval process to an ex-post restriction and review process. This will facilitate greatly the access of international investors to the onshore market.

Spencer Lake

I agree. You mentioned something quite interesting. We read more and more about the IMF and their focus on what they can do to help China. You have met most of the measures, but one is including the renminbi as a currency within the special drawing rights, as a full member of the IMF. Can you give us your view on that?

Mingyou Bao

That is the job of the IMF and it should not be decided by the People's Bank of China. However, you may know that, every five years, the IMF will conduct a review of the currencies in the basket of SDR. This year will be a very crucial year for such a review, because they may consider including the renminbi in the basket. To join the SDR basket of currencies, you need to qualify for two criteria. The first is the size of the economy and foreign trade. The second is whether the currency is freely useable. In terms of the first criterion, everybody knows that China is well qualified, because it is already the second-largest economy in the world. In terms of foreign trade, China accounted for nearly 13% of the world's total exports last year, while the United States accounted for only 8.6%; the third, Germany, accounted for 8%; followed by Japan at 3.6% and the UK at about 2.8%. Against these preconditions, China is well qualified to be included.

However, against the second criterion, whether the currency is freely useable, there might be different views on this issue. Although we maintained that we have made substantial progress in achieving the usage of the currency, the usage does not necessarily mean it is a freely convertible currency. It does not say 'freely convertible currency'; it just says 'free use of the currency'. If you look at Japan, when Japan joined the SDR in the 1970s, if I remember correctly, at that time, Japan had not fully liberalised its capital account transactions. People have different views on this and it is up to the IMF to make the decision.

However, Spencer, as I said, the financial markets should pay close attention to this development, because, if, finally, the renminbi is included in the SDR, it will create huge opportunities for investment, for both the private and official sectors. To some extent, inclusion of the Chinese currency in the SDR basket of currencies will also boost Chinese economic and financial reform. It will benefit China and also the international investors. That is why we should move forward to make a very wise decision on this.

Spencer Lake

What Mr Bao just said is quite important, because the international community absolutely needs to pay attention. We have had three fantastic presentations, highly technical, but what you can tell from those presentations is that there is a tremendous amount going on in China. The reform process is very focused, but also broad enough to capture quite a large audience of institutional, retail and corporate strategic demand around the world. We have to pay attention to that, because it is an absolute game changer. Some economies have done a better job of engaging in that, and you see the progress; you see what it means.

From a financial markets perspective, which is where we play day to day, the influence is quite significant. We are now seeing frictionless transactions take place where, 12 months ago, either you could not get it done or it cost you a lot. You now have five/seven-year cross-currency swaps between the CNH and the CNY in major currencies around the world, which is creating a significant alternative to funding through the synthetic market. We are seeing huge transactional volume take place, with Hong Kong as the centre, but around the world, we as a bank are seeing tremendous flows as the result of the clearing bank set up, the swap lines that have been put in place and simply the corporates that are trading. From a financial institution perspective, it is an unbelievable transformation.

I appreciate everybody taking the time and coming, because I know last night was a late night, but I do want people to pay attention. We as an organisation, at ICMA, will do what we can to continue this dialogue, create beachheads with our friends and make sure that everybody can understand more as it progresses. Thank you very much.

Martin Scheck

Thank you very much, everybody. That was fascinating and, as Spencer said, it is something that we need to be abreast of all the time.

The next session touches on a really fascinating and topical theme, and that is the theme of green bonds, and ICMA is heavily involved in the green bond market. The interest in green bonds has been growing very rapidly, and it is now a stated policy objective in most parts of the world. We heard a lot from Spencer in his introduction about the importance that the Chinese authorities are applying to developing a green ecosystem and a green bond market. That is just one of many. It was a question in the CMU green paper – a tautology there – and is really a global initiative. We run the secretariat for something called the green bond principles. Nick Pfaff is a Senior Director in our Market Practice and Regulatory Policy department. He has the responsibility for running that secretariat. I will let Nick introduce his two panellists.

Green Bonds in the Context of Socially Responsible Investment

Speakers:

Nicholas Pfaff, Senior Director, Market Practice and Regulatory Policy, ICMA

Christopher Flensborg, Head of Sustainable Products and Product Development, Skandinaviska Enskilda Banken (SEB)

Andrea Dore, Lead Financial Officer, Capital Markets, World Bank

Nicholas Pfaff

Good morning and welcome to everybody. I will start by introducing our panel.

- Andrea Dore is from the World Bank Treasury and is a Lead Financial Specialist. She was involved in some of the earliest green bonds, where the World Bank was a pioneer.

- Christopher Flensborg is a Managing Director at SEB. He is one of the key movers and shakers in the green bond market and is also a tireless advocate and international traveller. He has just flown in from California, and I think he went by Sweden and arrived this morning, which is quite an achievement.

We are going to have a short panel on green bonds and green bond principles. Before we get into the questions, I am just going to give you a quick update, first on green bonds and then on the green bond principles. What is a green bond? For those of you who may not know, it is a bond whose proceeds are dedicated to CO2-reduction purposes or wider environmental sustainability purposes: biodiversity, pollution, resources depletion, for example. As Martin mentioned, ICMA runs the secretariat of the green bond principles. They are two things. Firstly, they are self-regulatory principles. They provide guidance for issuers on disclosure and transparency. They also advise on the use of external assurance.

The green bond principles are also a community, whereby issuers, investors and intermediaries in the green bond market can express their support by signing up to the green bond principles and becoming members. There are also observers of the green bond principles, who may not be directly in the market, but may be stakeholders, for example assurance providers and NGOs. This community represents about 140 organisations today. It has its own governance. The governance is the green bond principles executive committee, with 18 organisations: six issuers, six intermediaries and six investors. The key role of this body is to update, at most annually, the green bond principles. For those of you whose organisations are already part of the green bond principles, we are having an update of the governance of the green bond principles, which is ongoing. There is a vote taking place, and I would encourage you very much to vote for this update of the governance, if that has not already happened.

Turning to my two panellists and starting with Christopher, as I mentioned, you are a key player, and you are also a member of our GBP ExCom. Can you give us your view on how the market has developed and where you think it is going?

Christopher Flensborg

I am going to focus a little bit more on why than how, because I guess you all want to know why you should get into this market and why not. Basically, we have seen a number of tipping points over the last eight years, ever since we were sitting in the room with the World Bank back in 2007, drafting the first mainstream green bond. The World Bank came out with eco bonds and coupons, and the EIB with climate awareness bonds, in 2007. In 2008, there was a mainstream bond launched to target five institutional investors in Sweden. Ever since then, we have seen a number of milestones.

People need to understand why they are doing this. It is important to understand that this is not only about engagement. There is a lot of value in this, and that is what we have learned on this development road. Basically, what has been going on over the last seven or eight years is a number of interactions between environmental and financial specialists where the values have been extracted. It started back in 2008, when we did the first issue, two weeks after Lehman went bankrupt. In 2007, when we created the instrument, everybody was raising the flag, going to find engagement. In 2008, after Lehman, people needed to understand why they were doing this.

What we learned is that climate, talking about mitigation, is having a lot of financial impacts. You know that, from the insurance industry, a reinsurer would never write a premium without knowing the statistics and prognosis on climate stress. They need to know when the next flooding is supposed to arrive. That means that there is a lot of financial interaction that needs to be understood, not only by the insurance companies but also by lenders who are actually lending to the projects and to farmers who are exposed to climate stress. That is one of the most important achievements by the green bonds, which is basically what has been going on over the last seven or eight years.

One good example of that was when we approached the Nederlandse Waterschapsbank, the Dutch water authority bank, which is basically financing the water protection in Holland. By interacting with them, we could suddenly share their experience of 400 years with the global financial society, teaching people about how to protect coasts and how to extract drain water from flooded areas. That is not only interesting but also heavily important. We know that from when we had Sandy hitting New York. That is basically what we have been seeing on the development of the green bonds.

On the other side, we have also seen a lot of other tipping points. We learned very early that, even though this was a very nice and very good product, it was not that easy to get people in. They needed to understand the motive or the value proposition for the individual drivers. What we have seen is that, slowly, investors like Zurich, BlackRock and State Street have been entering this phase, after they identified what the value proposition is, and after they have gained the insight that made them realise this is an instrument they can use for risk mitigation. That is what we have seen, at a broad level.

The last thing worth mentioning is the beauty of the green bond. The green bond is not a new financial instrument. It is basically just a replication. It is just a copy and paste of another instrument, meaning that anybody who can trade a bond, so all of us, can also trade a green bond, and you can use your existing infrastructure to engage. At the same time, of course, you need some kind of a quality control, hence the green bond principles and the verification that is part of a green bond.

Nicholas Pfaff

Thank you, Christopher. Andrea, the green bond market reached, last year, about $37 billion approximately. The World Bank remains a key issuer in this market and a founder. Can you tell us why the World Bank has been issuing green bonds and also perhaps what is the expected or hoped-for impact, both in capital market terms but also perhaps in terms of substantial environmental issues? Christopher, do not hesitate to comment on that also.

Andrea Dore

First of all, I would like to thank ICMA and all the organisers for this amazing conference. Thanks for the invitation to be here. The World Bank, like you mentioned, issued the first green bond in 2008. This fitted perfectly in the World Bank's overall climate strategy. Basically, this included trying to find innovative products that could help finance climate change. As many of you know, the World Bank is a global development institution that finances projects in developing countries. Many of the developing countries are those that are disproportionately impacted by the negative impacts of climate change. For the World Bank, therefore, that fit directly into the development mandate. That was important for the bank.

Just this week, we did our 100th green bond. We have issued over $1 billion of green bonds across 18 currencies. I recall being at that original meeting, like Christopher mentioned, when we had the Scandinavian investors, together with SEB. They wanted to support the climate and to make an impact, but they did not have the expertise to evaluate projects. They did not want to take the direct project risk, so they were looking for a triple-A asset, a plain vanilla bond, that they could invest in and where they could make a difference. That is the perspective of the World Bank in terms of the development of green bonds.

Since we have become involved in this product, one of the things we have seen is in terms of just the entire engagement. I work on the funding desk, issuing World Bank bonds, but now I get to speak to our environmental specialist. We get to speak to a lot of government agencies that are looking at that product. In fact, it is quite interest to see that, instead of speaking to banks just about business points, we are talking about the environment. What we have seen with respect to the green bonds and how that has evolved as a product is really elevating that discussion of climate change, taking it to the capital market forum.

From an issuer perspective, we are doing a lot more, not just in terms of raising funds, but the purpose of the funds. That is the fundamental thing about green bonds in terms of reporting on impact. You are supporting climate change issues; you are supporting projects that contribute positively to climate change. That is one key aspect, but also we are now providing information in terms of transparency to investors with respect to why we are raising these funds. Green bonds, as a product, like I said, are important for the World Bank from a development perspective. One of the other important aspects is that awareness component, really raising awareness in terms of those issues. Green bonds cannot solve the environmental challenges, but at least they are one part of the puzzle. They help. They are not the answer to deal with our climate change issues, but they definitely are part of the puzzle.

Nicholas Pfaff

Christopher, would you like to comment also on impact?

