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The issue of trust

Summer is often a quiet period – but not this year. There has been no let up and as most readers will be aware, it has been a particularly challenging summer for the reputation of the industry. Trust in the financial markets has been shaken to its core by the revelations over the setting of LIBOR, the full ramifications of which are yet to unfold.

Foreword by Martin Scheck, Chief Executive, ICMA

This raises a number of issues – both in the short term and the longer term.

First, in the short term what must be done to restore trust in the robustness of important reference rates?

And second, in the longer term how does one restore trust in an industry which has been battered repeatedly by crisis after crisis, in the knowledge that the challenge has just become greater?

Of course ICMA is a "securities association" and as such we focus on practices in the cross-border securities markets. Our broad-based membership encompasses a full range of market participants, large and small, buy and sell side, which engage with ICMA specifically from a securities market perspective. In this context ICMA strives to play a full role in restoring trust, through a number of our activities.

For example, given that many cash securities are referenced to floating rates (such as LIBOR), and our work in the ECP and repo markets, we are actively contributing to the first question by responding where we can to the calls for evidence such as those contained in the Wheatley Review of LIBOR. An area of particular concern is to ensure that the market for existing floating-rate securities continues to function without significant disruption and hence we emphasise in our response the importance of a continuing reference rate which can be applied seamlessly to the rate settings of existing securities contracts: in other words "continuity of contract" is vital.

The longer term issue of restoring trust is an area where participants from all segments of the financial markets have a role to play to a greater or lesser extent. At ICMA we are contributing to this by continuing to update and refresh our standards of good market practice in the primary and secondary debt markets. This also includes the provision of standard documentation, such as the GMRA. The framework we set out complements statutory regulation and provides essential clarity for market participants in their day to day operations in the securities markets. A different example, on the buy side, is the ICMA Private Wealth Management Charter of Quality.

In addition the measured and thoughtful work conducted with a full range of industry participants through our various committees and councils is the basis for balanced and well-researched input to the authorities, all of which is designed to foster a robust and well functioning securities market – thereby helping to avoid further events which would damage the reputation of the industry.

A further aspect is the contribution of our education efforts to market participants, either through seminars, roundtables and technical courses on aspects of our rules recommendations, guidelines and standard documentation, or through formal financial market education taught by ICMA Executive Education. The content of our seminars and roundtables, along with the suite of ICMA EE courses, is continually adapted and updated to reflect the current market circumstances and requirements. We believe that an educated, skilled – and suitably qualified – workforce is an essential prerequisite for a well-functioning capital market: ICMA's efforts contribute to this common good.

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Quarterly Assessment by Paul Richards

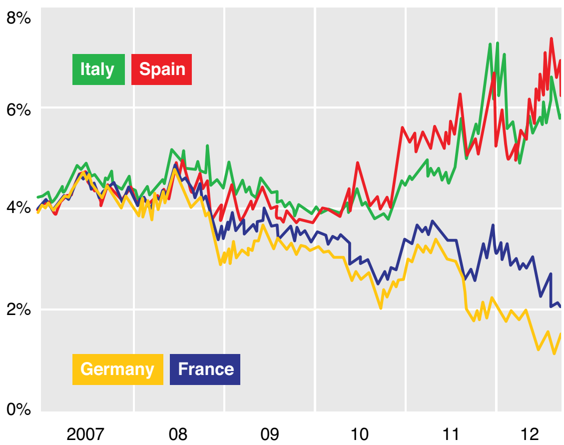
Saving the euro?

During the third quarter of 2012, the authorities announced two important initiatives intended to address the sovereign debt and banking problem in the euro area and help restore market confidence:

- *Sovereign debt:* The President of the ECB said on 26 July that "within our mandate, the ECB is ready to do whatever it takes to preserve the euro and, believe me, it will be enough." And, on 6 September, the ECB announced that it would be willing to intervene in unlimited amounts in the secondary market for short-dated sovereign debt of those countries in the euro area subject to "strict and effective conditionality" under a euro-area bail-out agreement.
- *Banking:* Following a decision by the euro-area authorities at their Summit on 29 June, the President of the European Commission put forward a proposal on 12 September for EU legislation to enable the ECB to become the "single supervisory mechanism" for banks in the euro area.

2. Both of these proposals have widespread implications for the international capital market in Europe. In anticipation of ECB intervention, sovereign bond yields at the short end of the yield curve, particularly in Spain and Italy, fell significantly on balance over the third quarter. The reductions at the short end of the yield curve also had an impact in reducing their long-term sovereign bond yields, and their spreads over bunds (though at the end of the third quarter spreads were still at a high level); and they encouraged new bond issuance by corporates and by financial institutions, including in Spain and Italy.

Chart:
Selected euro-area 10-year sovereign bond yields



Source: Goldman Sachs

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The sovereign debt problem and the banking problem in the euro area are related.

3. This Quarterly Assessment:

- summarises the sovereign debt and banking problem in the euro area (paragraphs 4-8);
- assesses the response from the euro-area authorities to the sovereign debt problem (paragraphs 9-14);
- assesses their response to the banking problem (paragraphs 15-23); and
- finally, considers the tests that will need to be met if there is to be a lasting restoration of market confidence (paragraphs 24-30).

The Quarterly Assessment covers the period until the end of the third quarter of 2012, and is the fifth in a series of Quarterly Assessments which have charted the course of the euro crisis and its implications for the international capital market in Europe, quarter by quarter.

The sovereign debt and banking problem

The sovereign debt problem

4. The sovereign debt problem is specific to the euro area because the 17 participating Member States use the euro as their single currency. As none of the governments in the euro area issues its own national currency, each government effectively borrows in foreign currency. If and when governments in the euro area cannot finance their own budget deficits because the market will no longer lend to them at a sustainable rate, they need to be bailed out by borrowing from the other governments. Five governments in the euro area have so far had to be bailed out: Greece (twice); Ireland; Portugal; Spain (for its banks); and Cyprus. In the case of Greece, its sovereign debts have also had to be written down and rescheduled. That has left the market with a concern that sovereign debts may not be risk-free elsewhere in the euro area. There has also been political speculation about whether Greece will eventually leave the euro area, if it is not able to meet the terms of its second bail-out and there is no agreement on modifying them. That has left the market with the concern that the commitment to the euro may no longer be irreversible. As a result, sovereign yield spreads over bunds, which were negligible before the crisis began, have over the past two years been wider at times than at any other time since the euro was launched in 1999, not just in Greece, but in some other euro-area countries such as Spain and Italy as well.

The banking problem

5. The banking problem is not specific to the euro area, but has been more intense in parts of the euro area than in most other countries. Before the crisis began in 2007, many banks over-lent (eg on property), especially in Ireland and Spain. Since the crisis began, a number of banks have run short of liquidity, as they have no longer been able to borrow from other banks in wholesale markets on an unsecured basis. So they have increasingly borrowed on a secured basis, and become increasingly reliant on borrowing from the ECB, which only lends to banks on a secured basis against eligible collateral. As a result, for these banks, eligible collateral has been in short supply. In addition to the shortage of liquidity, some banks have been at risk of insolvency, because of the losses they have suffered on their loans, and have needed extra capital, which the market has not been willing during the crisis to provide. They have also had to meet higher capital requirements set by the European Banking Authority (EBA), and have been expected by the market to meet future requirements under the EU Capital Requirements Directive (CRD) IV in advance.

The relationship between them

6. The sovereign debt problem and the banking problem in the euro area are related. Sovereigns depend on their national banks, because the banks invest in their own government debt (eg to ensure that they have sufficient liquidity). National banks depend on sovereigns, because sovereigns have been the backstop for their banks if they become insolvent and need more capital, which the market is not willing to provide. In some cases – eg in Ireland and Spain – governments have needed to provide so much capital to the banks that they have increased the risk of their own insolvency.

7. Contagion has compounded the problem:

- During the initial period after the euro was launched, bank lenders and investors in euro-area capital markets increased their cross-border exposure, and interest differentials between different national markets almost disappeared. But since the crisis began, bank lenders and investors have increasingly withdrawn within national boundaries (ie "home bias") or to "safe havens" in countries whose governments are still AAA-rated. In some cases, it appears that they have been encouraged to do so by their national regulators in order to reduce their risks. That has made some sovereigns (eg Italy and Spain) even more dependent on financing from their national banks.
- The main cross-border intermediary has become the ECB, which continues to provide short-term liquidity to the banks across the euro area, and has also provided longer-term finance (through the two three-year LTROs amounting to around €1 trillion in total in December 2011 and February 2012), as well as providing a safe home for deposits from banks, when they are not willing to lend to each other.
- The TARGET2 payment system linking the Eurosystem was in balance when the crisis began. But over the past five years, Germany, the Netherlands, Finland and Luxembourg have built up claims of around €1 trillion, on the one side, while Greece, Ireland, Portugal, Spain and Italy have built up liabilities of a similar amount, on the other side (eg as a result of depositors with banks on the periphery of the euro area switching their deposits to banks in its core).
- The size of the interest differentials between national markets has made the ECB's role in setting a single monetary policy for the euro area increasingly difficult because the monetary transmission mechanism has broken down. Despite an official ECB interest rate for the euro area as a whole of ¾%, the market has fragmented and there have been wide differences, not just between sovereign bond yields, but also between interest rates paid by corporates and by banks, in the periphery of the euro area and the core.

8. Of course, the sovereign debt and banking problem is not just a problem in the euro area. Other countries (eg the US and the UK) have faced economic difficulties too. The budget deficit in the US and the UK is much larger as a proportion of GDP than in the euro area, which is expected to be around 3% of GDP this year in aggregate. But the market does not currently look at the euro area as a single entity; it looks at the euro area as a series of separate national entities, which are collectively as strong as their weakest link. Uncertainty in the market about whether the commitment to the euro is irreversible, whether sovereigns are risk-free, and whether all banks are safe, has damaged market confidence and put back the prospects for a sustained economic recovery in the euro area, with knock-on effects elsewhere in Europe and more widely.

Resolving the sovereign debt problem

The Fiscal Compact

9. How are the euro-area authorities proposing to resolve the sovereign debt problem? First of all, they have agreed a Fiscal Compact, which limits the budget deficits of each participating Member State in the euro area to a maximum of 3% of GDP in the medium term. This is in essence what the Stability and Growth Pact (SGP) was originally established to achieve when the euro was launched in 1999. But the

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original SGP was not enforced. And it is not yet clear to the market why the new Fiscal Compact should be any easier to enforce than the old one. A Compact on Growth and Jobs has also been agreed. There is a question whether the Fiscal and Growth Compacts are consistent with one another. However, the Growth Compact is not large in relative terms (1% of euro-area GDP).

The European Stability Mechanism

10. In any case, the problem of how to finance the budget deficits of some governments in the euro area is not just a problem for the medium term; it has become an immediate problem in the short term for the five governments that have so far needed bail-outs. This problem is being addressed by establishing joint bail-out funds: initially, the European Financial Stability Facility (EFSF), which is temporary, and has been succeeded by the European Stability Mechanism (ESM) as a permanent replacement, now that it has been approved by the German Constitutional Court (on 12 September). In both cases, bail-out funding is subject to the government debtor agreeing to policy conditions set by the other government creditors. But the EFSF is limited to €440 billion, most of which has been used on existing bail-outs. Even the ESM is to be limited to €500 billion; and this figure is incremental only to existing EFSF commitments rather than to the EFSF as a whole. It would not be nearly large enough on its own to bail out a large euro-area government, if the market was no longer willing to finance it at a sustainable rate. Increasing the size of the ESM would require agreement by national parliaments, which would not be likely to be granted at present by the Bundestag.

Eurobonds

11. One way that has been proposed for addressing the sovereign debt problem would be through the issue of "eurobonds", jointly and severally guaranteed by all euro-area governments. A number of governments in the euro area, including the new French Government, are in favour of the issue of eurobonds, as they would provide access to market financing at sustainable rates for those governments which at the moment have no access to the market at all. But the German Government (and some others) are opposed to the issue of eurobonds on the grounds that there would need to be a complete political (ie fiscal) union in the euro area first, otherwise eurobonds would simply represent a way of transferring resources from governments with AAA credit ratings (like Germany) to other less creditworthy governments, without joint – and democratic – control over how the funds are spent in return. The issue of eurobonds might also require a change in the EU Treaty, which would need to be agreed by all EU Member States, and is unlikely to be feasible, at least for the time being.

The ECB

12. The most credible alternative in the short term is the ECB. Under the Treaty, the ECB is not permitted to purchase the debt of participating Member States in the primary market. But in countries outside the euro area, most central banks intervene to buy (and sell) government debt in the secondary market; purchases which are not "sterilised" (ie purchases whose monetary effects are not offset) represent "quantitative easing". In an attempt to prevent dysfunctional markets, between 2010 and early this year the ECB purchased in the secondary market, under its *Securities Market Programme (SMP)*, over €200 billion of sovereign debt, particularly the debt of governments in need – or potential need – of a bail-out. But secondary market intervention by the ECB has proved controversial (in particular in the Bundesbank), even though purchases of government debt have been sterilised, on the grounds that they contribute to systemic risk. In addition, purchases of government debt by the ECB have not until now been subject to policy conditions; or, if policy requirements have been set as a condition for intervention, it has not proved possible in practice to enforce them.

13. Despite the opposition of the Bundesbank, the ECB Governing Council has now decided that secondary market intervention in the sovereign bond market is "within its mandate" and necessary to counter the "convertibility" or "tail" risk that the euro area may break up:

- The ECB has stated that it is willing in principle to intervene in unlimited amounts in the secondary market through *Outright Monetary Transactions (OMTs),* concentrating on short-term debt with a residual maturity of between one and three years of euro-area sovereigns subject to "strict and effective conditionality" under a bail-out programme involving the EFSF/ESM, which the IMF will be asked to help design and monitor.

