Banks and Financial Conglomerates Unit
DG Markt
Rue de spa 2,
1000 Bruxelles

13 November 2012

Dear Sirs,

Response submission from the International Capital Market Association (ICMA)

Re: European Commission consultation on recommendations of the High-level Expert Group on reforming the structure of the EU banking sector

Introduction:

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 420 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for well over 40 years.

The ICMA notes that on 2 October the European Commission received the report prepared by the Liikanen High-level Expert Group (the "Group") on reforming the structure of the EU banking sector. The ICMA further notes that the European Commission has launched a consultation on the recommendations contained in the Group's report; and that this consultation is part of the European Commission's process for assessing the Group's report and recommendations.

Overall commentary on proposals:

Whilst the Group's report contains many interesting recommendations, the ICMA has determined that it will be of greatest value for its submission to focus on those few points of most direct relevance to the international capital market and where it seems most likely that the ICMA may have distinctive points to contribute. In overall terms, the ICMA considers that the recommendation:

(i) to separate securities trading activity, possibly isolating it from primary market activity, will have potentially significant adverse impacts on the international capital market; and

(ii) concerning certain details of how to design bail-in debt is not the best way to develop this important feature of recovery and resolution regimes.

[1] For more information regarding ICMA please go to http://www.icmagroup.org/

Before covering these points the ICMA wishes to highlight the existence of other official initiatives concerning similar issues, including the Vickers Report in the UK and the US "Volcker Rule". Inevitably there are elements of overlap amongst these initiatives and there is a risk that any final proposals which do emerge may not necessarily all fit neatly together, either with respect to their content and/or their timing. Since the implications of any combination of actual proposed changes may differ and cannot be assessed in advance of suitably detailed actual proposals, the ICMA respectfully requests that every effort be made to sustain on-going dialogues – both between the requisite officials and with the markets. It is in everyone's best interests that necessary issues are adequately addressed, whilst at the same time avoiding any unnecessary adverse implications for the international capital market.

Detailed commentary:

A. Separation of trading activity

The Group proposes that, in certain specified cases, proprietary trading and all assets or derivative positions incurred in the process of market-making, other than exempted activities, must be assigned to a separate legal entity; and that provision of hedging services to non-banking clients and securities underwriting are considered to be exempted activities.

Given that primary market debt origination (underwriting) and secondary market debt securities trading (market making) have been core to the ICMA's mission throughout its existence, the proposal to draw new boundaries between those entities authorised to conduct these activities is of significant interest to the ICMA.

The ICMA believes that the risks that underwriters will be taking if they are isolated from secondary market flows and information will be significantly increased. Since this separation is likely to result in lower liquidity and higher transaction costs, it must be anticipated that there will be equivalently higher fees for companies and other issuers, and hence higher funding costs.

However, the ICMA observes that it is noted in the Group's report that these activities could remain under the same holding company and that marketing could be done across the group. The ICMA wishes to highlight that, if such a separation of trading is introduced, the transfer of risk assets at fair market prices, from the underwriting entity to the secondary-market trading entity, must be allowable as already mentioned in the Group's report. Furthermore, to avoid undue risk and inefficiency there will also need to be a free-flow of secondary market knowledge from the secondary-market trading entity to the underwriting entity. Nevertheless, the ICMA is concerned that the effective realisation of such inter-entity arrangements will prove impractical to achieve. The two entities will not only have separate management and separate capital and funding constraints, but also, since risks cannot be shared due to the ring-fence, will have reduced scope for providing a holistic service to equity and bond issuers. Indeed it may be that, in terms of providing secondary market support, the economic interests of the two entities prove to be misaligned.

More broadly, however, the ICMA considers that there needs to be significant further work to determine if a recommendation for separation of trading would bring sufficient incremental benefits to justify its introduction. At the current time it is apparent that, more than ever, Europe needs a thriving and efficient capital market, able to meet the challenges of funding real economy needs whilst European economies' former dependence on funding through the channel of bank lending continues to diminish.

The ICMA is convinced that this is already a major challenge for the capital markets. Much work remains to be completed on developing a single, efficient capital market across the European Union, with markets and their supporting infrastructure still significantly fractured at Member State level. Meanwhile a huge programme of interrelated financial regulatory reform is already being out in place. This includes improvements to bank capital and liquidity (CRR/D) and to the resolvability of banks which do nevertheless run into difficulties (RRD); alongside improved rules for trading (MiFIR/D, SSR and MAR/D); and new requirements for clearing (EMIR) and settlement (CSDR). Other measures have already changed the rules for primary origination (PD) and will further improve investor protection (PRIPS), whilst the buy side of the industry must also come to terms with its new regulations (AIFMD and UCITS).