Christopher Flensborg

One of the things we have been going through a lot is the knowledge-sharing, creating an infrastructure that can understand and validate the drivers in climate and how they impact our balance sheets, creating an infrastructure that can assist with that transition. Also, it is very important that the value proposition is a key element of engaging in green bonds. This is not only about raising the flag, going in, saying, ‘We are also there.’ This is actually about exchanging information. It is about engaging with and using that information in a clever way. That is the real impact of green bonds.

Nicholas Pfaff

Moving to the green bond principles, and perhaps coming back to you first, Christopher, before Andrea, what kind of impact have the principles had on the development of the market?

Christopher Flensborg

The green bond principles, as a set of papers, are fairly loosely defined in the beginning here. They are a reference point, but they are also a point where people can get together. Having ICMA as the host of the green bond principles is fantastic. ICMA has recognition but also experience of acting in governing financial society. That means that, when investors or NGOs need to raise their voice and address the green bond principles, address banking society, they have one point of entrance. Rather than speaking to 10 different banks, they can go to ICMA and say, 'Guys, we have something to say about these principles.' What we have seen is that more than 20 North American investors last year got together, in an assembled letter, and gave an input on the green bond principles. They did not have to go to 15 different banks and come with 20 different opinions. They took one entrance to one receiver.

That means that we, in a structured way, can refine the principles, which are loose at this time, to address not only the purpose but also the form and structure of them. I would say that, while the green bond principles in themselves are a loose paper at this time, the structure and the hosting by ICMA is very good, and I will encourage everyone in this room to sign up to be a member, because this is the way we can grow this market.

Andrea Dore

They are voluntary guidelines, but they really create a framework. Like we said, the green bond market has developed. As we have seen, it started with multinational development institutions like the World Bank. From 2013 to 2014, we saw the green bond market coming from just a little over $10 billion to over $30 billion. We have seen all different types of institution coming in, whether it is corporate, utility or municipality. The green bond principles do help in terms of creating that framework that other issues could leverage on, if they want to access the green bond market. From that perspective, it is definitely a positive for the market.

Nicholas Pfaff

One of the other questions that has come up quite significantly, in the context of the current climate talks that are going to end in Paris this year, is as to whether the green bond market requires some form of incentive to move beyond the current level. The growth has been significant. We are at $40 billion, but that is still a relatively small market with respect to the wider bond market. Christopher, do you think that this market requires some form of additional incentive and should fit into these wider climate talks?

Christopher Flensborg

Yes, but I do not think it is going to be financial. There are a lot of discussions about pricing and different kinds of incentives. We have a very clear opinion on this. If you really want to go mainstream, you are talking about two fiduciary blocs, one borrower and one investor, that both have the same mandate, to get the best possible financial outcome. Unless the price is going to be the same, one of the parties is going to disappear. That means, to grow this market to be really mainstream, you need to come at the same price. Then you can talk about other incentives, like tax or regulatory incentives. When you talk about a tax incentive, it has the disadvantage that it is often short-lived; you do not know whether it is going to stay for two, four or six years. That means that institutional investors are unlikely to create big institutional strategies, meaning that it is not really benefiting structural capital shifts.

However, there are other incentives, like regulatory credit enhancement, for example. Allow lots of leverage, which is a very unpopular word these days, as bankers like to see it and the rest of the world do not. There is an argument that this is actually a clever thing to do, because we are facing increasing climate stress, which is having economic impacts. When you had Sandy hitting New York, you had interruption of business for several days – very, very expensive; you had the destruction of house values – very, very expensive. You have droughts in California right now, which are destroying farmer values. There are a lot of financial values impacted by climate stress.

You could argue that the long-term stability of financial markets might be stressed by this financial impact, meaning that there is a counter-value to the deleverage we have seen, so you might actually be allowed to do a little bit more leverage in climate-related areas to minimise the risk of financial instability in that way. Those kinds of incentives could be seen. However, what is much more important for all of us – because we all have a financial mandate – is not to wait for those incentives to come but to try to find out what kind of financial proposition there is in these instruments right now.

SEB, the bank I am working for, have identified a number of those. We have a much closer dialogue with our clients; we are learning a lot from our clients: from the World Bank, from KfW about energy transition, from the Dutch water authorities about water management, which we can use to advice the rest of our clients; we have a much more loyal relationship with our investors and issuers. I am sure that any of you who are willing to engage with this will see the same. That is the kind of analysis that needs to be done, rather than waiting for incentives. We do not think it is needed. We think they might actually be destructive, if done in the wrong way.

Nicholas Pfaff

Andrea, we discussed this yesterday and we had a conversation about the investment-grade nature of this market versus where it could go. I do not know if you want to comment from that perspective on the incentive question.

Andrea Dore

The market started with investment-grade, triple–A investments, like the World Bank, with the goal, hopefully, that investors would not only invest in this triple-A asset, but they would also go down that credit curve, investing directly in the project and taking the project risk as well. That is why it is great to be able to see all those different asset classes now being able to access the market and hopefully the investors. The really great thing about this product, and where we hope it will end up, is, like I mentioned at the beginning, the World Bank is really acting as a catalyst. Yes, the green bond has helped us in terms of diversification of investors; yes, it is a fundraising tool for us, but the ultimate goal is to really raise that awareness. We hope that investors will not only look at triple-A assets like ourselves, but will also look at investing, taking a direct project risk and being able to elevate that aspect in terms of the contribution across.

There is an additional thing for us, in terms of the different projects. One of the great things is that we have been able to communicate a lot with respect to some of the projects we finance in developing countries. We are financing putting solar panels on 1,000 schools out in China. We did a simple energy efficiency project in Mexico, just being able to put in 45 million more efficient lightbulbs into resident buildings. In one of the interesting projects that I liked very much, we were replacing refrigerators. We replaced over 1 million refrigerators in households in Mexico. That was an energy efficiency project. We gave those households financing to enable them to replace and buy those new refrigerators. After they had replaced the refrigerator, the savings from the utility bill were more than enough to pay for the new refrigerator, with a saving. It is not a complicated or fancy project, but it has a real impact.

For us, we want to be able to really communicate that information to investors, so they will feel comfortable not just investing in our asset class, but also taking on the project risk and seeing the real impact of the investment from a climate change perspective.

Christopher Flensborg

I would add an additional word to that. These are exactly the things we are learning. However, there are a number of things that are important in that context. We, as bankers and financiers, do not really know about climate, so how do we actually secure the labelling of 'green'? What is green and what is not green? We probably all have different shades of green. We all need to be in different boxes. We need to have some kind of system that assures that what we are doing is right.

The last word from our side would be that there has been some kind of inflow of engagement right now, where everyone wants to do green bonds. We compliment that. We warmly welcome competition and peers to join us, because this is important. At the same time, we also think that it is extremely important that those entrants take this seriously. Right now, Ban Ki-moon is standing up talking about green bonds; the White House is talking about green bonds; China is talking about green bonds. Everybody is actually seeing what the financial sector can do for society. We have a great chance; let us not destroy it. Make sure that, when you go in, you actually do green bonds and you know why it is green.

Andrea Dore

Hopefully, five or 10 years from now, we will not be talking about green bonds to get people aware of the climate change impact, it will be just part of the normal process in the capital markets area.

Nicholas Pfaff

I have a final question. With respect to the wider socially responsible investment sector, do you think that the green bond principles can have a wider application, for example for social bonds or SRI bonds?

Andrea Dore

Absolutely. There are four pillars in the framework: trying to identify clearly the use of proceeds and managing that process; coming up with criteria to evaluation the project, which is what we do with green bonds; how you determine that a project is green, which is what we have set up in our eligibility criteria, looking at energy efficiency and sustainability; and the last component is the reporting aspect. Whether you use the framework for climate change, climate change is one component of it. For instance, at the World Bank, all our projects are sustainable; all our projects go through the process of evaluation in terms of environmental, social and governance issues. However, for the green bond, you just focus on a subset, which is the climate change.

The green bond principles have created a framework focused on that subset, but it is applicable to other areas and you have other product. Apart from the green bond, we work on IFFIm, which is a vaccine bond, an excellent organisation whose purpose is primarily to raise funds for vaccinating kids. That is an application, in a sense, of that, so it can be used across the board, not just for green bonds.

Christopher Flensborg

From our experience, it is extremely important, when you do this, that you have very strict reporting, because you want to let investors participate in the projects. Unless you have a clear definition of what you are doing and transparency in respect of it, it would be impossible for the investors to actually take part, and that means they will disappear. It is important to have some very clear definitions and also some very clear reporting.

Nicholas Pfaff

On that, we are going to stop. Thank you very much, Andrea; thank you very much, Christopher.

[*Break*]

Martin Scheck

Welcome back, everybody. I am delighted to welcome our next speaker, Steven Maijoor. Steven is the Chair of the European Securities and Markets Authority. I think everybody here knows ESMA, but, just to labour the point a little bit, within the European Union framework, ESMA has an absolutely critical role to play. It is responsible not just for the direct supervision and regulation of certain market sectors, such as credit rating agencies, but also for the implementation of regulation that has been legislated by the European Parliament. Clearly, this is a very important phase that we are in right at the moment. ESMA is absolutely pivotal in getting the balance right between sensible implementation of regulation and allowing the market to function in a robust, resilient and efficient manner, to create jobs and growth.

Steven Maijoor was the first Chair of EMSA, appointed at its formation in 2011, and there are further details of his extensive résumé on the iPads. Without further ado, let me welcome you, Steven. Thank you very much for coming. We are looking forward to hearing your comments.

Priorities for a Capital Markets Union

Steven Maijoor

Chairman, European Securities and Markets Authority

I. Preamble

Thank you very much, Martin, for that kind introduction, but also already giving some policy advice, to some extent, regarding our technical standard-setting. Certainly, we are very much aware of the important implications of the current work that ESMA is doing, and I will also talk about that in my contribution. Let me first express that I am very happy to be back again at an ICMA event. It was last year in Berlin; obviously, I am very happy it is now in my home country. Thank you very much for organising it here, in Amsterdam. At the end of the day, the Netherlands and Amsterdam have a very long tradition in capital markets, so I think it is a very nice symbol to be here in Amsterdam.

What I would like to do in my contribution is, indeed, talk about the priorities of the capital markets union. As you are probably aware, the capital markets union was introduced by the President of the Commission, Juncker, in 2014, and it has been really impressing how the introduction of that term in 2014 has generated a lot of debates on developing capital markets in the EU. As you will understand, this is a very important topic also for EMSA, being the European Securities and Markets Authority. You will understand also that ESMA has heavily debated this topic in our Board and that we have reacted to the consultation.

I would like to start by giving the headline topics of ESMA's contribution to the capital markets union debate. In the second part of my contribution, I will talk about ongoing work, especially focusing on the current work on the well known acronyms, such as MiFID, MAR, CSDR, because, in themselves, they also should contribute to capital markets union and developing the internal market in the EU. I am sure that some of you will have an interest of your own in these important topics and the important work that is currently going on at ESMA.

II. ESMA's Contribution to CMU

1. Alternative Channels

Let me start with a couple of main elements of ESMA's contribution regarding the capital markets union. I will share with you four main headlines. First of all, the capital markets union will be about increasing the alternative channels to the banking system as a source of funding to the economy. In itself, we think that will really contribute to a more stable financial system. We have had the experience of a very strong concentration in the banking system, and you can expect that a financial system with more alternatives will be more stable and there will be less systemic risk, and, in that sense, it will be conducive to growth. It should also help in increasing the possibilities for equity financing of our economic system. Bank funding means debt funding. We know that the European economies are highly indebted and that we should try to get more equity into the system. That can be delivered by a capital markets union.