- Secondary market intervention by the ECB through OMTs is intended to complement financial support from the EFSF/ESM, which are permitted to purchase bonds in the primary market (ie at auction).
- The ECB is also willing to intervene in the secondary market to smooth the way, when a euro-area sovereign already subject to a bail-out programme wants to re-enter the primary bond market.
- The OMT programme will replace the original SMP: the ECB will hold the bonds purchased under the SMP until maturity.
- In the case of OMTs, the ECB will accept *pari passu* treatment with other bondholders.
- As with the SMP, the ECB's intervention through the OMT will be sterilised (ie the monetary effects will be offset).
- The ECB has also loosened collateral requirements on its loans to banks in countries subject to a bail-out by suspending the application of the minimum credit rating threshold (ie ignoring credit rating agency downgrades) in those countries; and expanded the list of assets to be used as eligible collateral to include marketable debt instruments denominated in US dollars, sterling and yen held in the euro area.
- Finally, the OMT programme is intended to be transparent: the market value of OMT holdings by the ECB will be published weekly, and the average maturity by country monthly.

14. The ECB's new Outright Monetary Transactions (OMT) programme differs from the original Securities Market Programme (SMP) in several important respects:

- Unlike the SMP, OMTs are subject to "strict and effective conditionality": ie there are "two legs" to the new policy. However, OMTs are only available to a government in the euro area if it applies to the ESM, and some governments in potential need of financial support may be reluctant to apply if the conditions are too strict, on the grounds that they have imposed strict conditions of their own already. And it is not clear what will happen if a government subject to conditionality reneges on the conditions. In those circumstances, the ECB can in theory stop intervening or sell the bonds that it has purchased, but in practice the severe consequences of doing so are likely to make this a difficult decision to take. Once ECB intervention begins, there is consequently a risk of moral hazard.
- Second, intervention in the secondary market by the ECB through OMTs is intended to be unlimited in amount, whereas intervention in the SMP was strictly limited, even though it eventually amounted to over €200 billion in total. No fixed yield caps or spreads over bunds have been set in advance at which intervention through OMTs will take place; there is no base level for yields at which the ECB considers that "convertibility" or "tail" risk has been eliminated in practice; and there is no set period of time for the OMT programme. These parameters have deliberately not been specified, because they are part of a policy of constructive ambiguity. It is not yet clear whether the market will test the ECB's unlimited commitment in practice.
- Third, the ECB's OMT holdings will be of shorter-term sovereign debt than before (ie closer to the ECB's short-term policy rates, and with a similar maximum maturity to the LTROs). It is possible that the lower yields available as a result at the short end of the yield curve may encourage governments to issue short rather than long-term bonds. That would also shorten the maturity profile of their existing debt and increase the amount that needs to be refinanced in the near term. But if the ECB's operations through OMTs are effective, they ought also to bring down yields on longer-term bonds. There is a related question about the monetary impact of OMTs. Like the SMP, the ECB has stated that the monetary impact of OMTs will be sterilised:

"The ECB is willing in principle to intervene in unlimited amounts in the secondary market subject to "strict and effective conditionality" under a bail-out programme.

ie the liquidity created by the ECB's secondary bond market purchases will be offset. That would be increasingly difficult to achieve if intervention under OMTs had to take place in very large amounts.

- Fourth, the ECB has explicitly stated that it will in future accept *pari passu* treatment with other creditors under OMTs. This is different from the position under the SMP, where the ECB in practice obtained preferred creditor status in the case of Greece. The market has been concerned that, if ECB purchases of sovereign debt are preferred, the larger the purchases made by the ECB, the further that remaining private sector holdings of sovereign debt will be subordinated, and the less incentive there is for private sector investors to return to the market. So the market has welcomed the change in the ECB's position. It has also been agreed that ESM lending to Spain will not be preferred. But there is still a question in the market about whether the ECB's acceptance of *pari passu* treatment in principle will be implemented in future in practice.

Resolving the banking problem

15. How are the euro-area authorities proposing to resolve the banking problem? In addition to the imposition of higher capital and liquidity requirements (under CRD IV), the authorities increasingly take the view that the banking problem in the euro area compounds the sovereign debt problem, and so the plan is to separate them as far as possible. But that is conditional on agreement on Banking Union in the euro area. What will this involve?

A single supervisory mechanism

16. The euro-area authorities decided at their Summit on 29 June that proposals should be considered before the end of 2012 for a "single supervisory mechanism" (SSM) for banks in the euro area, involving the ECB. On 12 September, as a first step towards Banking Union, the European Commission announced an EU legislative proposal under Article 127(6) of the existing Treaty. Article 127(6) stipulates that supervisory tasks can be conferred on the ECB, so a Treaty change is not required. If approved as currently proposed by the Commission:

- the ECB will be responsible for the prudential supervision of all credit institutions in the euro area, including for: authorising, and withdrawing the authorisation of, credit institutions; ensuring compliance with minimum capital requirements laid down under EU banking rules (and setting higher prudential requirements, where necessary); ensuring compliance with provisions on leverage and liquidity; applying capital buffers; and carrying out supervisory stress tests;
- the ECB will be able to require any of the banks in the euro area to take steps to ensure that they remain viable, and it will also be able to intervene early to prevent a breach of their capital requirements;
- EU Member States not in the euro area will be able to opt into the SSM by cooperating with the ECB if they wish;
- there will be a single supervisory handbook – as well as the single rulebook – for all bank supervisors throughout the European Economic Area (EEA);
- the role of the European Banking Authority (EBA) across the EEA as a whole will be maintained, but its voting arrangements will be changed under a separate legislative proposal;
- the current division of powers between home and host state regulators and supervisors will remain in place, with the ECB taking over the functions of the home and host authority for the euro area and any other participating Member States;
- the ECB is intended to be independent in carrying out its supervisory functions, while being accountable to the Council and the European Parliament;
- the costs of supervision will be borne by the banks subject to it.

17. The Commission has asked the Council and the European Parliament to agree to these changes by the end of 2012, with a view to the ECB taking the new powers from 1 January 2013, and with transitional arrangements under which: (i) the ECB can take over the supervision of any banks, particularly banks which have received or requested public funding, from 1 January 2013; (ii) the ECB will take over the supervision of the most systemically significant banks from 1 July 2013; and (iii) the ECB will take over supervision of all the remaining banks from 1 January 2014.

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Direct ESM intervention to recapitalise banks could help to break the link of interdependence between banks and their sovereigns.

18. Following the Commission’s proposal, the main areas for debate concern:

- whether the ECB should take responsibility for supervising all 6,000 banks in the euro area or only the 60 (or so) systemically significant cross-border banks, with a common set of supervisory rules for the remainder: the Commission argues that even banks outside the top 60 – eg some of the Spanish *cajas* – can pose a threat to financial stability; and that national supervisors will continue to play an important role in day-to-day supervision and in preparing and implementing decisions by the ECB (in much the same way as, on the monetary policy side, the ECB delegates tasks to the national central banks in the Eurosystem);
- whether the timetable proposed by the Commission is feasible, both for agreeing the legislation by the end of the year and, once the legislation has been agreed, for transferring responsibilities to the ECB, especially if the ECB needs to take over supervision of all the banks in the euro area;
- the potential conflict of interest between the ECB’s monetary policy and bank supervisory roles: the Commission is proposing that a supervisory board within the ECB should be created with “Chinese walls” to separate it from the monetary policy side of the ECB;
- the relationship between the ECB, which is responsible for banking supervision across the euro area, and the EBA, which is responsible for a single rulebook and consistent supervisory practice across the EEA as a whole. Although the voting powers of the EBA are due to be changed, so that Member States in the euro area do not have an inbuilt majority in the EBA, the Commission’s proposal limits the scope for EU Member States outside the euro area (like the UK) to influence EBA decisions.

Direct recapitalisation of banks via the ESM

19. Agreement on the single supervisory mechanism is a condition for direct ESM recapitalisation of euro-area banks. If this condition is met, direct ESM intervention to recapitalise banks could help to break the link of interdependence between banks and their sovereigns. That is because it would replace the previous system under which the euro-area authorities bail out national governments, enabling them to bail out their national banks, but at the cost of increasing their own government debt. Once the single supervisory mechanism is agreed, it is proposed that the ESM should be used to recapitalise banks directly in future, though there is still a question about whether these provisions will apply to “legacy” bank assets in Spain (for which there is a bail-out of up to €100 billion), or whether government guarantees will still be needed; and if direct recapitalisation by the ESM of banks in Spain does proceed, whether equivalent treatment will be offered in the case of other previous bail-outs (eg Ireland).

Bank resolution

20. For the time being, national authorities in the euro area will continue to be responsible for bank resolution at the point of failure. The European Commission has proposed – for adoption by the end of 2012 – a common framework under which bank shareholders and creditors bear their full share

of bank losses and recapitalisation costs, and under which Member States would be required to establish an *ex ante* resolution fund paid for by contributions by banks, with a mandatory borrowing facility between national schemes, within limits. But the European Commission intends in due course to present a proposal for a European authority to take over this role. Such a "single resolution mechanism" at euro-area level, backed by a common backstop, would be intended to help resolve banks that fail.

21. One of the main problems with resolving banks that fail is where the burden of failure should fall. Over €4.5 trillion of taxpayers' money has been used to rescue banks in the EU. There are three key questions about burden-sharing in the euro area in future:

- The first question concerns whether the burden on taxpayers should continue to fall exclusively at national level or whether the burden in the euro area can and should be shared at euro-area level.
- The second question concerns the distribution of the burden between shareholders, creditors and taxpayers. The European Commission has proposed that shareholders and creditors should bear the costs of resolution before any external funding is granted, and that private sector solutions should be found instead of using taxpayers' money. In the case of the Irish bail-out, senior creditors were protected, whereas in the case of the Spanish bail-out, there is a question about whether senior creditors should be "bailed in". Bailing in senior creditors (ie by writing down their holdings or converting them from debt to equity, in the case of resolution, to help recapitalise the financial institution concerned) may reduce the cost to taxpayers, but it may also have implications for the cost of bank financing in future. If the cost of new unsecured medium-term bank financing increases, banks may replace it with more short-term financing; or replace unsecured financing with secured financing, with the result that their remaining unsecured creditors have less security. But it may also lead to a greater distinction in the cost of funding between banks which are regarded by the market as safe and those which are less safe.
- The third question concerns whether any additional measures should be taken – eg to separate banks' wholesale from their retail activities – in an attempt to reduce the potential burden on taxpayers in future of banks being "too important to fail", and whether such measures would be cost-effective, unless risk management in the banks improves. The Vickers report in the UK and the Liikanen report in the EU as a whole both address the question of separation: the Vickers report proposes to ring-fence banks' retail activities, while the Liikanen report proposes to ring-fence banks' trading activities.

A pan-European deposit guarantee scheme

22. National deposit guarantee schemes in the EU have been harmonised at €100,000 per depositor, per institution, since the end of 2010; and in July 2010 the Commission made additional proposals for faster pay-outs and *ex ante* funding by contributions from banks and a mandatory borrowing facility between national schemes within fixed limits. These proposals are now intended for adoption by the end of 2012.

23. National deposit guarantee schemes are intended to prevent a bank run. But they would not be sufficient to prevent a bank run in a case in which depositors have lost confidence in the creditworthiness of their own government. A single euro-area deposit guarantee scheme could in principle overcome this through the use of mutual guarantees, but: (i) there is not currently agreement on a euro-area scheme, which would need to cover €5 trillion of bank deposits in the euro area; (ii) the amount guaranteed in each national scheme (ie €100k per depositor per institution) is unlikely to be sufficient to prevent a bank run; and (iii) the scheme would not provide any guarantee against the risk of a national government leaving the euro area. If it was financed by a levy on the banks, there would be a question about whether banks in surplus countries would be prepared to finance a scheme the effect of which would be to help protect their competitors in deficit countries. And if retail depositors were given preference in the resolution of a failing financial institution, the result might be to reduce the risk to the taxpayer from a deposit guarantee scheme, but would not necessarily remove it.

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Will the measures that the authorities have proposed have a lasting impact in restoring market confidence?

Restoring market confidence?

24. Will the measures that the authorities have proposed on OMTs and on Banking Union, if they go ahead as planned, have a lasting impact in restoring market confidence? There are a number of tests:

25. First of all, will they lead to a return to real growth in the economy of the euro area in the medium term? Without a return to growth, sovereign debt levels in parts of the euro area are unlikely to be sustainable, quite apart from the potential political implications.

26. Second, will they lead to an improvement in the competitiveness of the periphery of the euro area vis-à-vis the core? Without an improvement in the competitiveness of the periphery, continued transfers of resources will be needed to the periphery from the core:

- On the debtor side, external devaluation would give an opportunity for a debtor country to improve its competitiveness by shifting resources into net exports. But if the commitment to the euro is irrevocable, external devaluation is not possible. Internal devaluation is much harder and takes much longer, as it involves reducing wages and pensions. This is difficult to achieve politically (as the recent case of Portugal has shown), and economically it may involve an increase in unemployment, at least for a time. It is not clear how long the electorates in debtor countries are willing to accept the austerity involved. Since the crisis began, governments associated with austerity measures have frequently been voted out of office.
- Similarly, on the creditor side, the support from creditor countries to debtor countries has so far taken the form of loans. But there must be a question whether some of the loans will ultimately be repaid, and whether further loans will be needed in the future. In a fully integrated economy, transfers take place automatically from richer parts of the economy to poorer parts on a continuing basis. That risk across the euro area has already become a political issue in Germany and other creditor countries, though the outcome of the Dutch election on 13 September suggests that it is not yet of overriding importance.