The cost of accomplishing all these changes during a relatively compressed timeframe is not just financial but also arises through uncertainty in the business environment and the distraction of management attention from ongoing business development. All engaged in this process recognise the potential for the emergence of an improved financial services sector and the ICMA is striving to ensure that includes a stronger European capital market capable of performing its desired task of efficiently allocating funds to business needs.

The ICMA believes that in a thriving and efficient capital market, primary and secondary market trading activities play symbiotic roles. A healthy flow of primary market origination helps to stimulate secondary market trading, whilst improved liquidity in secondary markets helps to underpin investor confidence and thus boost conditions for new issuers.

Separation of these activities may impede this interrelationship, thus harming overall conditions for financing, whilst at the same time not delivering dramatic improvements to safety, of the system or of investors, over and above those which should already follow from the aforementioned programme of reforms. Neither can these concerns be dealt with simply by moving both primary and secondary market trading activities out from banks, as this would create a significant stress on underwriting capacity.

The ICMA perceives that there are many more detailed points for consideration where much more work is also needed before any move to the separation of primary and secondary market trading activities should be proposed. For example, how exactly would the split be expected to work taking due account of the interrelationships found within international firms, both across business lines and across geographies? How much would such a split impact the required amounts of capital and liquidity required to finance the affected business activities, considering both the likely scale of investor demand to provide finance and the levels of return which would be expected for this? And what would be the impacts on costs from lost economies of scale, as shared knowledge, systems, facilities and management all cease to be possible?

B. Bail-in

The ICMA's member firms include significant Issuer and Investor constituencies. As with its previous responses regarding bail-in proposals, the ICMA has sought input from both these constituencies in order to be in a position to present a synthesised view informed by both ends of the value chain – i.e. those firms that issue the senior unsecured debt potentially impacted by the contemplated bail-in regime; and those firms that invest in such debt instruments. The ICMA considers that this provides a well-informed, broadly based view of the proposals and, consequently, respectfully requests that the Commission give careful consideration to the points that this response raises.

The ICMA is particularly struck by the fact that the Group's report recommends that bail-in debt should be a distinct instrument within the capital hierarchy (the requirement for which may be substituted by simply holding more equity), as opposed to the European Commission's already tabled proposal which effectively makes bail-in a generally applicable feature of all senior unsecured debt.

On balance the ICMA opposes this particular recommendation for a separate category of bail-inable debt; and would prefer to see agreement reached on a suitably amended version of the European Commission's current proposals, for a bail-in regime which is broadly applicable to all senior unsecured debt. In particular, adoption of the broader approach will avoid a fracturing of the market for senior unsecured bank debt and the "cliff effect" which will arise if bail-in is suddenly to be applicable to just some sub-set of senior unsecured debt from a future date. Nevertheless the ICMA fully supports the view that the nature of all funding instruments should be fully transparent and that all more junior elements of the capital hierarchy should be fully subject to loss absorption (prior to the bail-in of senior unsecured debt) in applicable circumstances.

The ICMA is also particularly troubled by the Group's recommendation that bail-inable debt should not be held by banks. As the ICMA stated in its March 2011 bail-in response[2] to the European Commission the extension of bail-in to senior unsecured bank debt will either:

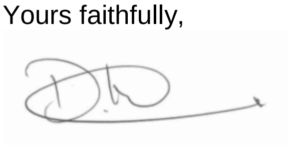
- Restrict investment criteria; and/or
- Make other asset classes more attractive on a relative value basis; and/or
- Justify a significant premium over current senior unsecured levels.

Already these considerations will lead to bail-in debt being relatively less easy to issue in volume at spreads consistent with necessary overall target funding levels. Introducing a further significant constraint to the investor base, by denying the possibility for banks to be holders of such paper would serve to significantly exacerbate these funding challenges. Requirements for transparency of holdings and large exposure limits offer appropriate ways in which it should be possible to manage legitimate concerns, without the need to resort to an overall ban on holdings.

Concluding statement:

The ICMA appreciates the valuable contribution made by the European Commission through this public consultation process and would like to thank the European Commission for its careful consideration of the points made in this response, which the ICMA would be happy to discuss in a meeting with the European Commission team should they consider such to be helpful. The ICMA will continue to closely follow related developments and remains at your disposal to discuss any of the above points, or any further questions which may be relevant to the assessment of international capital market impacts as work progresses.

Yours faithfully,



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2 http://www.icmagroup.org/assets/documents/Maket-Practice/Regulatory-Policy/Other-projects-related-docs/Debt write down consultation_final response.pdf