Let me talk very briefly on one channel that is heavily debated within the development of these new alternative channels to the banking system. One that is discussed very frequently is the securitisation channel. I would like to emphasise that there are already many reforms underway for this part of the market. In response to the financial crisis, we have seen more transparency on securitisation; more information on the underlying loan portfolio; obligations for skin in the game for those that originate securitisations; and also there is now the supervision and regulation of credit rating agencies. Any further development of this channel needs to take into the account the reform that is already underway.

2. Investor Protection and Participation

The second essential element of the capital markets union will be investor protection and investor participation. There is a lot of focus on the relationship between the funding channels and the companies' economic activities, but we should also realise that a change in our financial system, moving to a capital markets union, will also require different saving behaviours, especially on the retail side. We know that, on average, the typical European household saves via deposits, has fairly limited investments directly into the capital market, and, if you want to achieve a capital markets union, it also implies that the saving behaviours of retail investors need to change in the EU. That required investor protection. People are willing to participate in the capital markets only when they are well protected and feel comfortable to participate in the capital market. Obviously, that is relevant not only for the retail investors, but also for the institutional investors. Fair, clear and stable financial markets will be an essential part of the capital markets union.

3. SME Funding

The third general topic I would like to address regarding the capital markets union is the access to funding for SMEs. To some extent, you could argue that, in the European environment, we already have a capital markets union for the larger listed companies. The larger listed companies have a quite diverse European and international investor base, and we have been successful at a European level in getting to a CMU for the larger listed companies. The problems are for the smaller listed ones and for those SMEs that are considering going public and would like to attract investors from across the EU. In our view, that centres on information asymmetries and the problems for an investor in assessing the risks of an SME located in another member state of the EU. To address these information asymmetry issues, it is important that we progress on the standardisation of credit information and accounting information, and on the prospectus directive, trying to get to a situation where they are better able to assess the risks involved in SMEs across the EU.

4. Supervision

a. Consistency

Let me, then, move to the fourth and final general comment on the capital markets union before I move to the specific issues of our current work programme at EMSA. That relates to supervision. A successful capital markets union will imply a bigger capital market, and a bigger capital market means that you need to have improved supervision and better identification of the risks in the capital markets. There is also another role for supervision. If you have the single rulebook, with the same rules across the EU, they need to be supervised consistently across the EU. You will not have the idea of a single internal market if all 28 national regulators give different interpretations to the same rules.

b. Data Collection

Let me first focus on the point of better supervision in the EU. Securities and markets regulators have a limited tradition of collecting data on the non-banking sector and analysing these for risks in the financial system. That is currently being repaired and, as you probably know, there are many pieces of legislation that now require data collection and data provision by market participants to be shared with the national regulators and with ESMA. We fully understand your concerns in terms of data cost, etc. At the same time, you cannot supervise in the dark. We need to have these data to better understand the risks in financial markets, and it is now our obligation, both as ESMA and as the national regulators, to make sure that the data that are collected are used in a proper way, that we apply the right IT and that we transform that into useable action points regarding risks in the non-banking sector. I can assure you that, for the years to come, in ESMA's strategy, this issue around data collection, making sure that it works, will be important.

I would especially like to mention one element here, which is that 16 countries have recently decided to allocate the responsibility for the collection of transparency data for financial instruments to ESMA. For these 16 countries, ESMA will do the data collection. There will be the website at ESMA where you will get this information on the transparency data for these financial instruments. We think this can really help this one-stop shop to contribute to the single market.

c. Convergence

Let me then move to the point on supervisory convergence. It is not only about the identification of risks in financial markets; it is also about consistent supervision across the 28 national regulators. We know that there are still substantial differences in the way national supervisors supervise the EU requirements. We recently published a study on the national supervisory practices regarding best execution. We went to the national regulators and have shown publically the outcome of these assessments. You can, for example, see wide divergences in the way best execution is supervised at the national level. This means that we need to progress on that, and supervisory convergence will be important for our programme, as EMSA, in the years to come.

There are two elements here. First, this will be long, hard work. It is less visible that the single rulebook. Making a rule, to some extent, is easier than making sure that it is supervised consistently. Secondly, it is about having the right toolkit, as a regulator, to do that, and I think we can improve the powers of EMSA, for example, to ask for information from national regulators on their supervisory practices, and also the ability of EMSA to make public the outcomes of what they find at a national level.

III. ESMA's Tasks

1. Harmonised Framework

These were my main general remarks on the capital markets union. Let me now move to the specific task we are currently involved in. This indeed relates to all these horrible acronyms like EMIR, MiFID 2, MiFIR, MAD, MAR, CDSR. These rules and regulations were implemented in response to the financial crisis and had a strong stability perspective in mind, but we should not underestimate how, alongside, they really have improved the single market in the EU. If you are looking for an example, in the post-trading area, everything that has to do with CPPs, CSDs, OTC derivatives has really progressed in terms of getting to a European harmonised framework, alongside, indeed, being a safer system. Even the work we are doing currently, then, contributes to the capital markets union.

We are focusing currently on MiFID, MAR and CSDR. This is about trading venues, market abuse and the CSDs. This is one of the biggest pieces of legislation that we need to deliver. It is all about technical standards, making sure that the high-level legislation, with these technical standards works as well as possible on a day-to-day basis. Let me make three brief comments on transparency, settlement discipline and the extension of the scope of the market abuse requirements.

2. Transparency

Transparency in the bond markets is probably one of the hottest debated topics at the moment in the specialised circles in this area. The whole question centres on: if you go to more pre and post-trade transparency, will it develop markets; will it help markets; will it harm markets; or – to use some of the wording used – will it kill markets? Our view is that, if you calibrate it carefully, if you do it in a tailor-made way, it should help and it will help capital markets. Indeed, when there is very limited liquidity already and you move to more transparency, there is the risk of a further deterioration of liquidity and that you come into a vicious cycle in that respect.

At the same time, if you are looking at the experiences of other regions of the world that went through this process, the negative effects are only there when there is really a very illiquid market. The harm is especially in those cases. For those of you who are a bit more into these discussions, we have had heated debates about whether we should do the analysis of these new transparency requirements at the level of categories of bonds or at the level of individual bonds. This has added to the already long row of acronyms; we now have COFIA and IBIA. I cannot tell you today where we will end up, as ESMA, but we have to take that decision in the coming weeks. Obviously, we will come with the best possible solution, very much aware of the pros and cons of each solution.

Let me just emphasise one element. This part of our regulatory work has been supported by extensive data and evidence collection, and I think it belongs to one of the pieces of European rulemaking with the most extensive evidence and data set, before we draft the rule.

3. Settlement Discipline

On settlement discipline, the essence is: how can we further reduce settlement risk and settlement failure in the financial markets? This relates to the so-called buy-in regime: who should buy in and who has the responsibility for the buy-in when there is the risk of a settlement failure? We are, on the one hand, very much aware that we do not want to change fundamentally the business model, with big implications for collateral. On the other hand, just leaving that responsibility with the trading partners will be a too-weak system, so there we also need to take the right decision.

4. Market Abuse

The big change, of course, is the placing of market abuse requirements not only on the regulated markets but also on all other trading venues, bringing into the market abuse requirements all kinds of new financial instruments, like derivatives and emission allowances, and this is really new territory, both for the markets and also for the regulators, so that needs our close attention.

5. European-Level Decisions

Finally, before I reach a conclusion, let me make a few further remarks on supervisory convergence. While we are working now on this legal text, it is extremely important that this part also will be implemented as consistently as possible across the EU. The good news is that, in some areas, although the basic model will be a model where the supervision will be done at a national level, some important decisions can be taken at European level to promote convergence. When there is going to be, at a national level, a waiver of the transparency requirements, there will be the need for an opinion first from the ESMA Board of Supervisors to ensure convergence and consistency of these waivers across the EU.

6. Intervention Powers

Secondly, I would like to mention the so-called product intervention powers. We will get the powers, both at a national and a European level, to ban certain products when they would be detrimental to the financial markets. If you are looking at the bond markets, there have been some cases of mis-selling, in the past years, to retail investors, and it is very good now to have these powers from the perspective of the mis-selling scandals in some parts of the bond markets. We know it has been limited mis-selling, but there have been cases of mis-selling related to the retail investors in the bond markets.

IV. Concluding Remarks

Ladies and gentlemen, I am sure that I need to round up, so let me try to summarise as quickly as possible. The capital markets union is a very good initiative and very much supported. It should really help bring about a more stable financial system that is also more competitive, and, overall, should increase the availability of financing to our economy. This is about integrating the capital markets of the 28 national member states. Of course, that process has already been developing and ongoing for four decades, going back to the development and origins of the EU. What we need to do in the coming years is accelerate that process, and, if that acceleration is accomplished, I think the CMU will be successful.

At the same time, we should not forget that a lot of the new requirements that were developed in recent years can contribute to the CMU, and it is very important that we implement and apply them in a sensible way. Let us work on that together. Thank you very much for your attention. Are there any questions?

Liz Callaghan, ICMA

I have a question on the whole liquidity-determination area between COFIA and IBIA. If it is COFIA and you have a situation where you have either a bond or, indeed, a class of bonds that are illiquid, as it stands right now in MiFID, the entire class of bonds would have to be illiquid across Europe in order to change the liquidity classification. There seems to be no dynamic method of changing something that is deemed liquid when, in fact, it is illiquid. Is there any thought to having a dynamic mechanism to allow, quickly, a very market-responsive type of process, to change from something that is falsely advertised as liquid to illiquid?

Steven Maijoor

As you rightly say, this is about whether to assess liquidity on the basis of a group of bonds or at the individual level. Both systems have their pros and cons. One of the issues raised with COFIA is the misclassification of shares, where liquid shares are classified as illiquid and vice versa. The question is, indeed: can we quickly change these technical standards? The answer is not an optimistic one. The reason is that the way ESMA needs to work with making these determinations is that we need to use a regular technical standard. We have already said many times to the public that we need to have more flexible instruments to react to market developments. The liquidity issue is precisely one of the issues where that would be difficult, because, if it is framed in a technical standard, you would need to go through the regulatory process to change it. That is typically six to nine months, which might be too long to react to possible problems.

This relates not only to this issue; we will face similar issues with the so-called clearing requirement for OTC derivatives, where you would like to have a more flexible instrument, and also the trading requirement for OTC derivatives, where, indeed, when liquidity dries up, you would like to intervene quickly. We have been very vocal with the co-legislators to try to find a solution where we can react more quickly.

Godfried De Vidts

Everyone has the question on their lips but nobody dares to ask. On CSDR mandatory buy-in, we have done a lot of work as industry. Are you contemplating asking for a delay for the mandatory buy-in implementation from January 2016 until after T2S or not?

Steven Maijoor

We are in the middle of finalising our technical standards, and, in the standards, there will be the final implementation. We are very much aware of how it interacts with T2S issues and having the right timing there. I cannot finalise at this stage what the final outcome is. The only thing I would say, which, to some extent, is related to the previous point, is, as such, there is no power for ESMA to select and decide on that date. It is one of the limits to our powers, to select a date and say, ‘Let us put it there.’ Let us keep that there. We will have to take a final decision on this one in the coming weeks. Thank you very much.