27. Third, what are the political implications of broadening the role of the ECB beyond its original remit of being independent of governments to pursue price stability (like the Bundesbank used to be)? The extension of the ECB's role – as a result of the commitment to undertake unlimited OMTs, if necessary, and the responsibility for bank supervision in the euro area – will inevitably bring it into a closer relationship with euro-area governments. The ECB's role in secondary market intervention involves monitoring conditions for bail-outs agreed by euro-area governments in the Eurogroup through the ESM, and may lead to a much greater level of debt mutualisation in the euro area than before; and the ECB's role in supervising banks in the euro area involves taking decisions (eg about withdrawing the licences of individual banks) which in the past have carried reputational risk for the authorities concerned and political consequences in individual Member States. In addition, government money may be involved if banks need to be recapitalised, and governments may need to provide a backstop if banks need to be wound down. Is there sufficient democratic legitimacy for the extension of the ECB's role in a system in which most decisions about tax and expenditure are agreed in national parliaments rather than the European Parliament?

28. Fourth, does the ECB's commitment to do whatever it takes within its mandate to preserve the euro relate to the preservation of the euro area as a whole (eg including Greece) or only to the preservation of the euro (ie if necessary, allowing Greece to leave the euro area)? And if one country were to leave the euro area, how would it be possible to stop contagion to others?

29. Fifth, what are the implications from Banking Union in the euro area for the Single European Market across the EU as a whole? Euro-area governments will effectively have a qualified majority within the EU on Single Market measures; and the degree of financial integration within the euro area – not just in monetary policy, but in bail-out funding, banking supervision, deposit guarantees, bank resolution and crisis management – would be much greater than in the rest of the EU, leading to a widening gap between the euro area and the rest of the EU.

30. The outcome is not yet clear. But the prize is sustainable market financing of government debt; and, if confidence returns on a sustainable basis, the market will be able to help finance the economic recovery. Banks may be constrained because they are reducing their leverage in order to meet new and higher bank capital requirements, and their financing costs have increased. But to fill the gap and help finance the economic recovery, cross-border market-based finance could be provided by investors and asset managers through the international capital market, once market confidence is fully restored.

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In brief

- The sovereign debt problem and the banking problem in the euro area are related.
- The euro-area authorities are proposing to resolve the sovereign debt problem through the Fiscal Compact, which limits budget deficits, but whose effectiveness is untested; and joint bail-out funds, which are limited in size. The issue of joint and severally guaranteed "eurobonds" has been ruled out for the time being. That leaves the ECB as the most credible alternative in the short term. The ECB has announced its willingness to intervene in unlimited amounts in the secondary market for the sovereign debt of euro-area Member States subject to "strict and effective conditionality" under a bail-out.
- The euro-area authorities are proposing to resolve the banking problem by separating it as far as possible from the sovereign debt problem. A "single supervisory mechanism" based on the ECB is proposed as a first step towards Banking Union in the euro area. This is a condition for direct euro-area bail-outs of banks in future. The timetable is tight and there are a number of issues yet to be resolved.
- Will these measures have a lasting impact in restoring market confidence? The main tests are: whether they lead to a return to real economic growth and an improvement in the competitiveness of the periphery of the euro area in relation to the core; and how the political implications are addressed. The outcome is not yet clear.

Recent practical initiatives by ICMA

The purpose of this list is to summarise practical initiatives by ICMA since the previous Quarterly Report. ICMA responses to consultations by regulators are on the ICMA website.

Short-term markets

1. ICMA has responded to the Wheatley Review on the reform of LIBOR, focusing in the response on the continuity of contracts, particularly in the case of FRNs, and on the repo market; and also responded separately to the enquiry of the ECON Committee of the European Parliament along similar lines.
2. ICMA has responded, on the implications for the repo market, of the CPSS/IOSCO joint consultative report on the *Recovery and Resolution of Financial Market Infrastructures;* and the HM Treasury consultation on *Broadening the UK Resolution Regime.*
3. ICMA has responded, on limited points of particular interest for the repo market, to the BCBS/IOSCO joint consultative paper on *Margin Requirements for Non-Centrally-Cleared Derivatives.*
4. The Operations Group of ICMA's European Repo Council (ERC) has met the Chairman of the ECB's Task Force on adaptation to cross-CSD settlement in TARGET2 Securities (TFAX) to discuss in detail the feedback provided to TFAX on the CFSD ancillary services paper issued as part of the first TFAX mini-consultation.
5. To help advance adherence to best matching practice, the ICMA ERC Operations Group has conducted a review of current market supplier capabilities for automated matching services.
6. Representatives of the FSA and the European Commission (DGMARKT) spoke at the European Repo Council meeting in London on 27 September.

Primary markets

7. ICMA has been working with members on the implications for primary market documentation of the revision in the Prospectus Directive. The work is being overseen by the ICMA Legal & Documentation Committee.
8. A conference call has been held with ICMA members on FATCA, led by a partner from Allen & Overy.
9. The Public Sector Issuer Forum has held a meeting with senior representatives of the European Commission (DGMARKT) to discuss the impact of new regulatory initiatives on the sovereign, supranational and public sector agency (SSA) sector.
10. Representatives of the ICMA Financial Institutions Issuer Forum have held a meeting with the Chair and other representatives of the European Banking Authority (EBA) to discuss the implications of CRD IV for, *inter alia,* capital raising by financial institutions.
11. ICMA has submitted a response to the questions set out in the EBA consultation on *Draft Regulatory Technical Standards on Own Funds.*
12. ICMA has responded, on bail-in, to the CPSS/IOSCO consultation, drawing attention to the previous ICMA response to the Financial Stability Board consultation on *Effective Resolution of Systemically Important Financial Institutions.*
13. Progress is being made in revising the ICMA Primary Market Handbook, in consultation with an expert Working Group set up by the ICMA Legal & Documentation Committee.
14. The annual ICMA Primary Market Forum is planned for 15 November.

Secondary markets

15. ICMA has held meetings with officials and representatives of the market infrastructure to ensure that the proposed CSD Regulation does not precipitate changes in settlement which would be harmful to financial markets and the delivery of triparty services.
16. The ICMA Secondary Market Practices Committee has been considering the impact of the CSD Regulation on settlement discipline.
17. Representatives of the ICMA Secondary Market Practices Committee and the ERC Operations Group have met Monte Titoli to discuss operational issues.
18. In collaboration with SIX Swiss Exchange, ICMA has held a half-day conference examining the implications of the CSD Regulation and MiFID II/MiFIR from a market perspective; and in collaboration with the Bundesverband der Wertpapierfirmen e.V, (bwf), ICMA has held a one-day conference on recent regulatory and structural changes in the securities market in Europe.
19. Jointly with AFME and ISDA, ICMA has held a teleconference for members on MiFID II/MiFIR as these proposals reach a critical stage of debate in Europe.
20. ICMA has been holding discussions with other trade associations on planning how best to help members prepare for the implementation of MiFID II/MiFIR, once the EU legislative proposals have been agreed.
21. Following its contribution on Collective Action Clauses, ICMA continues to be involved in work on sovereign debt restructuring.

Asset management

22. The ICMA Private Wealth Management Charter of Quality was launched on 4 October at a seminar in Luxembourg involving ICMA and ABBL Private Banking Group Luxembourg. The Luxembourg Minister of Finance and the Head of the CSSF were keynote speakers at the seminar.
23. The ICMA Covered Bond Investor Council is promoting its transparency standard.
24. Representatives of the Solvency II Reporting Working Group have met the European Insurance and Occupational Pensions Authority (EIOPA) to discuss the implications for Solvency II for reporting by asset managers.
25. At the request of its members, the Executive Committee of the ICMA Asset Management and Investors Council (AMIC) has responded to the ESMA consultation on *Recallability of Repo and Reverse Repo Arrangements.*
26. The AMIC has responded to the BCBS/IOSCO consultation on *Margin Requirements for Non-Centrally-Cleared Derivatives.*
27. The AMIC Council will be meeting on 23 November at Credit Suisse in London. The meeting will be an opportunity to discuss both market-related issues and the AMIC Executive Committee's work programme for 2013.

Meetings with regulators

28. ICMA continues to lead delegations of members on both the sell side and the buy side for meetings with central banks and regulators, in addition to those already mentioned.

Regulatory Response to the Crisis

by David Hiscock

G20 financial regulatory reforms

On 3 August 2012 the FSB launched a peer review on resolution regimes. This review evaluated FSB member jurisdictions' existing resolution regimes across different financial sectors, as well as any planned changes to those regimes, using the Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes") as a benchmark. As part of this review, the FSB invited feedback from financial institutions, industry associations and other stakeholders on material inconsistencies or gaps (compared to the Key Attributes) of national resolution regimes in different FSB member jurisdictions.

On 22 August IOSCO published a consultation report on the *Technological Challenges to Effective Market Surveillance: Issues and Regulatory Tools*. This consultation report is based upon the results of an IOSCO survey, as well as presentations made to IOSCO by operators of trading venues, market authorities and industry representatives. It sets forth a number of questions for consultation and outlines proposed recommendations to assist market authorities in addressing the challenges posed by the latest technological developments to effective market surveillance, particularly with respect to:

- improving surveillance capabilities on a cross-market and cross-asset basis; and
- making more useful to Market Authorities the data collected for surveillance purposes.

Comments are sought by 10 October, following its analysis of which IOSCO will issue a final report.

On 14 September banking supervisors and central bankers representing more than 100 countries endorsed the BCBS's revised Core Principles for effective banking supervision, the global standard for the sound prudential regulation and supervision of banks and banking systems. Drawing on lessons learnt during the financial crisis that began in 2007, the revised Core Principles represent a significant step forward from the BCBS's 2006 Core Principles for effective banking supervision and the associated core principles methodology. They also reflect key advances in regulatory thinking in recent years that, among other things, include:

- devoting supervisory attention on a proportionate basis, in line with the risk profile and systemic importance of banks;
- applying a broad financial system perspective that considers both the macro- and micro-prudential elements of effective supervision;
- adopting effective crisis preparation and management strategies, together with orderly resolution frameworks and other measures to mitigate the impact of bank failures; and
- fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

On 24 September the Joint Forum issued its final report on *Principles for the Supervision of Financial Conglomerates.* This provides a set of principles which supersedes the compendium of principles on this topic developed in 1999 and published in 2001 by the Joint Forum. These updated principles are a broader and more consolidated set of internationally agreed principles, including guidance for policy makers on the powers and authority necessary for supervisors of financial conglomerates. They also focus on supervisory responsibility and guidance for supervisors on the governance, capital, liquidity and risk management frameworks of financial conglomerates. Importantly, these updated principles are structured in a manner that should facilitate their implementation across jurisdictions and over time

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European financial regulatory reforms

The Cyprus Presidency of the Council of the European Union published a note stating its priorities for the term of its Presidency, from 1 July - 31 December 2012. With respect to financial services regulation this document states: “It is of utmost significance that the regulatory framework of financial services is strengthened through the implementation of measures for greater market transparency, protection of consumers and investors and effective management of financial crises.”

The Cyprus Presidency’s website includes a section for the financial services policy area. This states that: “The Cyprus Presidency of the Council of the EU is committed to actively work for strengthening the regulation and supervision of the financial sector, in ensuring the proper and sound functioning of the financial institutions and financial markets. In particular, during the Cyprus Presidency particular attention will be given to the revision of the Markets in Financial Instruments Directive, the Crisis Management and Bank Resolution Framework, the revision of the Credit Rating Agencies Regulation, the Omnibus II Directive and the Capital Requirements Directive and Regulation.” Additionally, at page 16 of the Cyprus Presidency’s work programme there is a section on “Economic And Financial Affairs”, which includes three paragraphs under the heading of “Strengthening the European Financial Services Framework”.

On 12 September the European Commission adopted a package of proposals to set up a single supervisory mechanism (SSM) that contains:

- a legislative proposal for a Council Regulation to give specific tasks related to financial stability and banking supervision to the European Central Bank (ECB);
- a legislative proposal for a Regulation of the European Parliament and of the Council designed to align the existing Regulation 1093/2010 on the establishment of the European Banking Authority (EBA) to the modified framework for banking supervision; and
- a Communication outlining the Commission’s overall vision for the Banking Union, covering the single rulebook and the single supervisory mechanism, as well as the next steps involving a single bank resolution mechanism.

The Commission has called on the European Parliament and the Council to finalise, as soon as possible and in any case before the end of the year, not only these two new legislative proposals but also the DGS, CRR/CRD and RRD proposals already in process.

Following from a meeting of the EU’s Economy and Finance Ministers and Central Bank Governors, there was a 15 September Presidency press release: *Building on the Reform of the EU’s Financial Sector*. This notes that whilst under the proposed SSM ultimate responsibility for specific supervisory tasks related to the financial stability of all euro-area banks will lie with the ECB, national supervisors will continue to play an important role in day-to-day supervision and in preparing and implementing ECB decisions. Meanwhile after its initial debate, the European Parliament’s ECON indicated in a press release that this proposal was rather less warmly received than many other Commission proposals have been. MEPs nonetheless stressed the urgent need for it and pledged to strive to meet their tight deadline, whilst at the same time addressing the major hurdles in the way of strong EU bank supervision. ECON’s opening discussion pointed to what are likely to be MEPs’ key concerns: strong accountability of the supervisor, a clear division of tasks between EU and national levels, including

"This is the first of an annual series of Outlooks that aim to identify and assess potential systemic risks from securities markets – taking a global and forward-looking approach.

non-Eurozone countries, and differing supervision arrangements for different banks. Previously, ECON's 19 September press release flagged its view that the draft EU bank crisis resolution legislation must reflect the recent developments in thinking on a Banking Union, and the European Central Bank's mandate.

On 19 September the European Parliament's ECON conducted a hearing with the Chairpersons of the three ESAs, Steven Maijoor (ESMA); Andrea Enria (EBA); and Gabriel Bernardino (EIOPA). In his formal statement, Steven Maijoor firstly described the activities and achievements of the Joint Committee. He then moved on to describe ESMA's activities in the past twelve months, which have been driven by and focused on five areas: (i) the regulatory agenda; (ii) financial stability and crisis management; (iii) investor protection; (iv) the implementation and execution of CRA supervision; and (v) developing the ESMA organisation. Under point 1 he covered the EU single rulebook, promoting supervisory convergence and ESMA's role in the field on international cooperation. A short press release was issued following on from the hearing.

On 2 October the European Commission received the report prepared by the Liikanen High-level Expert Group on reforming the structure of the EU banking sector. In brief, the Liikanen Group recommends actions in the five following areas:

- mandatory separation of proprietary trading and other high-risk trading activities;
- possible additional separation of activities conditional on the recovery and resolution plan;
- possible amendments to the use of bail-in instruments as a resolution tool;
- a review of capital requirements on trading assets and real estate related loans; and
- a strengthening of the governance and control of banks.

This report will feed the European Commission's reflections on the need for further action. In considering the next steps the European Commission will look at the impact of these recommendations both on growth and on the safety and integrity of financial services; and also in light of the financial reforms that have already been advanced.

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Macro-prudential regulation

IOSCO's research department has prepared a report, *Securities Market Risk Outlook 2012* (the "Outlook" – dated May 2012), which has been circulated to IOSCO members only. Representing one step in a new role of IOSCO in the assessment and mitigation of global systemic risks, this is the first of an annual series of Outlooks that aim to identify and assess potential systemic risks from securities markets – taking a global and forward-looking approach to explore risks that could become systemic. It is based on a survey, conducted in October-November 2011, of regulators, securities market experts, academics and market

REGULATORY RESPONSE TO THE CRISIS

participants. It is acknowledged that this is the first risk outlook specific to securities markets and has limitations—specifically, around data availability and an absence of best practices and global methodologies for assessing systemic risk in securities markets.

The purpose of the annual Risk Outlook series is three fold:

(i) to inform the IOSCO Board and other IOSCO members about global systemic risks to securities markets;

(ii) to support the global risk identification and mitigation efforts by the Group of Twenty (G20), the Financial Stability Board (FSB), the IMF and other global organizations that are tackling similar issues, but from different sectoral perspectives; and

(iii) in the interests of public disclosure, this annual series will capture and synthesize into a single, accessible document some key issues and potential systemic risks currently being discussed by securities experts and regulators around the globe (albeit that this very first version will only be used internally and not published externally).

On 29 June 2012 the BCBS issued a consultative document on a framework for dealing with domestic systemically important banks (D-SIBs). This sets out a framework of principles covering the assessment methodology and the higher loss absorbency requirement for D-SIBs, taking a complementary perspective of the global systemically important bank (G-SIB) framework published by the BCBS in November 2011. It focuses on the impact that the distress or failure of banks will have on the domestic economy, the assessment and application of policy tools allowing for an appropriate degree of national discretion to accommodate the structural characteristics of individual jurisdictions. The proposed D-SIB framework requires banks, which have been identified as D-SIBs by their national authorities, to comply with the principles beginning in January 2016, consistent with the phase-in arrangements for the G-SIB framework. The BCBS will introduce a strong peer review process for the implementation of the principles.

On 12 July the ESRB published a macro-prudential commentary *Systemic Risk due to Retailisation?* The commentary reviews from a macro-prudential angle the possible risks stemming from increasing investment by retail investors in complex financial products. The conclusions include that: "Ongoing initiatives at the European level aimed at improving the transparency of retail financial products such as the forthcoming PRIPs initiative, accompanied by the current review of the Markets in Financial Instruments Directive (MiFID), could mitigate the risks entailed by the purchase of complex or unsuitable investment products by retail investors."

In 2012 the Financial Stability Institute (FSI) carried out a survey on the implementation of Basel II, 2.5 and III in jurisdictions that are neither members of the BCBS nor members of the EU. The methodology used in this survey is similar to the one adopted by the BCBS in October 2011 for its progress report on Basel III implementation. In line with the BCBS's approach, on 26 July 2012 the FSI published the results of its survey by disclosing the information received from 70 countries. Therefore, the results of this survey are being treated differently from those of past surveys, where the FSI published only the aggregated results. The FSI will be updating the results of this survey every year from March 2013 onwards.

The first issue of the reports of the ESRB Advisory Scientific Committee was released on 31 July 2012. The report *Forbearance, Resolution and Deposit Insurance* discusses a variety of issues involving difficulties in the banking sector, with a view to ascertaining the appropriate institutional infrastructure in the context of the European Union and the euro area.

On 29 August the ESRB published its advice to ESMA on eligible collateral for central counterparties (Art. 46 of EMIR). A more detailed accompanying paper, the ESRB's macro-prudential stance on eligible collateral for CCPs, was also published. The advice (officially dated 31 July) includes specific points concerning (i) the type of collateral that could be considered highly liquid; (ii) the haircuts to apply to collaterals; and (iii) the conditions under which commercial bank guarantees may be accepted as collateral.

On 18 September the UK Government issued a consultation on its proposals for the Financial Policy Committee's (FPC) direction-making tools. This seeks comments on the Government's intention to:

- make the FPC responsible for setting the level of the UK's counter-cyclical capital buffer;
- provide the FPC with a direction-making power to impose sectoral capital requirements; and
- provide the FPC with a time-varying leverage ratio direction-making tool, but no earlier than 2018 and subject to a review in 2017 to assess progress on international standards.

The document contains draft secondary legislation that will provide the FPC with its directive tools, and an impact assessment that contains illustrative estimates of the net benefits of the FPC's macro-prudential tools. Comments are sought by 11 December. The most recent meeting of the UK's interim FPC was held on 14 September and the record of the meeting was published on 27 September.

On 20 September the ESRB held its seventh regular General Board meeting in Frankfurt and issued an associated summary press release. In brief, considering the current situation the ESRB perceives that, since the previous

General Board meeting on 21 June, financial market tensions have subsided somewhat, but that high uncertainty and associated fragility persist in the EU financial system. In order to solidify the improvement and further restore confidence, all authorities, at both the national and the European level, must implement agreed measures fully and consistently. Additionally, from a macro-prudential perspective, the ESRB points to the need to:

- assess forbearance policies and their implications for provisioning;
- move forward with banks' balance sheet repair; and
- consider the implications of the ongoing balance sheet adjustments for a smooth provision of credit to the economy.

Looking ahead the ESRB had an exchange of views on the proposals recently put forward on the Banking Union, focussing on the macro-prudential aspects of the proposal to establish a single supervisory mechanism (SSM) for the euro area. The ESRB is of the opinion that the macro-prudential benefits of the SSM would be optimised if adequate resolution procedures for banks were implemented in parallel, for countries adhering to the banking union. Furthermore the ESRB noted that financial market reference rates have recently come under public scrutiny; and that it is necessary that their governance and the setting mechanisms be reformed.

Reporting on ESRB activities, the ESRB highlights its 20 September 2012 publication of the first issue of the *ESRB Risk Dashboard*, which comprises a quarterly set of quantitative and qualitative indicators aimed at identifying and measuring systemic risk. These cover interlinkages and composite measures of systemic risk; macro risk; credit risk; funding and liquidity; market risk; and profitability and solvency. An overview note, two annexes describing the underlying methodology and each indicator, and some data can be downloaded from the ESRB's website. Separately, in the context of the "act or explain" mechanism, the ESRB is processing the replies received from the addressees of its recommendations on: (i) lending in foreign currencies; (ii) US dollar-denominated funding of credit institutions; and (iii) the macro-prudential mandate of national authorities.

In addition to the current issues above, the ESRB reports that work is also ongoing on three medium-term projects:

- the treatment of long-term guarantees in insurance;
- vulnerabilities linked to bank funding (including asset encumbrance and the relevance of innovative instruments, such as synthetic ETFs and liquidity swaps); and
- interconnectedness and contagion, looking at how risks could propagate in CDS markets and in the interbank market; and also considering how enhanced monitoring could help to identify and reduce systemic vulnerabilities stemming from securities lending transactions (ie reuse of collateral, re-investment risk of cash collateral).

On 16 July 2012 the IMF published an update to its April 2012 Global Financial Stability Report (GFSR). Chapter 3 of the IMF's October 2012 GFSR examines whether the regulatory reforms designed to make the financial system safer are moving the system in the correct direction, using a benchmark set of features that include financial institutions and markets that are more transparent, less complex, and less leveraged. The analysis suggests that progress has been limited so far, in part because many of the reforms are still in the early stages of implementation. Chapter 4 evaluates how aspects of current changes to financial structure, including those elicited from regulatory reforms, may be associated with economic outcomes. Both chapters stress that the success of measures to produce a safer financial system depend on effective implementation of reforms and strong supervision.

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OTC (derivatives) regulatory developments

On 6 July 2012 the BCBS and IOSCO published a joint consultative paper on margin requirements for non-centrally-cleared derivatives. Responsive to the G20's agenda; and with the aim of further mitigating systemic risk in the derivatives markets, encouraging standardisation and promoting central clearing of derivatives by reflecting the generally higher risk of non-centrally-cleared derivatives, this consultative paper lays out a set of high-level principles on margining practices and treatment of collateral, and proposes margin requirements for non-centrally-cleared derivatives. Feedback related to the scope, feasibility and impact of the margin requirements, together with results from a quantitative impact study, will be considered in formulating a final joint proposal on margin requirements on non-centrally-cleared derivatives by year-end.

On 25 July the BCBS issued interim rules for the capitalisation of bank exposures to CCPs. The BCBS's framework for capitalising exposures to CCPs builds on the new CPSS-IOSCO *Principles for Financial Market Infrastructures* (PFMIs), which are designed to enhance the robustness of the essential infrastructure. Where a CCP is supervised in a manner consistent with these principles, exposures to such CCPs will receive a preferential capital treatment. In particular, trade exposures will receive a nominal risk-weight of 2%. In addition, these interim rules allow banks to choose from one of two approaches for determining the capital required for exposures to default funds: (i) a risk sensitive approach; or (ii) a simplified method under which default fund exposures will be subject to a 1250% risk weight subject to an overall cap based on the volume of a bank's trade exposures. These rules also include provisions on indirect clearing that allow clients to benefit from the preferential treatment for central clearing. Further work in this area is planned for 2013.

On 26 September 2012, the EBA adopted the draft Regulatory Technical Standards (RTS) on capital requirements for CCPs under the EMIR. The EBA also adopted an Opinion on the same topic, in order to raise awareness of the European Commission regarding market developments and supervisory practices which should be taken into consideration for a future review of the EMIR Regulation. The draft RTS will now be sent to the European Commission who shall decide whether to endorse it within 3 months. Following an eventual endorsement by the European Commission, the European Parliament and the Council of the EU may object to the RTS before it enters into force. The RTS will have the legal form of a Regulation and will be directly applicable across the European Union.

On 27 September ESMA published its technical standards on the Regulation on OTC derivatives, central counterparties and trade repositories (EMIR), which set out the specific details of how EMIR's requirements are to be implemented. These standards are designed to:

- increase transparency and supervision by defining the details of derivatives transactions that need to be reported to trade repositories, including the information to be provided to ESMA for the authorisation and supervision of trade repositories and the data to be made available to relevant authorities and the public; and by setting out how the clearing thresholds will operate;
- reduce counterparty risks by setting out the risk mitigation techniques for OTC derivatives that are not centrally cleared, such as timely confirmation, portfolio compression and reconciliation; and
- ensure sound and resilient CCPs by defining a set of organisational, conduct of business and prudential requirements for CCPs including margin requirements, default fund, default waterfall, liquidity risk management, and investment policy of CCPs, as well as stress and back tests.

This final report will be submitted to the European Commission, which now has three months to decide whether to endorse ESMA's draft technical standards.

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“These rules also include provisions on indirect clearing that allow clients to benefit from the preferential treatment for central clearing.

by David Hiscock

Short-Term Markets

European repo market

Recovery and resolution of non-banks: On 31 July 2012 the CPSS and IOSCO published for public comment a joint consultative report on the *Recovery and Resolution of Financial Market Infrastructures.* This includes points relating to: "moratorium preventing outgoing payments from an FMI"; "set-off, netting, collateralisation, segregation of client assets"; and "stays on early termination rights based upon entry into resolution". The ERC submitted a response, which included a few observations on these particular points and referred back to the ERC's August 2011 submission to the FSB on similar concerns in context of bank resolution proposals.

Additionally, on 1 August HM Treasury released a consultation paper *on Broadening the UK Resolution Regime* to cover non-bank financial institutions (investment firms & parent undertakings; CCPs; other FMIs; and insurers). This consultation said very little about the details of concern to the ERC, as covered by the above mentioned ERC response to CPSS and IOSCO, simply noting in respect of these points that HM Treasury anticipates enacting whatever measures are agreed at EU level. Accordingly the ERC responded to HM Treasury by drawing attention to its response to CPSS and IOSCO; and recalling the ERC's March 2010 response to an earlier HMT paper on resolution of investment banks.