Martin Scheck

That was wonderful. Thank you very much indeed. It is much appreciated that you came here today. Let us move on to the next panel, which is on two of the most important areas to most of ICMA’s members, namely the primary and secondary debt capital markets. We are going to have Martin Egan to moderate this panel. Martin is the Global Head of Primary Markets and Origination for BNP Paribas, and he is also a Board member and Vice Chairman of ICMA. Importantly for us, he has been chairing our Primary Market Practices Committee at ICMA now for many, many years, so has a great experience in that area.

We will have an introductory comment from Kitty Yoh. We are very grateful to Kitty for making these introductory comments to set the scene for this panel. Kitty has been appointed to the ICMA Board recently. She is Deputy Treasurer at GECC and one of the best known and most experienced practitioners in the primary debt capital markets globally, I think it is fair to say.

Developments in Primary and Secondary Bond Markets

Kitty Yoh

Deputy Treasurer, Long Term Funding, GE Capital

I. Preamble

Thank you very much, Martin. I am very honoured to be part of this panel, addressing a subject that, as has been discussed a lot in the past day or so, is of incredible importance to all of us. For issuers like GE Capital, the debt markets have provided a vital source of financing for us to run our businesses. For the buy side, they have provided an investment vehicle that has generated returns, satisfying both the fund managers and their clients. Finally, for the general business sector, they have been a vital source of financing, which ultimately influences the global health of the economies that we all live in.

II. Market Dynamics

1. Benign Climate

Many of my observations will be familiar to those of you who attended the sessions yesterday and this morning. 2013 and 2014 were an extraordinary period, in the sense that central banks took actions that provided a very benign climate for issuers like GE Capital and also, in some ways, for the investment community. We have seen, as a result of that, record issuance in Europe and the United States in many sectors; expansion of the type of products made available to both issuers and investors; and, in certain instances, an expansion of available credit to investors and issuers who are smaller institutions and perhaps also of lower credit.

2. Challenges Ahead

However, it is the fundamental truth of any market that there are cycles, and I personally believe that we are at a crossroad here in the debt markets and will, indeed, see more challenging circumstances facing all of us as we go forward. We have already seen, as has been remarked upon, much greater volatility in interest rates. This has been followed by volatility in credit spreads. We have also started to see more distancing in the economic conditions in the United States versus those in the eurozone and in Japan, meaning that the relative central banks are going to need to make individualised decisions as to how to handle the situation for their particular economy, while also taking account of what the greater impact is on other countries.

3. Geopolitical Event

We also continue to experience geopolitical events that sometimes overshadow market events. Greece’s challenges are very close to home in Europe, but the situation in Russia is also something that we all monitor. The turmoil in the Middle East continues, and, as we see, in the UK, voters are going to start voicing their view on whether or not they should remain a part of the EU.

4. Regulatory Changes

In addition to all these market circumstances, there has been a strong theme of the regulatory changes, which, as we all know, continues to evolve and will continue to provide a challenge to the ability of this market to really deliver what it has done historically: that is, an issuer's ability to fund efficiently, an investor's ability to invest effectively and a dealer's ability to, quite frankly, underwrite and support the bond markets, while earning a respectable return on capital. After all, everyone is here to remain in business, and we need to acknowledge the realities of that situation.

Dodd-Frank Volcker in the US, LCR, NSFR, TLAC, MiFID, the FSB's initiatives around shadow banking and other reforms in Europe will continue to profoundly affect all of us. Concerns about reduced secondary market liquidity are a by-product of some of these effects, and enormous concerns have naturally been raised about the ability of the market to continue doing what it is supposed to. Some have called for standardisation. Whether or not that will create a more homogenous, less fragmented corporate bond market is being studied by many, including the Bank of England via the FEMR review, and, as we have heard, the European Commission, on capital market standardisation. It will raise a lot of lively debate for all market participants, as we consider the implications.

All of these initiatives have a laudable goal. Fundamentally, they seek to ensure that markets function in a safe, fair and ethical manner. Those of us who lived through the events of 2008 and 2009, and, frankly, sadly, some of the more recent events, such as the Libor fixing and FX fixing situations, absolutely understand what the regulators are trying to achieve. The challenge is how to balance those goals with giving issuers, investors and dealers the flexibility to meet all the diverse requirements that are being voiced here.

III. Concluding Remarks

The reason the bond markets have survived these many years – and I have been a participant in them for close to 30 years – is that the markets have always found a way to adjust to changing circumstances. That is the challenge that faces all of us, and ICMA can provide a very valuable forum for these issues to be debated and for all of us to engage in advocacy, because, at the end of the day, we need to find the compromise solutions that will result in the best balance between the regulatory concerns and the concerns of investors, issuers and dealers so that, in essence, the market can continue to be the source of capital that it was always designed to.

With that, I will turn it over to Martin to get into the panel discussion.

Panel: Developments in Primary and Secondary Bond Markets

Moderator:

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

Panellists:

Michael Gower, Treasurer, Rabobank Group

Anne Leclercq, Director Treasury & Capital Markets, Belgian Debt Agency

Rutger Schellens, Global Head Capital Market Solutions, ABN AMRO

Roman Schmidt, Global Head of Corporate Finance, Commerzbank AG

Kitty Yoh, Deputy Treasurer, Long Term Funding, GE Capital

Martin Egan

Thank you very much, Kitty, for those excellent words, which really set the tone for our panel. We have all enjoyed the conference so far, and the plan behind our panel is to get down to the nitty gritty of how it is affecting key market participants. I would like to start by asking all our panellists, and going to Anne first, since we were here last year, how has 2015 been for you as a key user of the marketplace?

Anne Leclercq

As you know, Martin, we are a sovereign issuer, which means that we are a frequent borrower. Therefore, we have to continue to adhere to our strategy, which is predictability and liquidity. Of course, being only a medium-sized borrower, we want to have to have a bit of flexibility in our issuance programme. We do that by being very responsive towards the market when choosing the lines we are going to auction, and by creating instruments that are tailor-made. This gives us the opportunity to diversify our investor base, because, once an investor has been investing in our special instrument, he might be interested to buy our OLOs.

In terms of debt management strategy, we continue on the same path we started on in 2010. We continue to lengthen the average life of the portfolio. The idea is that we need to have an average portfolio life of about eight years, which is quite long; it would be the second longest in the eurozone, after Austria. I believe that we will be able to do that by the end of this year. It is very important for us, because it helps us to stabilise the service cost of our debt. As you know, we have a debt-to-GDP ratio that is quite high. If we can stabilise the deficit from that point of view, it is certainly a very good development.

If we translate those two elements – the strategy and the debt management strategies – into what we have done last year and during the first four months, we have done substantial front-loading already; we have done 60% of what we have to do this year. Moreover, we have done quite some issuance in different instruments. We have done some dollars; we have done some sterling. We are still looking at the possibility of doing some inflation-linked and have also been able to issue at around 12 years; most of what we have done, all together, is around 12 years. It is meeting what we really wanted to do.

Looking at what we are going to do in the future, which is only 40% of what we have to do this year, we are still planning to do – if possible, of course – a very long syndicated issue. For the moment, the market is a bit too volatile, so I would say that the code word for that very long issue is 'wait and see': look where the markets are; look what we can do now; look what we can do in September. On the other side, we also try to continue to diversify with different instruments. We are very keen to do something in dollars or continue to do something in sterling. Most of the time, we try to do something above seven years. We also want to continue to be very flexible, so we listen to the market and try to find out where it is, in order to make auctions that are as successful as possible. As I said, though, the auction amount that we still have to do is quite small, as we did quite some front-loading.

The last element I would like to mention with regard to issuance strategies is, as I said, there is a possibility of doing some inflation-linked under the EMTN programme. Inflation expectations have been rising, so the possibility of eventually doing something there is quite high.

What is the main challenge? If we move away from the issuance, the main challenges are, number one, liquidity, number two, liquidity, and number three, liquidity. Liquidity is really something we are very careful about. We try to adapt part of the issuance strategy, but also part of the incentives, towards the primary dealers, if necessary, in order to create the liquidity that is necessary in the market.

Martin Egan

Very good, thank you. Michael, you are one of the most experienced borrowers in the marketplace. What do you think about 2014 and 2015 for Rabobank?

Michael Gower

It has not been easy. Seeing Kitty here makes me go back to 2003-2005, remembering the days of being triple-A and trying to always catch up to your issuance volumes. That is a long time ago. We hit a high of around €47 billion in 2009-2010, never quite managing to get to your €50 billion. That is now cut down by half, so the world has changed. Listening to the comments this morning and yesterday, the regulatory environment we cannot escape as being the dominant factor in any bank strategic decision-making around market approach over the last 12-18 months. A lot of concerns or challenges we face as a bank have not been so much on the liquidity side, but more around the regulation and the demands on the capital side. Of course, Rabobank has always been a very highly capitalised bank; we have always relied on wholesale markets to raise equity or hybrid capital, and that has very much helped the senior debt strategy, which has been a well known and well established part of our toolbox.

The market really has changed over the last 12-18 months. Investor awareness, investor scepticism, unintended consequences of attempts to, with good will, pacify the market and make it safer, better performing and more predictable for all, have made banks very apprehensive, Rabobank included, about actually being able to go and make statements and raise capital as part of a longer-term strategy.

Our view has always been that we have looked to try to identify not necessarily the letter of the regulatory intent but rather the spirit of the regulatory intent behind the action. We have done that for a number of years in the way we have raised capital and liquidity, in terms of both markets and structure, but it is getting more difficult. At the end of the day, our view, quite simply, is that the desire globally, not only in Europe but also in the US and in Asia, is for the regulatory system to have a higher quantum of capital in it, come what may. Our approach to that has been one of acceptance and, as a result of that, activities have been very much geared towards balance sheet optimisation, absolute levels of capital and future planning in that regard, but, to echo points made before, are there concerns about liquidity as we raise those instruments? Absolutely, and that is a significant concern for the future.

Martin Egan

We are going to come back on the liquidity subject in some detail a bit later, but it has been a recurring theme throughout the last couple of days. Rutger, from your activities, how has it been?

Rutger Schellens

It definitely has changed. Everything that has been said I will not repeat. The capital impact is huge. We restarted ABN AMRO five or six years ago, and we had to adjust our strategy. We did so last year. We really geared it towards the full value chain of the core customers of the bank, from primary to secondary, not only being able to offer our clients capital market solutions on the origination side, but also being able to speak directly to the core investors for those capital market instruments, so the European investor base. We feel we have adjusted the model as such that we can operate and have a profitable business, given the hugely increased cost of running that machine.

We are on the run, as you probably all have heard, towards an IPO, which is also quite a detailed process. Capital management and having clarity about your plans around capital management and balance sheet management, are crucially important, so the agenda is definitely geared towards that.

Martin Egan

Roman, you are right in the thick of it. Tell us more.

Roman Schmidt

This year has been very good for us. If you look at it, being the second largest German bank, we have 110,000 corporate customers. The corporate bond market has been very, very good. As you know, the overall euro issuance has been 50% more than last year, so, so far, we have seen good markets for us. In some areas, like covered bonds, for example, and financial institutions, everybody had a very good start to the year. It is slowing down a little bit. We have seen SSA issuance being 30% less this year, year on year, than last year, which is probably due to the lower-interest-rate environment. From my point of view, cooperative relationships are back at work, and we have been profiting from that over the last years.