Margins for non-CCP derivatives: On 6 July the BCBS and IOSCO published for public comment a joint consultative report on *Margin Requirements for Non-Centrally-Cleared Derivatives*. This consultative paper sought stakeholders' views on the formulation of consistent regulatory margin requirements across jurisdictions. Whilst the margin requirements considered by this consultative paper are specifically concerned with non-centrally-cleared derivatives, they are nevertheless just one part of a much broader framework of requirements for the utilisation of collateral. Given that the repo market is the channel through which collateral flows, the ERC composed a response which was prepared in order to highlight a number of points considered as being relevant from the perspective of leading repo market participants.

Shadow banking: Whilst we continue to await the formal conclusions of the FSB's shadow banking workstream on repos and securities lending, others continue to develop their related thinking. In anticipation of the proposals which the European Commission will make, in light of its earlier shadow banking consultation and the international level shadow banking work (of the FSB, IOSCO and the BCBS), the European Parliament is preparing its report on *Shadow Banking* – the *rapporteur* responsible for this report is the Belgian Socialist MEP, Saïd El Khadraoui.

A draft of this report, dated 14 August 2012, was published; including, of particular significance for repo, the following elements:

B.5 – "Supports, therefore, as a first step, the creation by the ECB of a central EU database on euro repo transactions, and invites the Commission to submit a legislative proposal for the creation of such a database by the end of 2013, after undertaking a feasibility study";

B.6 – "Stresses, further, the need to obtain a fuller overview of risk transfers by financial institutions, in order to determine who has purchased what from whom and how the transferred risks are supported; invites the Commission, therefore, to undertake a study (in early 2013) and submit a report (by mid-2013) regarding the feasibility of setting up a public non-profit utility as a central registry for risk transfers, which should be able to capture and monitor risk transfer data in real time"; and

C.13 – "Takes note of the importance of the repo and security lending market; invites the Commission to adopt measures, by the beginning of 2013, to increase transparency, as well as to allow regulators to impose minimum haircuts or margin levels for the collateralised financing markets".

On 27 September David Rule, who is the Chair of the FSB's securities lending and repo workstream within its shadow banking project, addressed the ICMA ERC's General Meeting in London. He stated that, whilst those engaged in this FSB workstream are keenly aware of the importance of repo markets, there are perceived risks which may need to be addressed by policy measures. Through the work done thus far it has been agreed that relevant policy goals are to:

- provide sufficient transparency to the authorities and limit risks to financial stability from excessive leverage and maturity transformation;
- subject cash collateral reinvestment to regulatory limits on liquidity and leverage risks;
- restrict, or put a floor on the cost of, secured borrowing against assets subject to procyclical variation in valuations/volatility, to reduce the potential for excessive leverage to build and for large swings in system leverage;
- mitigate the risk that large forced sales of collateral in one market segment arise as a channel of risk transmission beyond that market segment and throughout the broader financial system;
- reduce financial stability risks arising from client uncertainty about the extent to which assets have been rehypothecated and the treatment in case of bankruptcy, and to limit rehypothecation of client assets (without offsetting indebtedness) to financial intermediaries subject to liquidity regulation;
- reduce the risk of financial contagion and opacity; and
- improve collateral valuation standards.

> "Those engaged in this FSB workstream are keenly aware of the importance of repo markets.

Various policy options are being considered in order to achieve these goals. To address transparency concerns there should be improvement in regulatory

Hypothecation *Pledgors are said to hypothecate collateral to pledgees. Typically, the pledgee cannot use the collateral as the pledgor retains legal ownership. Rehypothecation is a special case where the pledgor gives specific permission for the pledgee to use the collateral and is usually limited to financial assets. Nevertheless, the pledgor retains a security interest in the collateral. This contrasts with repo (under the GMRA) in which there is a sale, with full title transfer. Since no security interest is retained the security sold in the opening leg of the repo may be freely (re)used by the purchaser, as is the case with any other asset which he owns.*

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The US SEC's work on potential new regulations for MMFs officially ran aground.

reporting; market transparency; corporate disclosures; and reporting by fund managers to end-investors. Market structure may be improved through increased use of central clearing, particularly in relation to securities lending. New regulations may impose minimum haircuts, limit rehypothecation and set minimum regulatory standards for cash collateral reinvestment; and for collateral valuation and management.

The FSB's securities lending and repo workstream will present its report to the FSB plenary in October and will seek approval to conduct a consultation on the policy proposals which it is making. The FSB will in turn report to the November meeting of G20 Finance Ministers and Central Bank Governors and it is hoped that the consultation will be published at about this time. In the meantime the European Commission is continuing its work on a parallel track, which will lead to an EU shadow banking legislative proposal.

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ECP market

Shadow banking: The European Parliament is preparing its report on *Shadow Banking*, a draft of which, dated 14 August 2012, was made public. With respect to securitisation (ie ABCP) and MMFs, the following elements of this short draft may be noted:

C.14 – "Believes that incentives associated with securitisation need to be adequately addressed; invites the Commission to examine the securitisation market and to submit a legislative proposal at the latest by the beginning of 2013 for limiting the number of times a financial product can be securitised; calls on it to impose particular requirements on suppliers of securitisation (eg originators or sponsors) to retain part of the risks associated with securitisation and of measures to achieve transparency, by the introduction of an external valuer of the underlying assets and standardisation of securitisation products as well as resolution processes"; and

C.15 – "Recognises the important role money market funds (MMFs) fulfil in the financing of financial institutions in the short run and in allowing for risk diversification; recognises the different role and structure of MMFs based in the EU and the US; recognises that the 2010 ESMA guidelines imposed stricter standards on MMFs (credit quality, maturity of underlying securities and better disclosure to investors); notes, however, that some MMFs, in particular those offering a stable net asset value to investors, are vulnerable to massive runs; stresses, therefore, that additional measures need to be taken to improve the resilience of these funds and to cover the liquidity risk; invites the Commission to submit a legislative proposal at the beginning of 2013 requiring MMFs either to adopt a variable asset value with a daily evaluation or, if retaining a constant value, to be subject to capital requirements".

Asset-backed commercial paper (ABCP): As announced on 4 July 2012, IOSCO held a roundtable discussion on issues arising from its work on securitisation, in the context of its work on shadow banking and as part of the ongoing effort to facilitate the sustained recovery of sound securitization markets globally. The meeting focused on IOSCO's recently published consultation report on *Global Developments in Securitization Regulation*, which was drafted by IOSCO's Task Force on Unregulated Markets and Products (TFUMP). Measures being considered in this area deal with risk retention, improvement in transparency and the standardization of product disclosure.

A 6 September IOSCO press release reported on a subsequent TFUMP meeting held in Brussels, to discuss structured products and securitization-related issues, at the invitation of the Belgian Financial Services and Markets Authority (FSMA).

Fitch's Annual ABCP Conference was held on 17 September. The opening session, *ABCP Review & Expectations*, involved an overview of US ABCP market conditions and outstandings from Kevin

"It is important that any reform of the rate-setting process for existing transactions referenced to LIBOR does not disrupt the international capital market.

Corrigan (Head of US ABCP, Fitch Ratings) and parallel observations regarding the European ABCP market from Emma-Jane Fulcher (Head of EMEA ABCP, Fitch Ratings). The second session was an update on European banks, delivered by James Longsdon (Financial Institutions, Fitch Ratings). The closing session was a panel discussion, moderated by Emma-Jane Fulcher, under the heading, *ABCP Drivers, Motivations and Way Forward*. Moody's 10th Annual ABCP Conference takes place on 15 November, with analysts from Moody's ABCP group being joined by market participants to discuss issues which affect the EMEA ABCP market.

Money market funds (MMFs): The US SEC's work on potential new regulations for MMFs officially ran aground, with SEC Chairman Mary Schapiro issuing a 22 August statement confirming that three Commissioners, constituting a majority of the Commission, would not support an SEC staff proposal to reform the structure of MMFs. Commissioner Luis Aguilar, one of the three dissenting Commissioners, issued his own statement on 23 August. In this he emphasised his support for the issuance of a concept release, which asks serious and probing questions about the cash management industry as a whole – rather than just considering MMFs in isolation – to diagnose its frailties and assess where reforms are required.

And then on 28 August the other two dissenting Commissioners, Daniel Gallagher and Troy Paredes, also issued a statement. They stress that, whilst not being prepared to support the Chairman's preferred alternatives of a "floating NAV" and a capital buffer coupled with a holdback restriction, they are not opposed to further improvements to the Commission's oversight and regulation; and urge that the Chairman take a different way forward for strengthening the resiliency of money market funds. This approach would: (i) empower money market fund boards to impose "gates" on redemptions; (ii) mandate enhanced disclosure about the risks of investing in money market funds; and (iii) conduct a searching inquiry into, and a critical analysis of, a number of articulated issues.

Meanwhile on 25 August the Chairman of the Board of IOSCO, Masamichi Kono, issued a statement reaffirming that IOSCO will continue its work, on the basis of the mandate given to it by the G20 Heads of State and the FSB, to develop policy recommendations for strengthening oversight and regulation of the shadow banking system, including MMFs. The IOSCO Board agreed upon IOSCO's further course of action on this important subject at its meeting in Madrid on 3/4 October 2012, and will report to the G20 Finance Ministers' meeting in November 2012.

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LIBOR and other benchmarks

The UK Chancellor of the Exchequer commissioned Martin Wheatley, Managing Director of the FSA, to undertake a review of the structure and governance of LIBOR and the corresponding criminal sanctions regime. Consequently on 10 August 2012 a discussion paper was launched, setting out the Wheatley Review's initial proposals for reform and seeking feedback by 7 September. Drawing comments from a broad group of ICMA member experts, ICMA refined an initial draft and submitted comments against the deadline. In brief, this stated that ICMA considers that the authorities' focus in reforming LIBOR should be on regulating the governance of the process for setting LIBOR to ensure that it cannot be manipulated and to prevent market abuse; and that it is important that any reform of the rate-setting process for existing transactions referenced to LIBOR does not disrupt the international capital market.

After the meeting of the Economic Consultative Committee in Basel on 9 September, Sir Mervyn King issued the following statement: "The BIS Governors look forward with great interest to the recommendations of the Wheatley LIBOR Review, and to the reports of other official groups examining reference rates used in financial markets. The BIS Governors have agreed to set up a group of senior officials to take forward examination of these issues, and to consult with the market in order to provide input into the wider official debate coordinated by the FSB."

On 28 September the Wheatley Review of LIBOR published its final report. Through the process of analysis and consultation leading up to this report, the Wheatley Review reached three fundamental conclusions that underpin its recommendations:

(i) there is a clear case in favour of comprehensively reforming LIBOR, rather than replacing the benchmark;

(ii) transaction data should be explicitly used to support LIBOR submissions; and

(iii) market participants should continue to play a significant role in the production and oversight of LIBOR.

Drawing on these three fundamental conclusions, the report presents the Wheatley Review's ten-point plan for the comprehensive reform of LIBOR, which includes:

- new and robust regulation;
- a fundamental overhaul of the way LIBOR is run, including taking responsibility away from the BBA;
- a requirement for banks to back up their submissions with evidence of relevant transactions; and
- detailed technical changes to refine the way LIBOR is put together, to make it much harder to manipulate.

The report contains a number of recommendations for the UK Government, the BBA and the banks, and the regulatory authorities both in the UK and internationally. The UK Government has indicated that the Financial Services Bill, currently being considered by the House of Lords, will be the legislative vehicle for taking forward those recommendations which are accepted. Under the leadership of Martin Wheatley, the conduct business unit of the FSA, and in particular the markets division, will work closely with the BBA and the banks to ensure that the recommendations addressed to market participants are implemented. Martin Wheatley and the FSA will also continue to engage proactively with international partners in relation to the global debate on benchmarks, working closely with the Treasury and the Bank of England; and hope to inform other work being done by international organisations to strengthen globally significant benchmarks.

The European Parliament's ECON issued a questionnaire for public consultation on *Market Manipulation: Lessons and Reform Post LIBOR/ EURIBOR*. This public consultation was organised in the context of the preparation of the ECON Committee reports by Arlene McCarthy MEP based on the Commission's amended proposals of 25 July 2012 for a Regulation on insider dealing and market manipulation (market abuse) (COM(2012)421) and for a Directive on criminal sanctions for insider dealing and market manipulation (COM(2012)420). Following directly on from ICMA's work on the Wheatley Review of LIBOR, an ICMA response to this ECON questionnaire was compiled and submitted. The responses to the ECON questionnaire were all directly taken from the "Overall commentary on proposals" in the ICMA's Wheatley response letter.

On 5 September the European Commission launched a consultation inviting stakeholders to comment on possible new rules for the production and use of indices serving as benchmarks in financial and other contracts. The ultimate objective of this initiative is to ensure the integrity of benchmarks and the consultation will run until 15 November 2012. It is a wide-ranging consultation, covering all benchmarks, "It is a wide-ranging consultation, covering all benchmarks, not just interest rate benchmarks such as LIBOR but also commodities and real estate price indices, for example.

not just interest rate benchmarks such as LIBOR but also commodities and real estate price indices, for example, and seeking to identify possible shortcomings at every stage in the production and use of benchmarks. The extent of the need for any necessary changes to the legal framework, to ensure the future integrity of benchmarks, will be assessed in light of this work.