Martin Egan

Kitty, as you have told us already, you had a very dramatic last few months, at least.

Kitty Yoh

In terms of funding, the needs, last year and this year, were substantially smaller than we had experienced in the past. Just to give a sense of magnitude, 2007 was sort of the high point, when we did something in the order of about $90 billion of funding in one year. Because of that, what we had done is a great deal of diversification. We were issuing in 15-plus currencies. Then, market by market, we were very careful about developing our investor base, whether there was retail there, middle market or just institutional. As we had a smaller funding programme, like we faced in the last year or so, we obviously benefited from all that previous work. What funding we had to do, therefore, we were able to get done very efficiently at very attractive absolute-yield levels and also spreads.

I alluded to the fact that, in the last couple of months, you have seen much greater volatility, and so that means, obviously, that you have to choose your windows carefully. One of the things that, as a company, we announced on 10 April is that we were going to make ourselves much smaller and be very focused on what we call three vertical businesses, which are aligned to what GE Industrial does: aircraft leasing, energy financial and healthcare, and basically sell the rest of our portfolio, because, to be honest, the cost of regulation was too great for us to be able to efficiently hurdle, given what our requirements were for return on capital. We are experiencing, therefore, first hand, some of the decisions that arise, given this new environment that we live in.

Martin Egan

It is clear that, thankfully, all our panel participants have had a pretty good end of 2014 and 2015, but there are obviously some headwinds in play. If we look at the marketplace even in the last few days, volatility is back with a vengeance, even thinking back to the beginning of the year with the dramatic moves in the Swiss franc market. Is this volatility good or bad news for you, Michael?

Michael Gower

It makes life interesting. The real lesson we have learned – and, to be fair, it is an approach we have always taken – is that we are benefiting now, to Kitty's point, from the work we have done in the past. The execution approach has had to be a lot more razor-sharp in its form than in the days of lackadaisically watching books build and gentle waiting for investors to return with feedback. We are just not able to take that type of market risk anymore. What that has also led to, strategically, is, when people are planning processes at company and board-directional level, assumptions about available liquidity and capital are simply not as hard and fast as they used to be. We can have good intentions about going into market *x* with structure *y*, but, despite a planning process, if there happens to be significant volatility and you wake up and the Swiss peg has dropped, all bets are off. Speed of reaction and execution has become vital.

Martin Egan

Anne, does this recent volatility scare you? We have seen pretty big moves in the European rate market.

Anne Leclercq

Yes, indeed. I would say, as a sovereign, we rather prefer a market that is a bit more stable. However, on the other side, as our market-makers are all primary dealers and bankers, a bit of volatility, most of the time, can also help to raise the profits. To that extent, I believe that some volatility is not too bad, as long as it is not too much. Now, when I look a little bit at what we have seen in the last month in investor flows – and I am thinking only of the first four months, because we do not have a great view on what has been happening in the month of May – the big theme was a lack of duration. We saw that with fund managers, with central banks and also with banks. When you look at different geographical zones, we have seen quite a lot of banks coming in from peripheral countries, trying probably too much, which they had to do for LCR reasons.

The only figures I have at the moment on the month of May show that volatility has been, to some extent, not really helping the P&L of the banks. I see Martin looking at me. We have seen a 25-30% decrease in turnover in the electronic inter-dealer market. From the talks I have had with the primaries, I believe that the decrease in the customer market was not that much, but I certainly believe that there was a change in attitude from customers, because we have seen more investors going to the shorter end and into sovereign debt as some kind of parking place, until they decide on where the markets are going.

Martin Egan

If we look at the themes we have been looking at already, volatility and regulation, Roman, how is the maelstrom of regulation affecting your day-to-day activities?

Roman Schmidt

It feeds a little bit into volatility as well. The regulations we have seen clearly mean that we have less trading inventory. With less incentive to have trading inventory, we all basically, as market participants, just let prices go. What we have seen over the last one and a half years is that, every time we had a government state intervention, whether it was ECB on QE, whether it was the Swiss National Bank, everybody was feeling extremely sure about certain positions, on the Swiss franc and the government bond securities as well, and being long bunds seemed to be a pretty safe bet over the last months. After that turned around, you did not have that much resistance anymore. That, paired with less market-making, makes the market do what they normally do: i.e. they will go where the most pain is, and the most pain obviously was with bunds, all the way up to 92BPS.

Martin Egan

Rutger, for you, is regulation dominating everything?

Roman Schmidt

I do not know that it is dominating everything, no. Before 1 January, we were complaining that there was not enough volatility; now we have seen some volatility. It is like the weather sometimes. We saw similar volatility in 1995, where, in the first half, we had a huge swing and the bund did go down. I think it is a little bit of unpredictability, not on fundamentals but individual and regulatory actions, for instance by the Swiss National Bank, having an impact on that market. It is that unpredictability where are lot of the core investors are wrongly positioned or want to change their portfolio, and the capacity in the market to warehouse some of that volatility has gone. That is a side effect of all the regulatory changes we have seen. It is not intended, but it is there, and we have to ensure we make the regulators aware of this. I think they are aware, but we have not seen any action so far.

Martin Egan

We are quite happy to work with regulators to define better regulation. We are now going to ask the audience a very simple question: what would be the main effect of EU regulations on the debt capital markets? Is it a permanent drop in overall capital market activity; limited supply of investments fuelling further liquidity risk in the secondary market; too many unintended consequences to consider; none of the above – the market will adapt? Let us vote now. We have some music as well.

[*Votes cast*]

What is the answer? Look at that. What is interesting, bearing in mind what we have discussing over the last few days, is the quite broad sweep in terms of replies, which suggests that we will all have to work ever more closely together with regulators to improve the future market aspects.

Rutger Schellens

It shows that this is a meeting of market practitioners and the International Capital Market Association, because 33% of you think that the markets will sort it out. That is what I believe as well. The markets have always sorted it out and they will sort it out.

Martin Egan

I would have voted for that as well, but perhaps I am the eternal optimist. Moving on, something very close to the hearts of many of us in this room is the new level of focus around market practice across the board. For many of our seasoned borrowers especially, they are very much part of the equation. We are trying to get more transparency in the marketplace; we want borrowers to be part of an execution process. I would like to start with Kitty. Obviously market practice is under close inspection. Are you happy with market practice currently around your new-issue deal execution or does anything particularly concern you?

Kitty Yoh

Speaking from our perspective, we work with a group of dealers with whom we have had a long relationship and they have earned our trust over many years. We think that they act in a very fair manner in terms of the advice that they give us. They actually tell us not to do a transaction in certain markets if the true belief is that it is not a good idea. They have been with us on visits to the buy side and we are aware that there is a very deep discussion on the other side with what investors are looking for. In our transactions, therefore, we have always felt and continue to feel that the deals are allocated in a fair manner. We look at how the allocations are done. We do not necessarily jump in there and insist that we are a participant in the process, because, if you are using five lead underwriters on a transaction, that would not be the most efficient thing to do, but we do look at the list of people who put orders in, cast an eye on the allocation, and it always seems to us to be done in a way that is very logical and fair. I cannot say that we have anything to complain about.

Martin Egan

Obviously, with this regulation on one hand, illiquidity on the other, it must make it more difficult overall to execute deals. Michael, you have issued many different instruments over time. Are you still happy with the market practice of today around deal execution, or do you think it will evolve into a more constrained practice?

Michael Gower

Constraint is clearly there. People are concerned. I must say, echoing Kitty's comments, we are very happy with the dealer groups that we have. Again, we have worked with certain institutions and individuals for many years, and I think that is a very important part of the execution process. One aspect we have always felt very strongly about is that every transaction we do is very much our transaction. If, heaven forbid, a deal does not go well, it is very much our problem. You cannot be in the blame game. You cannot say, 'Well, the underwriters did it badly. Things were badly allocated. The process was not up to scratch.' It is very much the issuer's transaction.

Translating that into the allocation process, we very much allocate securities, from an issuer's point of view. To the extent that the dealers are paid to underwrite and distribute, that is what we ask and expect them to do. Therefore, from the perspective of allocations, we are quite comfortable that the allocations that happen are allocations, and it is our transaction. Everybody has to play their role. From a liquidity point of view, we expect them to provide that in the secondary market, but, obviously, regulation has constrained that. Our solution has been to ensure that we provide a lot of liquidity in our own paper, and that is something that the buy side has certainly recognised over the last number of years.

Martin Egan

Anne, from your perspective, do you get the service you need around new-issue activity?

Anne Leclercq

Up to now, we have certainly got the service that we needed, but I agree with what Michael said. For the issues we do, it is our issuance, because a syndication is indeed a tri-party transaction, but, finally, the issue is a contractual agreement between the issuer and the investor, and, when something goes wrong, it is mainly the issuer who has to be blamed, so he should be in the driver's seat, together with the lead managers. With regard to the allocations, we are really part of the allocation cause, because we also believe that, after having done 250 one-on-one meetings during 13 years, we probably know our investors to some extent – not everybody, but at least most of them – and we probably also know how they will react and how we should be allocating some of the bonds. We really believe that being part of the syndication process is a plus, not only for the investor but also for the banks that are there, because they will be acting much more as a team when the issuer is in the driver's seat than when the issuer is not in the driving seat.

I would like to add something there. I have been reading the handbook on primary markets that has been made by ICMA. I fully subscribe to it. I think it is a very good idea to lay out different market practices and to give some clear definitions about some of the different elements of the issuance process. However, I think it is very wise to keep a little bit of flexibility, because, as is mentioned in the primary market handbook, a syndication is an art, not a science, and, every time you stand in front of a new syndicated issue, you always find something different.

This being said, I would like just to add a little critique on the primary market handbook. I really believe that there should be a bit more place in the primary market handbook for the issuer. The tri-party transaction has been clearly described with regard to the roles of the investor and of different banks, but, to some extent, it is an opportunity to make the investor more involved in the primary market transactions. If you do that, the primary market handbook will be more valuable and accepted through the whole of the community, not only the investors but also the banks and the issuers.

Martin Egan

We are taking all these notes. For those who are not aware, we have a number of recommendations around market practices. I am very glad to hear that our issuer practitioners are pleased that the visibility on the activity is pronounced. Your point is fair: all participants want direction and help, and we think we should be offering that service via ICMA. Is there anything to add about market activity?

Roman Schmidt

The main thing, really, is about transparency. We have come a long way in the last years, if you think about opening up each other's order books: when an order comes in, everybody sees it at the same time. There is already a lot of transparency and we all need to work together on that so there is a better understanding for the allocation process.

Rutger Schellens

It would be transparency and the definition of the role of the market-maker versus market-user.

Martin Egan

We are going to have another question now, which is going to confuse you because it is completely unrelated to everything we have discussed, but we are quite keen to have the answer to it, and then we will crack on. The question is: will we see more direct lending and disintermediation of banks over the short term? This is just to make sure you are thinking about all aspects of activity. The answers are: yes, due to regulatory constraints from bank lending; no – bank lending, together with some diversification, will continue to provide sufficient funding; it is impossible to tell until the overall macro and regulatory climate stabilises. We have discussed this a lot over the last few days, so we thought we would throw it into the mix. Press your buttons now. Let us have that very cheap music.