On 14 September IOSCO announced that, in light of the significant issues raised by investigations into attempted manipulation of benchmarks and related enforcement actions, it has constituted a Board Level Task Force on Financial Market Benchmarks to identify relevant benchmark-related policy issues and develop global policy guidance and principles for benchmark-related activities of particular relevance to market regulators. This high level Task Force is composed of members of the IOSCO Board and will be chaired by Martin Wheatley, and by Gary Gensler, the Chairman of the US Commodity Futures Trading Commission (CFTC). In developing policy guidance and principles for financial market benchmarks, the Task Force will consider issues related to necessary enforcement powers, information sharing and sanctions regimes. The Task Force will aim to produce a consultation report towards the end of this year or early next year, while its work is expected to require at least until the first quarter of 2013 to complete.

On 24 September the European Parliament held a public hearing on the topic of market manipulation. The first session of the hearing, on tackling the culture of manipulation, included contributions from Gary Gensler, and Michel Barnier, European Commissioner (DGMARKT); and the second session, on establishing integrity and trust post LIBOR/EURIBOR, included contributions from Joaquín Almunia, Commissioner DGComp and Masamichi Kono, IOSCO Chairman. Following the hearing a press release indicated that MEPs consider that Libor needs trust, transparency and integrity, but regulation too.

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ECB eligible collateral

by Serena Vecchiato

As some banks' access to refinancing operations started to be restricted by a lack of eligible collateral, in 2008 the ECB decided upon a temporary expansion of the list of eligible collateral. Since then, the Eurosystem has taken ongoing measures to support bank lending, generally increasing the amount of assets on euro-area banks' balance sheets that can be used to obtain central bank refinancing. This flexibility in the Eurosystem's collateral framework, together with the fact that access to Eurosystem open market operations is granted to a large pool of counterparties, has been key in supporting the implementation of monetary policy in times of stress.

This has, however, led to some divergence between private and public collateral usage in funding markets. Back in the pre-crisis days, the two markets worked in tandem. Participants engaging with the ECB face an incentive to take advantage of the flexibility it offers regarding eligible collateral, whilst allocating other collateral against more restrictive private market requirements.

According to the latest ECB *Annual Report*, in 2011 the average amount of eligible collateral was €13.2 trillion, a 6% decrease compared with 2010. This trend was due to a significant decrease in uncovered bank bonds, mainly owing to the expiry of the state guarantees on these bonds, as well as in ABSs which were subject to tighter rating requirements as of 1 March 2011.

Central government securities, which amounted to €6 trillion, accounted for 46% of total eligible collateral, followed by uncovered bank bonds (€1.9 trillion, or 14%) and covered bank bonds (€1.5 trillion, or 12%). Beyond marketable collateral, eligible collateral also includes non-marketable assets, mostly credit claims and fixed-term deposits.

In terms of collateral actually put forward in Eurosystem credit operations, non-marketable assets became the largest component by asset type in 2011, accounting for 23% of the total, compared to 18% in 2010. By contrast, central government securities only represent 14% of collateral put forward in 2011.

Since the beginning of 2012, there have been a number of developments relating to the eligibility of collateral.

In early February 2012, the ECB formally decided as a temporary solution to accept additional performing credit claims as collateral, with eligibility requirements to be defined by national central banks. Later that same month, the ECB decided temporarily to suspend the eligibility of marketable debt instruments issued or fully guaranteed by the Hellenic Republic for use as collateral in the Eurosystem monetary policy operations. This position was reversed in early March upon activation of a collateral enhancement scheme. This scheme was valid until 25 July, following which these securities again became ineligible for the time being.

In June, the ECB decided "*on additional measures to improve the access of the banking sector to Eurosystem operations in order to further support the provision of credit to households and non-financial corporations.*" To achieve this, the ECB decided to reduce the rating threshold and amend the eligibility requirements for certain ABSs.

Two further types of ABSs have been considered eligible. The first includes: auto loan, leasing and consumer finance ABSs and ABSs backed by commercial mortgages (CMBSs) with a rating of at least "single A". These securities will be subject to a valuation haircut of 16%.

The second new type of ABSs allowed are residential mortgage-backed securities (RMBSs), securities backed by loans to small and medium-sized enterprises (SMEs), auto loan, leasing and consumer finance ABSs and CMBSs with a second-best rating of at least "triple B". They will subject to a valuation haircut of at least 26%.

Finally, on 6 September the ECB decided on further measures to preserve collateral availability.

First, it changed the eligibility for central government assets by suspending the application of the minimum credit rating threshold under certain conditions. Second, it expanded the list of eligible assets, to include marketable debt instruments denominated in currencies other than the euro, namely the US dollar, the pounds sterling and the Japanese yen, provided that they are issued and held in the euro area.

While the ECB's expansion of the types of collateral eligible in its open market operations provides liquidity insurance to the banking system, it is worth remembering that this should not be seen as a permanent source of funding. Banks need to manage the risk of liquidity on their own balance sheets and develop long-term funding strategies which avoid reliance on central bank financing.

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Second Basel III liquidity monitoring exercise

by Serena Vecchiato

Following our article on the Basel III liquidity monitoring exercise in Issue 26 of this Quarterly Report, we have taken a look at the results of the second Basel III monitoring exercise conducted by the European Banking Authority and published in September 2012.

The exercise, which aimed at outlining the ability of banks to comply with the new liquidity measures, should these provisions have been implemented on the date for which the data were submitted, was conducted on the data submitted by 155 European banks on 31 December 2011.

Compared to the previous exercise, which referred to data collected on 30 June 2011, the new results showed an improvement in the ability of banks in the sample to meet or exceed the minimum Liquidity Coverage Ratio (LCR) requirements – ie 37% of banks were compliant with the ratio, compared to 34% of the previous exercise. Along with this, the results were also encouraging for the Net Stable Funding Ratio (NSFR), for which 40% of the banks in the sample were compliant with the ratio, compared to 37% of the previous one.

Additionally, a quite important result relates to the composition of LCR liquid assets. Within Level 1 assets, 0% risk-weighted securities issued or guaranteed by sovereigns, central banks and public sector entities, and cash and central bank reserves comprise significant portions of the qualifying pool. There has been, however, a switch in these two types of assets, with the latter increasing its contribution to the overall composition to 44.7% as at end of December 2011 from 30.1% as end of June 2011, while the former decreased from 53.9% to 40.8%.

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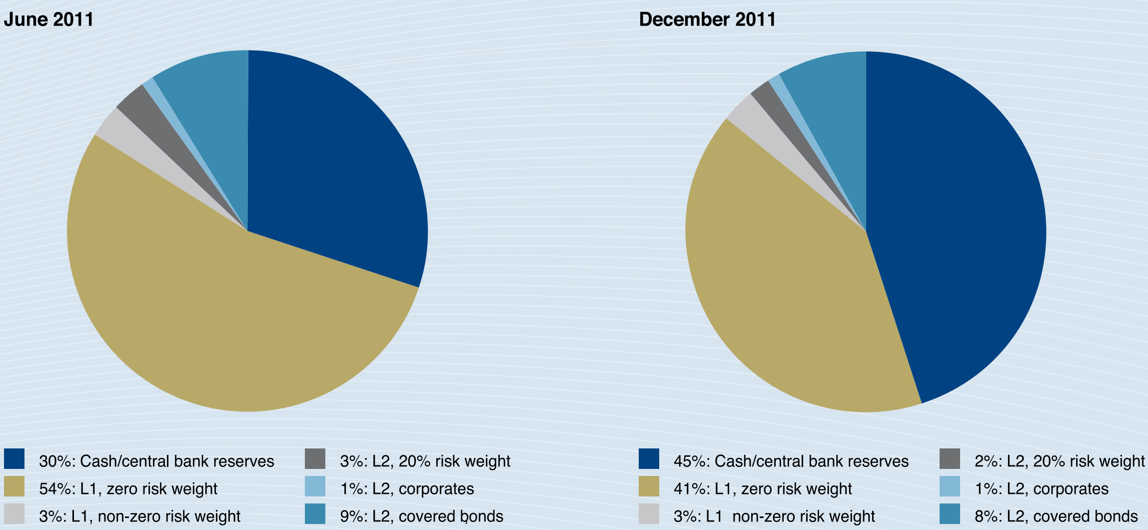
Charts: Comparison of the composition of eligible high-quality liquid assets as of 30 June 2011 and 31 December 2011



Source: EBA

by Ruari Ewing

The Prospectus Directive (PD) regime: First implemented in 2005 under the EU's Financial Services Action Plan (FSAP), the Prospectus Directive (PD) regime governs the content, approval and publication of prospectuses for (i) the admission of securities to trading on EEA-regulated markets and (ii) the non-exempt offering of securities in the EEA. It consists of the Level 1 Directive itself (transposed by EEA national laws) and a Level 2 PD Implementing Regulation (which is directly applicable under EEA national laws, without transposition). A first review of the PD regime has been under way since 2006 and is nearing completion.

Primary Markets

Prospectus Directive revision

The passing of the 1 July 2012 deadline for national transposition of the 2010 PD amending Directive has not marked an end to developments relating to this first review of the PD regime.

At Level 1, EU Member State transposition by the 1 July deadline seems to have been mixed, with reports of early, on time, late and partial transpositions. Some jurisdictions have published guidance explaining the applicable regime in the absence of transposition by 1 July, which is helpful. The European Commission will ultimately investigate and confirm transposition, but this may take some time. The Commission published in early August a table of post-FSAP transpositions, confirming Latvian and Slovakian transposition of the PD amending Directive and noting other Member States' notification of transposition as being either pending or under Commission examination.

At Level 2, the expected second amending Regulation EU/862/2012 (L2/B Regulation) to the PD implementing Regulation (PDR) was published in the EU's *Official Journal* on 22 September, with immediate effect. This follows the first amending Regulation EU/486/2012 (L2/A Regulation) commented on in the 2012Q3 edition of this Quarterly Report. The L2/B Regulation covers the mechanics for "general" and "individual" consent to third party prospectus use, as well as issuer "own" indices (including related indices) and auditor reviews of profit forecasts/estimates. Aside from its date of coming into effect, the L2/B Regulation is substantively the same as the Commission's preceding proposal. Though the Regulation has not been given retroactive effect from 1 July as some had feared, many (if not most) had been seeking to comply with its provisions (as set out in the proposal) as strongly

The 1 July 2012 deadline for national transposition of the 2010 PD amending Directive has not marked an end to developments.

recommended by ESMA in its *Questions and Answers on Prospectuses* (see further below).

Also at Level 2, ICMA did not respond to ESMA's 20 June consultation (L2/C consultation) concerning a third limb of technical advice on possible delegated acts under the amended PD, as its focus was on exchangeable and convertible bonds that are more closely linked to the equity markets than to the debt markets. ESMA has published the responses it received.

At Level 3, ESMA has continued being particularly active in its coordination role, publishing:

- a 15th updated version of its *Questions and Answers on Prospectuses*, which changed the section of Q&A No.78 (issue specific details concerning Category B items) following the coming into force of the L2/A Regulation and introduced a new Q&A No.80 on the format of the summary (including required legend wording);
- a 16th updated version of its *Questions and Answers on Prospectuses*, which acknowledged that some of the existing Q&A might be out of date or contain incorrect legislative references, replaced the old Q&A No.56 on retail cascades with a new "consent" Q&A No.81 that recommended prospectuses "anticipate" "immediately" and "so far as possible" the finalised L2/B Regulation on the basis of the Commission's preceding proposal;
- a 17th updated version of its *Questions and Answers on Prospectuses*, which notably introduces a new Q&A No.82 on summaries under the proportionate disclosure regimes (not generally material to cross-border Eurobond issuance) and, following the coming into effect of the L2/B Regulation, deletes Q&A No.81 (see above) and moves Q&A No.79 (see further the PD article in the 2012Q3 edition of this Quarterly Report);
- a list of means for communication final terms to national regulators;
- January 2011 to December 2011 data on prospectuses approved and passported;
- January 2012 to June 2012 data on prospectuses approved and passported; and
- a consultation on further amendments to ESMA's recommendations concerning mineral companies.

At the industry level, ICMA has been continuing its work trying to update the ICMA *pro formas* of final terms and pricing supplement set out in the ICMA Primary Market Handbook, with initial drafts informally circulated. However, given some pending uncertainties as to the full implications of the changes (see next article), it may be some time (potentially even a few months) before ICMA is able to publish a revised version of the existing Handbook item (Standard Documentation II in Section 7 that is available to subscribers and ICMA members). ICMA is similarly working on model retail cascade language relating to the amended regime's provisions regarding consent to prospectus use.

Any queries should in the meantime be directed to the author of this article. Distinctly, ICMA is no longer intending to update the ICMA Equity EEA Standard Form Selling Restrictions (Part B of Standard Documentation IX in Section 7 that is available to subscribers and ICMA members) that were previously deleted on a provisional basis pending review. This is because ICMA understands lead managers of equity transactions have been conferring informally over appropriately updated wording for equity EEA selling restrictions.

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PD review: history and outlook

The PD review has been running since 2006 and is still ongoing. It makes many changes to the existing system of approvals for admission and public offer prospectuses, but current uncertainties mean that it is too early to judge its net impact (though reduced supply and fragmented structures are quite possible).

1 July 2012 was the national transposition deadline for the PD amending Directive and when the L2/A Regulation started applying to new prospectus approvals (issues under previously approved prospectuses are thankfully grandfathered). Though three months have elapsed since the transposition deadline, it remains too early to draw conclusions as to the net impact of the changes.