[*Votes cast*]

There is a reasonably strong acceptable of the first answer, which is fairly rational, but to see 44% not as convinced is an interesting dynamic.

This panel has been in the marketplace for many years, with lots of experience. We now have truly terrible secondary market liquidity; that is provocative, possibly. Will we see this return? For all of us, it is incredibly relevant, as practitioners, borrowers, underwriting banks and trading institutions. What do you think about secondary market liquidity? Roman, I will start with you. You are very experienced in many aspects. Will we see market liquidity return?

Roman Schmidt

That has been an eternal question over the last 28 years, since I have looked at it. From my experience, market liquidity is not really about market-makers getting together and saying, 'This is what the bid-offer spread should be.' Market liquidity is a free market result. If we have less volatility in a very benign market, everybody is happy to quote spreads, and spreads come closer and closer, and that goes for the equity market as much as for the fixed income market. Over the last weeks, we have seen a lot of volatility, but, in the one and a half years before, we basically have seen a one-way market, which was basically: you have to hold government bond securities and credit spreads are going to come in. If you look, over the last one and a half years, every market participant is trying not to outdo, but to mimic, the next one. That means that you have, broadly, only buyers of credit for a longer period of time, and who is going to make a two-way market then? This will only come back when we start trading in ranges again and when the big themes, as in credit tightening or buying of government-bond securities, are out of the market.

Martin Egan

Kitty, if you also throw in higher rates in the US, what is that going to do to market liquidity?

Kitty Yoh

The way I would phrase the market liquidity question is that we need to take a step back and say: what does that symbolise; what is it intended to achieve; has the market experienced some fundamental changes so that we might need to look at it a different way? Market liquidity, when you come right down to it, is the desire by the buy side to be able to buy and sell securities at a reasonable bid-offer spread in lots that they would find suitable for the portfolios they manage. That is it, at its very basic. For an issuer, if you have a market that can accommodate that, it speaks much more that your secondary levels are at the efficient price and, presumably, your new-issue premium, therefore, is going to be compressed versus somebody building in additional premium for illiquidity, as sometimes happens now.

I think we would all agree, basically, that is the point about it. Is it rates? There is no question: when rates are on the move, it is going to make people behave in a more cautious way. Is it regulation? Yes, the higher capital that is required does have an impact. The other elephant in the room that nobody has talked about is that fund managers have also experienced consolidation on their end. The size of some of those institutions relative to the issuers or to the dealers is now multiples of what it used to be. As a result of that, they have much bigger portfolios that people are managing. Whereas, before, lots of 10 million were absolutely fine, 10 million means very little now when a lot of these institutions, if they want to shift tactics or anything like that, have to have a much bigger amount that they trade to be meaningful for their portfolios. That is the structural element, besides regulation: the players are of different magnitudes or have changed. Maybe this needs to be a broader conversation, in essence.

Martin Egan

One of the panellists yesterday, Anne, suggested even poor liquidity in the European government bond market. I was in a panel in the Middle East early on this week, and one investor was decrying liquidity in US Treasuries. I think we would all agree it is a big cause for concern, but, from your perspective, liquidity is everything: how bad is it?

Anne Leclercq

Liquidity is a very difficult concept, to start with, because it is a concept with different elements that have to be looked at. It is not only a concept about volume and bid-offer spreads, but it is also immediacy and resilience. Volumes are easy to measure; bid-offer spreads are very easy to measure; immediacy and resilience are a bit more difficult. We have started to do some work on that within the European debt market groups. We have seen, indeed, that volumes and bid-offer spreads have not decreased that substantially, so bid-offer spreads are more or less in line with what we have seen for a couple of years, and, more precisely, since probably 2014. Volumes are a little bit less, but not very much more.

However, what we have seen, and what we are trying to compute and show, is that the immediacy and resilience of the markets are different, in the sense that the size you can transact in one transaction is much lower. Also, the market is reacting much more quickly after a lower transaction that has been done. We are trying to grasp that, for the moment. We all have the feeling that, indeed, it is there, but we do not know very well how to show it. It is important that we are able to show that, because, at a certain moment in time, we will have to be able to show to regulators that the cumulative effect of some of the regulations might be quite detrimental for sovereign debt markets.

All in all, we see some changes, yes, not very much yet, but we believe that some cumulative effects of regulation might have a detrimental effect on the liquidity. This being said, as a sovereign, we can still try to change part of the business model that we have at the moment and change some of the evaluation methods we have with our primary dealers, to ensure that market-makers are still sufficiently incentivised to do their jobs. I totally agree with what Kitty said: we see much bigger amounts with fund managers. What we have seen is not so much a buying amount or a selling amount, but it is really buying and selling, almost for the same sizes, month by month, which really shows that the importance of those investors in the markets is much bigger than it used to be before.

Martin Egan

Michael, does the market illiquidity affect the pricing of your deals at this point in time or not? It sounds like you have pretty liquid markets in your securities. Does it affect pricing?

Michael Gower

The short answer is no. The simple reason is that we have decided the way we run the balance sheet is to ensure we provide as much liquidity to the holders of those securities, both ways, as we possibly can. It does mean you have to hold higher buffers if you have a portfolio which, in our base, is €150 billion. You have to hold a material amount of that in liquid format, in order that people can, to your point, get in and get out, and it is both ways. From a practical perspective, this is a huge opportunity for dealers, advisers, underwriters to differentiate themselves. We certainly use it, from our perspective, in dealer selection, and, from what we hear from the traditional buy side, it is certainly something they are looking at from their banks, and now, increasingly, away from the traditional banking sector, whether it is into insurance companies, pension funds, hedge funds, who are actually becoming liquidity providers themselves.

Martin Egan

We will have one final question to the audience. In the interim, I would like all our panellists to think of two words each for the outlook for the rest of this year. The question is: how do you think the provision of secondary market liquidity will evolve in 2015? It has to improve; it will stay the same; it will deteriorate; it will dry up completely. Maestro, let us have some music.

[*Votes cast*]

It is a mixed bag again. I was hoping a few more of you would have chosen the fourth answer, and then we could drive our regulatory friends to consider some softening of regulation. Undoubtedly, the trend is going to be difficult. The very senior panels yesterday, with key investors, reinforced how important the provision of liquidity is in the marketplace, and we need to work together to improve it.

Panellists, we have two words each to describe the view of the rest of 2015. Kitty, I will start with you.

Kitty Yoh

Flexibility and cautiousness.

Roman Schmidt

The same volatility, not necessarily from the last week, but the last two months.

Rutger Schellens

Agility and caution.

Michael Gower

Unpredictability and alertness.

Anne Leclercq

Unpredictability and not being complacent.

Martin Egan

Those words make a lot of sense for all of us in this room.

We have time for questions from the iPad. What do the panellists feel about the regulatory requirement that each allocation in every deal has to be justified, and that justification recorded?

One of the suggestions from regulators is that we articulate, on every transaction and every allocation, our rationale. For the more frequent issuers, I presume that must be a rather daunting thought.

Kitty Yoh

On a practical basis, it would be very difficult. In many of our transactions, we could have two hundred and something orders in the book. If those had to be all individually recorded as to why they were allocated, this percentage versus that, realistically speaking, you are looking at a two-day execution process, which then subjects the issuer to all sorts of risks, including that the market will move. While I understand why somebody thought about that in terms of justifying the allocation, I do not see practically how it could work.

Michael Gower

I would agree with that. In terms of the practicalities, I find it difficult to imagine how it would actually work. Coming back to the point of who owns the transaction, there is a common misconception, still, amongst regulators that the underwriting banks who are distributing these transactions actually control and own them. If you look at the allocation process with the understanding that it is a contract between issuer and investor, the concern, whilst it may not go away, changes, and I am not sure there would necessarily be a need to go, line by line, through the rationale.

Anne Leclercq

As we are supervised by our state supervisor, we, of course, have to provide some general lines on how we allocate our bonds, but this does not prevent us from going away from some of those more general lines, and those we can explain, I would say. We do not have to explain, but we can explain whenever it is necessary. I think that makes sense, but doing it individually – markets are volatile; investors want to know where they stand as quickly as possible – is a no go.

Martin Egan

The final thing I would say is that we are aiming to get better regulation in the marketplace. The more the Market Practice Committee, and our relevant borrower committees especially, can work with regulators to help define new market practices, the better.

Thank you to my panellists for an exceptional job, and to Kitty for her opening comments. It feels like 2015 could be a bit more challenging. Thank you for your participation as an audience and your very good responses. Enjoy the rest of the conference.

Martin Scheck

Thank you very much, Martin and panellists. That brings us to the last panel of our conference, on the world of secured financing and why it is so important. It has a particular focus on the role of collateral and the mechanics of moving collateral around the market, i.e. repo, to where it is needed. Godfried De Vidts is the Director of European Affairs at ICAP and plays a major role at ICMA. He is a Board member, but, perhaps more importantly, he is the Chairman of the European Repo Council and has been for many years.

Panel: Secured Financing – Why it is Important?

Moderator:

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

Panellists:

Richard Hochreutiner, Head Global Collateral and Director, Group Treasury, Swiss Re

Michael Manna, Head of Fixed Income Financing Trading, EMEA, Barclays

Michel Semaan, Managing Director, Nomura and Member of the ICMA European Repo Committee

Andreas Biewald, Managing Director, Global Head of Funding, Commerzbank

Godfried De Vidts

Thank you, Martin. We are the last panel. As you can see, I brought up my suitcase, but that was not to say I want to leave straight away. It is for something else, which I will tell you in a minute. Repo is the last panel of the day, and it maybe coincides with a recent press release in London, where repo is considered the worst job in the City, so these are four of the worst paid people in the City or in Europe, because they are repo traders, so times are tough. First of all, as I have said before, bonds and repo are like a marriage. They are very difficult to separate. It takes two to tango, and you cannot have a good bond market without a repo market. These are the issues that we want to tackle.

This slide shows you the alphabet soup of regulation. Basically, we have a long list of regulations. Even when I made the slide, I could not even remember what half of them mean. We have a tsunami of regulation that is impacting a lot of business, but, in particular, the repo market. The second slide is a picture of four commissioners: Mr Bolkestein, who introduced the 'Giovannini barriers'; Charlie McCreevy, who said, 'You do it – we trust the industry'; Michel Barnier, who said, 'I'll do it – we don't trust you'; and now we have, of course, Lord Hill and capital markets union. You see this is an evolution in regulation: over-regulation, under-regulation, and then trying to balance it.

Behind those four commissioners, we had central bankers. In the eurozone, we had Mr Duisenberg, Jean-Claude Trichet and now Mario Draghi. Of course, we have others, like Edward George, Mervyn King and Mark Carney, so we have actually a lot of officials who are very important for our market. For the repo market, but also other people in ICMA, we focus a lot on helping those people understand how markets function. I must admit, as Chairman of the ERC for the last 15 years, we have failed massively, because they still do not know what repo means, and that is part of our discussion today.

We have two questions. This is the first. Do you see repo volumes: going through the roof; staying flat; dropping even more – or do you not know? Please vote.

[*Votes cast*]

I think you are going to get paid even less in the future.

This is the second question. Looking at your involvement in the repo or securities lending market, are you: lending assets in your daily businesses; thinking of using them, but the regulatory tsunami scares you; not allowed to lend on stock; or not really sure what you want to do? Can you please vote now?

[*Votes cast*]

That is encouraging, because we are going to need all the liquidity we can have.

We have four members of the European Repo Council here and I have prepared a number of topics to discuss out of that tsunami build-up that we have seen. Before we do that, I want to congratulate Richard Hochreutiner, because he is the first non-sell side in the European Repo Council, so we are opening to the market. I also have a special gift for you, because I read recently that Swiss insurance companies do not want to place cash deposits in central banks anymore, but put them in suitcases, so here is my suitcase for you. Thank you very much.

Michel, can you give us a comment on the Securities Financing Transactions Regulation (SFTR) and the Bank Resolution and Recovery Directive (BRRD)? What is the issue there?

Michel Semaan

Thank you, Godfried. Going through it quickly, because I know that we are standing between you and lunch, on the SFTR side, without going through the plethora of matters that we have to discuss, such as reporting, be it at position or transaction level, and others, I would highlight two main points. The first one is about the onus that would be put on counterparties, when transacting in a secured funding manner, to highlight the risk that they are entering into through that transaction. It does not make sense to us, as market professionals, for a very simple reason, which is that we are market professionals; that is the whole idea, and we are transacting under a master agreement that has been thoroughly developed, with a lot of thought behind it, and is a clear benchmark that contains the whole legal regime and underpins those transactions. Therefore, we do not see what gain this gives us. Once you have signed into a master agreement, you are already fully aware of the risks you are entering into. That is the first point.

The second point is the dangerous amalgamation of the words and practices of re-hypothecation of securities and re-use of securities. These are very different things and there is – I hope that this will be resolved sooner rather than later – a danger or a risk of applying the new regime of SFTR, which would apply to re-hypothecation, to re-use. There is a difference between the two, re-hypothecation being a pledge of securities between a fund and investors behind it, whereas re-use is governed by a title-transfer collateral agreement. This really is the essence of our market. The title transfer is exactly what it means: there is a change of ownership; there is a move from one counterparty to another. That is the flexibility that we have had and seek to keep having, because it is the oil in the engine.

I do not see how we can have to ask permission to use something that we own. If I reverse in a security, legally, for me, it is equivalent to owning it outright, and, once I own it, I can do whatever I want with it: I can sell it; I can lend it; I can keep it. The whole idea is that I am not supposed to ask permission to use something I own and that I bought, effectively. In a nutshell, this amalgamation would impact the pillars of our market, which are title transfer of collateral and netting. We cannot touch these, in my opinion, because that would definitely lead to further erosion of liquidity in a market that is already under multiple other pressures.

Moving on to the BRRD, the main point I will raise there is the fact that this European directive allows for regulators and creditors to impose a temporary moratorium on contractual termination rights, so it imposes a stay of execution, basically. That is the main feature of this directive, as far as we are concerned. Now, let us be clear. The intention is extremely good, but, like everything else, the devil is in the detail, and it is all a matter of how it is executed and harmonised at a European level. There are 28 jurisdictions that are not on a level playing field at the moment, as far as this is concerned. Yesterday, the Dutch Minister of Finance was praising – and I agree – the fact that we have this directive as part and parcel of the banking union and that it will allow for an orderly unwind and a better solution that effectively leads to a bail-in of troubled entities. While this is extremely good, the issue we see right now is that there is no harmonisation of the directive.

In the UK, the term is, I think, gold-plated, as in it is legislated; it is law. If you are under an English law agreement, it is definitely there. However, today, the main issue, to sum it up, is the uncertainty we still have, because the regulators in whichever jurisdiction we are dealing with have discretion. That discretion in imposing a stay of execution leads to uncertainty, and we cannot have that in a market that is already, as I said earlier, seeing its liquidity dropping day by day. I would like to say that I voice my support for this clause, as long as it is fully harmonised. At the moment, it is not. The way it is implemented in Germany is different to the way it is implemented in the UK. France has not implemented it yet. Does it mean that I want to move to France and work out of there? Definitely not; plus, usually, the direction of travel is the other way round, between France and the UK.

The other point that is extremely important, on which I will conclude, is, as far as the stay of execution is concerned, the thorny issue is on the buy side – and this has to be resolved – whereby the buy side has, first and foremost, a fiduciary duty to their clients. My concern is those actual clients – and some of them have voiced this – will see this stay of execution as an additional risk to their lending activities, to their collateral going out to the dealer community or repo markets at large. If that is the case, my concern is that some of them – and I hope a minority, not more – might think that the risk-reward ratio is not sensible anymore. I was about to throw it to you, Richard, to see if you had had any feedback. Can you give us your own opinion of whether it is a real risk or not? That, for us, would be a dramatic loss of collateral and cash puts.

Richard Hochreutiner

Speaking from the buy side, the way we would see this is that the intent of a stay is commendable: it is to avoid an unorderly situation. The way the stay is implemented is essential for us to get enthusiastic or not like it. There are two main elements there, which, from a buy-side perspective, are important. The first is that the stay has to allow for margining during the stay, because, if you are stuck there, you can see that your counterparty is troubled, the markets are all over the place, you cannot sell your collateral but you are not getting any margin during that time, so now you have to look at your risk or close-out model and add another two days' market volatility to your close-out. That increases the overall risk of your programme and, essentially, you end up thinking, ‘Well, maybe the risk-reward is no longer there in the same ratio as it was before.’

The second thing to say is that, if you have a stay which is a level field and it does not in any way allow you to act in a homogenous way, particularly if you are dealing out of different jurisdictions, it is a very difficult situation. If you look at all those new regulations, none of them entice lenders to participate in this market, meaning that, if your risks are going up but you have so much more work to do, more regulations to comply with and more pressure, you have to question. We do not have to be in this market. That is the key difference between the buy side and the banks.

Godfried De Vidts

Let us move on, but this is an important issue. ICMA’s legal department is working on this with the authorities. By the end of the year, we need to have a solution. The variation margin is a point to take on board in those discussions in the coming weeks.

Michael, there are a lot of discussions about LCR, liquidity buffers, and I think that is understood, but I get even more questions on NSFR. First of all, what does NSFR stand for? Secondly, we have had requests from people to do a workshop in London, and you have volunteered, or I appointed you as a volunteer, for that workshop. Can you elaborate on that, and also on your remark in the Euroclear conference three weeks ago on CSDR: it will not happen? Why did you say that?

Michael Manna

It is because I believe in Santa Claus.

Godfried De Vidts

Do you believe in Santa Claus? Because we are in Holland, we have to say Zwarte Piet.

Michael Manna

I am not going to do a workshop on net stable funding ratio here. My colleague who works deep in the world of treasury will back me up on a few of my thoughts. Firstly, you have to think about NSFR as just part of a suite of liquidity rules that the regulators are putting in place. This is not some new standalone concept. The three pillars of Basel III are capital, leverage and liquidity. Why is liquidity so important? It is because the crisis proved that the market itself did not appreciate the concept of maturity-mismatch and thought liquidity would always be there, so now it has been regulated.

When you look at the suite of regulation we have, we have LCR and NSFR. It is interesting that what they are looking to do is collapse that gap of your maturity transformation and avoid the cliff effect. LCR looks at your underlying asset and it looks at a shorter duration; you are looking at 45, 100 days, that end of the curve. It will look at any type of asset on your balance sheet that is not under the high-quality definition of the jurisdiction you are in, without looking at the counterparty you fund with. NSFR gets a bit personal. It looks where you are getting your money from and attributes a value to the stability of that money, so it is your required stable funding over your available stable funding. It looks at a horizon greater than six months. Everyone talks about the one year, but there is a six-month-to-one-year bucket.

What does that mean? Well, now you have two ratios that you have to account for when you look at your asset side and your liquidity mismatch between assets and liabilities. This is the concept that I have to remind people about: when you talk about repo or the sec lending desk, the repo desk is nothing more than a bank in a bank. I make loans all day long. I generate assets that sit on our balance sheet. I run maturity mismatch. Now the repo desks – and, might I add, the margin accounts in the prime area, which would affect more the equity side – will have to look at their longer-dated funding.

There are only two ways to solve the problem. Either you go out and match-fund everything you have – happy days; good luck finding it – or you fund yourself, but then what happens is that you do not meet your ratios. Then it is over to the treasury department, which will have to raise liabilities that are greater than a year. That is not a free sandwich. What happens then is, when the treasury raises a liability on the bank's balance sheet, it needs an asset. Those assets have to be high quality assets or bank deposits. That creates leverage. This is an interesting concept, where your liquidity requirements will impact, depending on how you fund yourself, your leverage ratios. Depending on the bank you work with, that gets charged back to repo desk, so my liquidity mismatch that drives behaviour in my treasury to raise additional liabilities gets charged back to me. If I think I am using one unit of balance sheet to generate that asset, in reality, it is probably 1.1 or 1.2. All of that starts to impact how we fund, what we charge and how much balance sheet is out there: once again, the connectedness between leverage, capital and liquidity.

The final bit is, potentially, if you look at when it gets personal on whom you borrow from, you could get a bifurcation in the liquidity markets themselves. If you, under NSFR, are the good looking girl in the room and everyone wants to talk to you, guess what, you have pricing power, because the liquidity that you provide to my balance sheet gets preferential treatment, versus if you are somebody else that does not. Non-financial corporates are the best. Another bank is the worst on the spectrum. You can get a bifurcation in the funding markets where, for people that, under NSFR, tick the boxes very positively, I will pay more for that, versus, when the next person comes in looking to give me liquidity, I will pay less. You can get a bifurcation there.

That is NSFR very quickly, just to try to demystify it slightly, but you cannot think of it as just NSFR standing up by itself. It is just part of the whole suite of liquidity regime that we have. In addition, you have to think about the ramifications of leverage, and then you have the final bit: how does the market change its behaviour around that? I hope that helps the audience around net stable funding. Did you want to add anything, Andreas, given you are the one that is charging me the balance sheet?

Andreas Biewald

It is important that the costs, as Michael nicely displayed, are reaching the desk levels in banks. The bank who is charging the treasury department first, who is aware of who is consuming how much and charging hard cash for that, will be the smartest and first with regards to the new environment. It is important for banks and treasuries to have these internal transfer pricings for collateral and liquidity under the new regulatory regime in place, in order to avoid allocating the three components Michael mentioned a couple of times to the wrong business.

Godfried De Vidts

We will do a workshop in the coming months in London. I invited Michael already to chair that.

To me, CSDR is as bad as FTT. FTT, on fixed income, will kill the repo market. Will CSDR do the same, if it comes through like it is presented?

Michael Manna

I am sure there is plenty of material in ICMA's great paper, and we also have a survey on the potential impact on repo spreads, but, for the national treasuries that are here, the cash market spreads are probably the more interesting part of the survey. This is the classic example of what I like to call the cottage industry of regulation. The core of regulation, on a macro-prudential basis, has been around Basel: affect the bank's balance sheet and have it change behaviour through the system. Now you have this cottage industry. All different types of groups and bodies are looking at how banks are structured, how the markets act, how participants in those markets act.

The buy-in, to me, is just another one of those, where it is, in isolation, you could argue, a good idea. Part of a good functioning cash market is that you make delivery and people are incentivised to fulfil their obligations and their trades. Once again, implementing a great idea could be miles away from what you could actually achieve. I would love to meet the people that actually put this together, because, clearly, they do not come to work every day and try to settle trades. The impact on the repo desk, the back office, the middle office and processing, is, to me, not well thought out.