This is largely because the very late publication of the relevant Level 2 measures (which is still ongoing) has left both industry and regulators struggling, in this transitional phase, to develop their initial understanding of the new provisions, which are often unclear or inconsistent. Regulators seem to have also, with some exceptions, been reluctant to engage with industry in advance of transactions to discuss potential practical approaches. As a result, prospectus approvals tend to be running at the longer end of the potential timelines. In this respect, whilst pan-European harmonisation is important, certainty of national interpretations is crucial – ESMA and the Commission could consider later what national differences are sufficiently significant to warrant harmonisation at Level 3 or Level 4.

Recapping on the history of the PD review, the first step of the process was the then CESR's call for evidence in November 2006. This was followed by a June 2007 CESR report and then, at Level 1, by a January 2009 Commission consultation, a September 2009 Commission proposal, EU institution Trilogue in the first half of 2010 and finally publication of the PD amending Directive in December 2010. There has so far followed, since early 2011 at Level 2, a Commission mandate requesting ESMA advice, three ESMA consultations, two ESMA advice reports, two Commission amending Regulation proposals and, so far, publication of two amending Regulations (and at Level 3 ESMA has revised its *Questions and Answers on Prospectuses* four times since June). Further Level 2 and Level 3 developments are expected, so the current review still has some time to run. It will be interesting to observe the gap between the end of this review process and the beginning of the next (second) review of the PD regime as the Commission is required to assess the functioning of the amended PD regime by 1 January 2016 and then report to the European Parliament and Council (making proposals for further changes to the regime where appropriate).

Recapping on the PD's historic fundamentals, the regime requires publication of an approved prospectus prior to any (i) non-exempt "public offer" in the EEA (widely defined as communication of sufficient information to enable investment decisions) or (ii) admission to trading on an EEA "regulated market". The prospectus must include (a) all information necessary to enable informed assessments of issuers, guarantors and securities (presented in an easily analysable and comprehensible form), (b) "minimum" information required by the relevant annexes of the PD implementing Regulation (PDR); and (c) a summary (except generally for high denomination issues). Prospectuses approved in the "home" jurisdiction are valid throughout the EEA on a passported basis for up to 12 months – provided they are supplemented with any significant new information (which can trigger walk-away rights). Exempt offers under the PD include, *inter alia,* offers (x) to "qualified investors", (y) with a high denomination (minimum now increased from €50k to €100k) or (z) to a small number of investors per EEA Member State (maximum now increased from 100 to 150 persons). High-denomination prospectuses (in the admission to trading context) distinctly benefit from a reduced disclosure burden (including logically no "minimum" information on "offer" terms). In relation to debt issuance programmes, only a base prospectus (BP) need be approved, with final terms (FTs) relating to each issue only being filed with the relevant home regulator (and notified to any host regulators).

In this respect the main changes emerging from the review seem to be:

(i) increasing the high denomination exemption from €50k to €100k;

(ii) aligning the PD qualified investor (QI) definition with its MiFID counterpart;

(iii) mandating an issue-specific summary (ISS) under programmes;

(iv) strictly prescribing a standard form, length and content for the prospectus summary and ISS;

(v) improving the liability regime for the prospectus summary;

(vi) requiring written consent for third party prospectus use (helping issuers control their potential liability in retail cascades) and strictly prescribing the disclosure of such consent, according to whether it is "general" or "individual";

(vii) strictly prescribing what information can be included in FTs by reference to an "A"/"B"/"C" categorisation of the PDR minimum information items and otherwise to a very small list of additional information: Cat. "A" information must be included in the BP with only option selection allowed in FTs, Cat. "C" information can be included in FTs and Cat. "B" information is in between (with just amounts, currencies, dates, time periods, percentages, reference rates, screen pages, names and places seemingly being allowed in FTs);

(viii) "proportionate" disclosure regimes for SMEs, mid-caps and rights issues (not fundamental to Eurobond issuance); and

(ix) lesser changes concerning passporting mechanics, prospectus publication means, language requirements, timing of supplement walkway rights, the annual information update (deleted), non-PD prospectus advertisement "Wild West" legends, host jurisdiction withholding tax information, related entity indices and auditor reports on preliminary results.

It remains unclear which uncertainties may be resolved in this transitional phase and which, once clarified, will constitute long term challenges to the functioning of the primary debt markets. Currently uncertainties raised include: whether BPs will include both a BP summary and a form of ISS; how to calculate the applicable summary/ISS length cap; whether some information may be required in the summary though not required in the prospectus itself; the actual scope of grandfathering of PDR amendments given recent tightening (distinct from the amendments to the PD and PDR provisions) of regulatory interpretations on the use of FTs; limitations on the use of final terms to tap issues under prior grandfathered prospectuses; prohibiting the inclusion of non-significant information in supplements; how to disclose non-significant information that is not covered by the PDR minimum information items and thus within the "A"/"B"/"C" categorisations (for example information needed by clearing systems); practical scope of issue-specific supplements; risk of supplements compromising underlying prospectus grandfathering; whether BPs can include information about possible non-PD issuance; precise operation of the language regimes applicable to the summary and FTs; whether PD-exempt offers of securities, which benefit from a PD regulated market admission prospectus, need to disclose in the prospectus offer information, need to provide a retail summary or are subject to the supplement walk-away right; whether the MiFID opt-down mechanics apply to qualified investors in the PD context; the scope of tax disclosure "at source"; detailed operation of the retail cascade consent mechanics; and the practical scope of the "Wild West" legend requirement.

> **"Only time will tell how to judge the net impact of the PD review.**

It is possible we may well see a reduction in market supply (to EEA retail and potentially to EEA regulated markets) and otherwise a fragmenting of programme structures and more stand-alone issuance, etc. (involving more familiarisation work for all, including investors). Only time will tell how to judge the net impact of the PD review. In the background to all this, however, is the apparent redundancy of the PD prospectus under the Commission's PRIPS' proposal (see next article).

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Packaged Retail Investment Products

On 3 July the European Commission published its much anticipated proposal, over 32 pages, for a directly-applicable Regulation on Packaged Retail Investment Products (PRIPs), together with a 99 page impact assessment.

The proposal envisages a "key information document" (KID) as a very short document (expected by many to be two/three pages along the lines of the existing UCITS KID), upon which retail investors will be able, without "being required to read other documents", to "take an informed investment decision". Investors relying on the KID will be able to claim for loss suffered through its use, unless the KID fully complies with the Regulation, including being "accurate, fair, clear and not misleading". The proposal raises several, appropriately "key", questions.

Concerning PRIPs that are securities, the proposal envisages the Prospectus Directive (PD) regime continuing to apply separately, with merely "matching" key information obligations under the PD being disapplied where a KID is prepared. The proposal however seems effectively to render the entire PD prospectus redundant (and not merely its summaries) since: (a) the prospectus purpose (to contain "all information which [...] is necessary to enable investors to make an informed assessment") is the same as that of the KID; and (b) the proposal explicitly states that retail investors do not need to read the prospectus.

It is unclear to what extent it is possible to ensure that a two or three page KID contains *all* information relevant to an informed investment decision. In this respect, it is also unclear whether the KID will cover credit risk – information material to an investment decision in a securities context (where whatever payout is due under a PRIP's structure depends further on the issuer's solvency to honour it) though not generally in the UCITS context (where the KID represents more of an investment mandate than a specific individual investment). Describing the issuer's "credit" means describing the issuer's business, which in today's world is generally international and highly complex – so including this meaningfully in the KID would seem open to question and any partial attempt to do so could well be misleading (whilst unqualified reliance on credit ratings has been criticised following the financial crisis).

Though consumer behavioural research indicates that retail investors (a) may indeed not generally read long documents (such as prospectuses), it also indicates that retail investors (b) misunderstand short documents (a 30% misunderstanding rate being noted in the Commission's KID 2009 testing report for simple UCITS) and (c) act irrationally (a concern reiterated this year by the incoming head of the UK's Financial Conduct Authority). So it does not seem evident that retail investment decisions will actually be better informed by the KID. Though the proposal acknowledges that disclosure rules (such those relating to KIDs) complement rules on sales (such as under MiFID), it states that PRIPs legislation is to be developed independently of legislation relating to distribution/advice (and that financial education and product regulation are to be equally out of scope).

The proposal envisages product "manufacturers" having responsibility for preparing and publishing the KID (in the accepted languages of the Member States where the PRIP will be sold) and reviewing/updating it "regularly" (and also having liability for the KID's content), whilst distributors would be responsible just for providing the KID to retail investors – *inter alia* so as to ensure the same KID is used for a particular PRIP by all distributors. In this respect, it seems a manufacturer could be liable to retail investors where the manufacturer's (public) KID is used by a third party distributor, long after the manufacturer has stopped offering the PRIP (and so presumably ceased updating it as no further retail investor decisions require informing) and without the manufacturer's consent (or even knowledge), to re-offer the manufacturer's PRIP securities (acquired in the secondary market) – potentially in EEA Member States that the manufacturer never targeted (and thus prepared appropriate KID translations for). Further, being a manufacturer document, the KID could presumably not include distributor-level (ie investor-facing) information such as distributor costs and individual investors' tax treatment – but the proposal is open in this respect.

Other points of concern that may need clarification include, *inter alia*, the reverse burden of proof (particularly when combined with the above substantive liability questions), whether costs other

In brief

The Commission proposes a very short KID as the sole basis for retail investors to take informed investment decisions, which raises questions as to investor misunderstanding and potential liability for PRIPs providers as well as potentially real economy businesses seeking to issue simple bonds. The continued relevance of the Prospectus Directive regime is also brought into question.

than those to be deducted from the investment return require disclosure, the definition of "manufacturer" and the Directive-like nature of many provisions that seem to be addressed to Member States themselves.

Though the proposal notes that PRIPs are "essential for meeting the needs of EU citizens" (allowing risk spreading, other benefits not individually available to retail investors, more efficient participation investment markets, deeper capital markets and better diversification options), there are concerns that the KID, as proposed, may well reduce the supply and choice of investments available to EU citizens without better informing their investment decisions. The scope of the proposal is not strictly limited to PRIPs, as extension to other, non-packaged, financial products is contemplated after four years – potentially including vanilla fixed and floating rate corporate bonds (which gives additional salience to current concerns).

The KID proposal seems to allow scope for investment misunderstanding, whilst it is crucial that retail investment decisions are actually well informed (merely assigning responsibility for misunderstanding could promote systemic risk). This would be a pity, since a well-configured KID has the potential to empower retail investors in their engagement with savings and investment. An option worth exploring would be a KID that acts just as an overview of a product's structure (a "taster") that would help retail investors engage with the retail intermediaries assisting them (notably under MiFID's suitability and appropriateness provisions – appropriately enforced). In this respect, such intermediaries would have accounted for the full product information (available in the relevant prospectus) as part of their "know your product" procedures. Self-directed retail investors, where permitted, would have to make the appropriate commitment to review the full prospectus. In either case, KID liability would be referenced to the prospectus as is currently the case in the new UCITS KID regime that came into full effect on 1 July.

ICMA continues to support the Joint Associations Committee on retail structured products (JAC) in engaging European authorities on the PRIPs project.

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It is crucial that retail investment decisions are actually well informed.

French pre-sounding rules

In France, a 14 June Ministerial order was published on 11 July in the French *Official Journal*, amending, with effect from 11 October, Art. 216-1 of the General Regulation (RG) of the French regulator AMF regarding pre-soundings. The new and old versions of Art. 216-1 are included in the RG (and its non-binding English translation). The French financial markets association AMAFI published in parallel a Code of Conduct (together with a non-binding English translation), also applicable from 11 October and approved by the AMF as professional rules. AMAFI also published a commentary on the Code (and a non-binding English translation).

Under the new provisions, "sounding" requirements are triggered where investors are questioned in the context of preparing a transaction (though the Code only seems to apply where the querying is done at issuer/seller request). Specific requirements include: (a) keeping records (even where no inside or even seemingly any non-public information is communicated) *inter alia* of the basis for the "inside" (or not) qualification of information communicated and of the persons sounded; and (b) investor prior consent to being wall-crossed.

It is unclear to whether firms are subject to these requirements concerning pre-soundings where they are not directly regulated by the AMF. In any case, similar developments have been taking place at the European level (see separate article).

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MAD review

There have been several developments recently concerning the revamping of the EU's existing Market Abuse Directive (MAD) regime into a new Market Abuse Regulation (MAR) and a related criminal sanctions Directive (MAD II). These include:

- a 21 June European Council Presidency MAR progress report that noted, regarding inside information, the awaiting of the outcome of the Geltl/ Daimler case (the judgment for which has since been published);
- a 3 July Presidency list of outstanding issues;
- a 4 July Presidency MAR compromise that seems to have no substantive impact in the areas of inside information and stabilisation; and
- a 25 July Commission MAR amendment proposal that focuses on manipulation of benchmarks following the current debate around LIBOR.

However most significant seems to be the 3 September Presidency MAR compromise that introduces, *inter alia*, what seems to be an explicit safe harbour for pre-sounding that seems to echo recent French developments (see article in box). Generally under the MAR draft, disclosure of inside information amounts to sanctionable "improper disclosure" unless this is done "in the normal course of the exercise of [one's] employment, profession or duties". However, under the new concept of pre-sounding (effectively communication, prior to transaction announcement, by/for issuers, of information to potential investors to gauge interest in a transaction and related conditions such as size/pricing), it is proposed that disclosure of inside information is not "improper" where the sounder:

- before sounding, (a) specifically considers whether inside information is involved and (b) keeps a written record of the conclusion and rationale;
- informs the sounded investor that (i) the information disclosed is "inside" (in the sounder's opinion) and (ii) the sounded investor is restricted from trading (including cancelling pending orders) and bound by confidentiality; and
- keeps record of the information given, timing thereof and the identity of investors concerned.