Godfried De Vidts

I know who wrote it, and they are not there anymore. That is the problem.

Michael Manna

I was going to say, I hope they are smaller than I am. It is this concept of, once again, the pendulum swinging: the pendulum swings all the way out, and people come and give constructive feedback. Where, say, from 2010 to 2012, when banks wanted to give feedback about regulation, it was like, 'We are not listening to you; you are the ones that caused this problem', there is now a more constructive dialogue with the regulators. Yes, an unintended consequence is that this got through.

Will sense prevail? I tend to be a serial optimist – people say that – and I have not been proven wrong yet. I think this will get readjusted. If anyone out there has an influence on it, frankly, if you have a big issue with fails, just follow the Fed and put a fail charge. Trust me. 300BPS focuses the mind. It is simple; it is easy to implement; and, because it is mandated, it allows bank to pass it on to the real money that has been somewhat insulated from fail charges. That would be a more elegant solution, if I can give my two cents.

Godfried De Vidts

We have voiced those concerns and suggestions to ESMA and the Commission as well, of course. Richard, you are the first ever elected buy-side member in the European Repo Council. In general, the buy side has come late to the party, but I think it now also understands that repo is important. First of all, what do you, as a buy-side representative, aim to get out of this participation in the long term? Also, historically, do you see repo as a benefit to your business or is it something where you have to do it because of EMIR and Dodd Frank, but you really do not want to do it?

Richard Hochreutiner

There were a number of questions there. To start with, what do I expect to get out of or to be able to contribute to the European repo environment? The buy side has actually been in a very nice position: sit back; let the banks take the beating; see how it pans out and it will be all fine. Much to what Michael was saying before, one of the key issues is, if you, as a banker – and I used to be one – go to regulators and try to bring the reality into some of the regulatory initiatives, like you say, you are the banker: 'Go away; you made this problem.' The buy side, which is perceived not to have been part of making the problem, has an important role to play, to go out and say, 'Look, if this happens, it is going to harm the life insurance industry like this, or the pension fund industry like this.' There is probably more credibility, whether for right or for wrong, that the buy side can bring to the argument, to say, 'This is what it is going to mean for the so-called real economy.'

That is one of the reasons why I think it is important for the buy side to step up and become part of this. To your question, why use repo, for us, at least at Swiss Re, we have always been concerned about our bank risk. We use repo predominantly for two reasons. One is to reduce our bank risk, so lend money on a secured basis rather than hoping there will be some magic hand coming in and segregating our cash out when it is too late. That has really allowed us to tremendously reduce and also diversify our risk. We can lend money to more people than we would on an unsecured basis, so that has been a major advantage.

Specifically for the insurance or reinsurance industry, it is also a great cash management tool for us. If we need to secure large amounts of short-term funding, repo is a fantastic tool for us to be able to do that. It helps us do duration management as well in our portfolios. Those are the real major uses that we have for the product, and they have been tremendously beneficial. You were talking about the good looking girl in the room. I am the ugly, red-headed stepson in the room, because nobody wants my cash anymore. Why would you want to have so-called 'fast money'? It does not help you. It is on your balance sheet, but it does not help you. That is another reason why, if you have large amounts of cash, you need to be very careful as to how you can place that in a mindful, balanced way.

Godfried De Vidts

When I chair the ERC, I have two camps: the repo traders and the treasuries. Andreas is the odd one on this panel. He is a treasurer and he uses repo. Can you comment on your activity? Also, you are very much impacted now under QE. Can you comment on QE?

Andreas Biewald

Michael Gower in the previous panel already mentioned balance sheet optimisation. The word 'optimisation' was used a couple of times this morning and yesterday already. The optimisation of liquidity and collateral is dominating the daily work in treasury currently, split into the unsecured deposit base and the HQLA liquidity buffer environment. The unsecured deposit base is currently filtered and looked at through regulatory-useful and less useful liquidity or cash. Not useful or low-value wholesale deposits do not account, as we all know, for any ratio. That is something where banks are actively thinking about negative rates, fees or nominal maximum amounts on accounts for the customers. These kinds of deposits are increasing the bank's balance sheet without having any re-use or any value.

On the other side, there is the HQLA definition, the liquidity buffer and the ECB deposit rate of minus 20. As most of you know, in cash bonds as well as the relevant repo GC markets in core Europe, HQLA are already trading below the minus 20, and treasuries start actively thinking about keeping the cash with a central bank, over-fulfilling or not actively managing the minimum reserve requirement anymore, just leaving the cash in the central bank account, instead of doing the transmission from cash, via repo, into collateral and putting that collateral towards the liquidity buffer of the bank.

To answer your question, Godfried, the treasury-driven repo business will shrink as well, because it does not make sense to trade a GC pooling basket, for example, at minus 18 or minus 19 if I could park the liquidity at minus 20 within a solva zero, triple-A central bank in New York or Frankfurt. It does not make sense, cost-wise, capital-wise, brokerage-wise, to do this transfer anymore. We calculated a bit around internally and found out that we should not do any reverse repo trade which has minus 16 or below as an interest rate on it, in order to avoid not useful repo business.

All in all, it works out like it always works out when central banks are flooding the market with liquidity. We had the same experience after the three-year allocation, a couple of years ago, of the LTRO of the ECB, and we currently stand at a €300 billion surplus of liquidity that will double by the end of the programme, quickly. I am pretty convinced that Mr Draghi will bring that programme to an end, or that programme will end, as was announced, by the end of September 2016, so we have to live with an increasing outstanding liquidity. Due to these various optimisation programmes going on in banks, treasuries will be less active in repo markets.

Godfried De Vidts

We have a lot more issues to discuss, but we do not have the time. I have two more questions for the audience before we close. The third question is: how confident are you that the issues we discuss now are understood by the central banks and the regulators? Are you: very confident; quite confident; slightly nervous; not confident at all? Please vote.

[*Votes cast*]

Oh my god. This is something I have said many times in private circles and I can say in public now. We do many conferences. We make a lot of efforts to raise the issues. The problem is that those who should listen are never there, so we will send this slide to Paris, to ESMA.

Andreas Biewald

If I may say something on that, what I observe in certain committees and discussions with central banks is the strict difference between the people from market operations and the people from the SSM. Of course, there needs to be a Chinese wall and it is important to have this Chinese wall. Nonetheless, the info flow and the market knowledge we are giving, via ICMA and via our group, towards the central bank community needs to find its way to the single supervisory mechanism. We are getting asked too often, 'Why is the market not functioning?' by central bankers, given the fact that they sit in the same house as regulatory colleagues implementing tools that are hindering the implementation of monetary policy.

Godfried De Vidts

I agree. It is good for me, because it keeps me in a job, as I have to go and visit all those people, so there is a positive side as well.

I have a fourth question. Does the buy side understand what is going on? They are the same answers. Please vote.

[*Votes cast*]

Richard, you have done a good job so far.

Richard Hochreutiner

Thank you very much, everybody. I would like to say something. We were at an event in Brussels, sponsored by Euroclear, where there were a few discussions around the buy side's involvement. I need to say that I think there is a lot of interest right now in getting more involved. I do think there are some large institutions, maybe like us, which I like to believe have a certain degree of sophistication, but there is also a need for the repo or collateral desks in banks to help educate some of the buy-side clientele.

I have often heard, 'Oh, you have to have liquid collateral.' Well, after the discussions we had before about whether there is liquid collateral, we will leave that aside. To have liquid collateral is a great thing, and it is something that should be there to help, but how you actually liquidate that collateral is a second consideration that, if you are in a bank, you take for granted. If you have to liquidate collateral, call over to the mortgage desk or the equities desk: 'Hey, do you sell that?' What do you do, though, if you are sat there on your own in an office and there is no mortgage desk to talk to? It is important that the buy side organisations think through, 'What am I going to do when it comes to having to sell that hopefully liquid collateral?'

Godfried De Vidts

Andreas, do you have any final reflections?

Andreas Biewald

I was very clear that the central banks are currently in charge of all our instruments, as well as of the regulation. Sometimes, we have to implement it and then discuss what we can smoothen, but the implementation takes quite some time, and one or the other person, job or function in banks is not there anymore. That is my fear: by the end of 2016, not all of us might survive that surplus liquidity haul.

Michel Semaan

I would like to finish on a positive note. Despite the numerous regulatory initiatives and the multiple pressures we are under, we have managed to adapt before, and I am hopeful that we will adapt again. I am not copying yesterday's remark about our industry being sexy and creative. I will let you judge the sexy. I will say that I hope, for the next couple of years, it will be, in two words like the previous panel, creative and profitable. That would be my last thought.

Michael Manna

I also want to end on a positive. We are going through what would be probably the most disruptive thing that has happened to the financial world since Glass-Steagall. We are just coming out of a financial super-cycle that ended not so well. In a society and a sector that is measured on daily P&L, we have to be a bit cognisant that, first, the regulation that was implemented gave us a very long runway for that implementation, which gives time for people to observe if things do not work out as they intended them to.

Secondly, through that, you get the unintended consequences, both macro-prudential, and, like I said before, the cottage industry. My view is that some of it will survive and the market will adjust. How do we adjust? We adjust on price. Remember, banks are cost-plus; asset managers are cost-plus. At the end of the day, pricing will change and drive behaviour. What I have noticed on my desk is, specifically in a small microcosm, less physical leverage, more derivatives leverage. There are a lot of interesting things that we have front-row seats for over the next couple of years, but I am similar to you. We just have to work through it, and, at the end of the day, the system will recalibrate itself to the new rulebook.

Godfried De Vidts

On that positive note, I would like to thank my panellists for an interesting discussion. Thank you for listening.

Closing Remarks

Martin Scheck

Chief Executive, ICMA

I. Acknowledgements

Thank you, Godfried; thank you, panellists. That brings us to the end of the 2015 AGM and conference. I very much hope that you have enjoyed the conference over the last two days, found it interesting and stimulating, and also that you found the evening events to your liking. There are a number of people I would really like to thank before we break. First, I would like to thank all the speakers and panellists for coming up to share their views. Secondly, I would like to thank the sponsors: not just the gold sponsors, but all of the sponsors. They all have a role to play. They are all up here. Thank you very much to the sponsors.

Thirdly, I would like to thank the exhibitors. I hope that you found time to go and visit their stands. I know there has been a lot of traffic there, so hopefully they are happy with what they have had this year and will come back and support us again next year. I would particularly like to thank the ICMA staff. They have done a terrific job in terms of organising this conference and making it all run smoothly. It takes a massive amount of work over the course of really the entire last year to put a conference like this together, so I would really like to thank the ICMA staff for their work. Lastly, I would like to thank all of you. It would not be much of a conference without an audience. It has been fantastic that you have come in such numbers. Again, thank you for taking your time. I do hope that you found it worthwhile.

II. Review of the Conference

With that, I think we have had a really stimulating event. We have had some top-quality speakers from the very heart of the European project yesterday and today, and we have had some fabulous speakers from the Chinese side, which is new thing for us. We have had very good panels. Now I would like to take a look at the last couple of days.

[*Video shown*]

III. AGM 2016 – Dublin

The last word from me: where are we going next year?

[*Video shown*]

Thank you all. Have a safe journey home.

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