There is also a requirement (albeit just in a Recital) that the sounded investor must inform the sounder of the identity of persons whom the sounded investor wallcrosses internally in developing a response to the sounding.

Related proposed provisions are that:

- if information later ceases to be "inside", the sounders shall: (i) inform the sounded investor as soon as possible that this is so (in the sounder's opinion); and (ii) keep a record thereof (though it seems unclear whether sounders are required to continuously keep information under review in this respect);
- records be kept for 5 years;
- ESMA develops technical standards for communication means and record formats;
- ESMA issues guidelines for investors on: (i) factors relevant to considering whether information might be "inside"; (ii) steps one should take when in possession of inside information to avoid insider dealing / improper disclosure; and (iii) records one should maintain to evidence this (though it is unclear whether compliance will constitute a safe harbour); and
- non-compliance with the main proposed provisions is not presumed to constitute improper disclosure, though the safe-harbour is lost.

Council Presidency compromises are a recurring feature of negotiations as the European Council seeks to arrive at a common position that will serve as a basis for subsequent Trilogue negotiations with the European Parliament and Commission. ICMA will continue to observe (and as much as possible feed into) developments in this area.

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Non-compliance with the proposed provisions is not presumed to constitute improper disclosure, though the safe-harbour is lost.

Facing up to FATCA

by Leland Goss

The US Foreign Account Tax Compliance Act (FATCA) is a far reaching piece of legislation. While intended primarily to stop tax avoidance by wealthy US citizens investing offshore, FATCA will significantly impact non-US firms perhaps much more than many currently realise and will impose a costly and complex compliance burden upon financial services firms globally.

A complete explanation or guide to FATCA is not possible here, however, ICMA is working closely with its members and industry experts to assist with understanding its practical application and ramifications for the business of our members and assisting with its implementation over the coming months. A new section of ICMA's website (www.icmagroup.org/fatca) is dedicated to providing and linking third party materials and resources regarding FATCA.

Some facts about FATCA

In order to be compliant with FATCA, foreign financial institutions (including any non-US entity that holds financial assets for the account of others or is in the business of investing or trading securities (FFIs)) must agree to perform certain due diligence procedures and report information regarding identified US accounts (Participating FFIs). FFIs who do not comply (Non-Participating FFIs) will be subject to a penalty deduction of 30% on US source income and the gross proceeds from the sale of US debt and equity instruments, *irrespective of whether payments are made to the FFI itself or on behalf of the FFI's clients*.

Importantly, from 1 January 2017, Participating FFIs must deduct withholding on payments to non-participating or uncooperative FFIs ("passthru payments") and non-US investors or counterparties therefore may only receive the full payment if *all* the intermediaries in the chain are Participating FFIs or are otherwise compliant. Note that passthru payment withholding potentially applies to transactions in any security or asset whether or not issued by a US issuer. Because major financial institutions and intermediaries in the payment, custody and settlement chain will likely have US assets and therefore have to become Participating FFIs, these key market participants and other Participating FFIs are going to be unwilling or reluctant to transact with Non-Participating FFIs.

FATCA is aimed not just at US investors investing in US assets through foreign intermediaries. Any investor or fund which derives some income from the US is subject to the law. Thus, a Dutch wealth manager investing its Dutch clients' funds solely in the Netherlands might appear to be outside FATCA. However, the law will

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Passthru payment withholding potentially applies to transactions in any security or asset whether or not issued by a US issuer.

apply to investments which the manager may have in other Dutch institutions such as a Dutch bank, which itself derives some of its income from the US, and result in the Dutch wealth manager becoming subject to withholding.

Furthermore, the fact that a non compliant FFI avoids doing business with US customers or holding assets that produce withholdable payments does not necessarily exclude the FFI from the effects of FATCA as the rules regarding “passthru” payments mentioned above generally make a non-participating FFI subject to withholding on payments from Participating FFIs. The end-result, through the operation of both the new rules and commercial interests, quite possibly is a world where US withholding may be largely avoided by non-US market participants by virtue of their compliance with FATCA’s due diligence and disclosure obligations.

The operation of FATCA as described above may be altered by inter-governmental agreements (IGAs) between the US and partner jurisdictions. The first IGA has been signed by the US and the UK, and has the effect of eliminating FATCA withholding on payments made to and by compliant FFIs in the UK. Given the number of jurisdictions which are usually involved in a typical payment chain, however, this development should not change the need to monitor and deal with FATCA risk in the near to medium-term.

Repurchase agreements

The burden of the withholding obligation will fall on the Participating FFI under a repo documented on the standard form of Global Master Repurchase Agreement published jointly by the ICMA and SIFMA unless the agreement is specifically amended otherwise.

A repo may be characterised, for US federal income tax purposes, as one of the following three types of transactions: (a) as a secured loan; (b) as a disposal of the collateral; or (c) as a combination of (a) and (b).

- Where the buyer/lender is not permitted to rehypothecate or otherwise dispose of the collateral the repo will be characterised as a secured loan and the seller remains the owner of the collateral for US tax purposes.
- Where the buyer is permitted to rehypothecate or dispose of the collateral, and does so, the repo will be treated for US tax purposes as a transfer of the collateral from the seller to the buyer. Upon maturity the buyer will be treated as transferring a replacement asset to the seller.
- Where the buyer is permitted to rehypothecate or dispose of the collateral *but does not do so*, it is not clear whether the transaction will be treated as a secured loan or a disposal and taxed as described above. Complicating matters further, where additional collateral is transferred by either party, similar rules will apply to the additional collateral.

Finally, FATCA withholding may apply to a repo if either of the parties is a Non-Participating FFI and the other is either a Participating FFI or a US person. The withholding may also apply even where neither the seller nor the buyer is a US person and may apply where the collateral is not a US debt or equity obligation.

It is clear that compliance will be a complex and costly process for many firms who should act now to ensure that they are ready in time to meet the approaching deadlines for the implementation of FATCA.

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Liability management: exit consents

Large-scale debt restructuring of banks, financial institutions and companies as a result of the economic situation and the impact of the euro crisis have led to a recent surge in liability management exercises. A recent English High Court ruling on exit consents – a widely-used mechanism in debt restructurings – is highly significant, and although it is with respect to an English law-governed liability management transaction, its effect is expected to have a wider reach throughout Europe.

In summary, a Bank offered Noteholders €0.20 per €1 in nominal value of Notes exchanged pursuant to the exchange offer. Any Noteholder participating in the offer at this rate was also deemed to vote in favour of an extraordinary resolution to squeeze out any non-participating Noteholders (the Claimants) at a rate of €0.01 per €1,000 by way of a call option. Unusually, the Bank announced the results of the exchange offer the day before the meeting to pass the relevant extraordinary resolution (as opposed to just after, which is more usual practice).

While the complete theoretical extinction of the Claimants' rights as anticipated by the call option itself was not ruled to be *ultra vires* (as such modifications were allowed under the Trust Deed), the extraordinary resolution could not be passed by the relevant proportion of Noteholders because Mr Justice Briggs concluded that, at the time of the meeting, the Notes were actually held for the benefit or account of the Bank, and under the Trust Deed, "*Neither the Issuer nor any Subsidiary shall be entitled to vote at any meeting in respect of Notes beneficially held by it or for its account*". In addition, in finding for the Claimants, Briggs J characterised the extraordinary resolution itself as a disincentive to Noteholders to reject the offer, leading him to conclude that the "*the exit consent is, quite simply, a coercive threat which the issuer invites the majority to levy against the minority, nothing more or less. Its only function is the intimidation of a potential minority, based upon the fear of any individual member of the class that, by rejecting the exchange and voting against the resolution, he (or it) will be left out in the cold*."

The key points to note from the case are that: (i) modifications to terms and conditions which may seem detrimental to Noteholders may still be upheld if they fall within the modification powers of the security documentation; (ii) the contract between the Bank and the exchanging Noteholders was formed at the point when the Bank publicly announced acceptance of the Notes offered for exchange; so as to avoid any unintended consequences, care needs to be taken as to when that contract is, and is intended to be, concluded; and (iii) the decision in this case casts some doubt on the validity of the exit consent mechanism where the dissenting minority receives a less favourable commercial deal than the majority. Whether any such invalidity depends on the extent of the disadvantage is less clear, although further clarity on this point may be forthcoming from the Court of Appeal if the judgment is appealed and not overturned.

> This decision casts some doubt on exit consent validity where the dissenting minority receives a less favourable commercial deal than the majority.

This third issue is one of significant importance which could "*prima facie apply to any form of exit consent which imposed less favourable consequences upon those who declined to participate in the associated exchange offer, even if not amounting in substance, as they do in the present case, to a complete expropriation of the relevant securities*." Obviously, not all exit consents are structured in such a punitive manner. However, the judgment can be seen as sounding a cautionary note, albeit one which offers guidance on what the courts will regard as permissible.

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Own funds

On 4 April 2012 the European Banking Authority (EBA) launched a consultation on draft Regulatory Technical Standards (RTS) on own funds (Part one). The ICMA submitted a response to the EBA on 3 July 2012, which was compiled with the assistance of the members of the ICMA Financial Institution Issuer Forum (FIIF). In brief, the ICMA emphasised the need for a balance between regulatory requirements for a capital conservation instrument, and an ability to market it to fixed income investors without them being subordinated to common equity holders. Alternatives were proposed to the effect that either distributions should not be payable on common equity or additional Tier 1 capital in either a temporary or a permanent write-down situation, or distributions should still be able to be made on the reduced amount not subject to the temporary write-down. With respect to write-ups, the ICMA suggested that banks should have full discretion to write up an instrument (and at a more accelerated rate than proposed by the RTS) and to manage their own capital, which includes granting them the maximum flexibility for payments of distributions on a temporary write-down in order to satisfy their fixed income investors and allow their positions to recover. It is widely anticipated that some adjustments will be made to the RTS to take account of the market consensus.

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Asset encumbrance

The debate surrounding asset encumbrance continues. Recent research reports suggest that, although historically loss-given default may have been the relevant indicator to the assessment of asset encumbrance, this has been surpassed by the probability of default, ie focus has shifted from the extent of losses to a creditor in insolvency or recovery after a default to the likelihood of a bank default. However, with the introduction of the bail-in regime, bank defaults are likely to become less frequent as legislators move to make shareholders and creditors bear the losses of a failed bank under the bail-in regime. In addition, it has been suggested that high asset encumbrance ratios are not necessarily indicative of an institution's stress, and that a range of considerations, among them regional funding models, bail-in and depositor preference, may even be more relevant than balance sheet encumbrance. The ICMA will continue to work with interested parties to examine the relevance of asset encumbrance and review the appropriateness of any related potential regulatory or legislative intervention.

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Crisis management

As reported in the Third Quarter 2012 edition of this Quarterly Report, on 6 June 2012 the European Commission adopted a legislative proposal for *Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms* (the Crisis Management Directive).

Andrew Gracie, Director in the Special Resolution Unit at the Bank of England, recently gave a speech to the British Bankers' Association (BBA) on the practical processes for implementing a bail-in resolution power under the Crisis Management Directive, in which he considers how in real terms a bail-in could work in the face of certain legal, operational and financial obstacles, whilst highlighting some of the associated practical challenges along the way.

In terms of general themes, Andrew Gracie notes that creditors of failing banks should bear losses, as they would do in insolvency, but without the financial instability and disruption to critical functions that the sudden insolvency of a G-SIFI would otherwise cause. However, he considers that bail-in cannot, and should not, be used in isolation and should be considered as one tool among several that ensures a bank can be resolved by assigning losses to shareholders and creditors rather than public funds. Rather, he considers that its role in isolation is to help keep a bank's vital operations functioning and avoid the disaster that would result from a bank suddenly ceasing to trade. He is also of the opinion that it is important that bail-in follows the creditor hierarchy, secured claims are protected and netting arrangements are respected.

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How the capital markets can save lives: the IFFim/GAVI model

Personal view by René Karsenti

The current crisis has cast a shadow over government aid for global health and development. This is unfortunate and avoidable. Capital markets can play a key role in maintaining this important work.

I can attest to this. As a financial markets executive who has worked in development, I know the public sector is not the only choice to support global aid. There is also a new, highly efficient alternative: offering investors socially responsible investment (SRI) or impact investing opportunities that make financial sense and offer tangible social benefits.

These alternatives have brought billions of dollars toward socially beneficial projects, largely unaffected by public sector budget deficits. In fact, it is because budgets are under such strain that there has been intense scrutiny on what works – and what does not – in global development.

Since the beginning of the year I have had the privilege of chairing the Board of a supranational institution issuing such investment products: The International Finance Facility for Immunisation (IFFIm). IFFIm plays an intermediating role in the capital markets between investors interested in SRI, or impact investing, and the GAVI Alliance, a partnership with several public and private sector partners, such as UNICEF, the World Health Organization and the Bill & Melinda Gates Foundation. GAVI's mission is to save children's lives and protect people's health by increasing access to immunisation in the poorest countries.

IFFIm does this by utilising long-term government pledges to issue bonds. Through this intermediating role, IFFIm has secured US$6.3 billion in pledges from nine governments to be paid over 23 years. This, in turn, has helped raise US$3.7 billion on the capital markets for GAVI at a cost competitive with donors' funding costs.

The World Bank acts as IFFIm's treasury manager and has been key to its success in the capital markets. Over the past six years, IFFIm has issued some 25 bonds in a range of currencies and maturities for a variety of investors, ranging from institutions to private individuals. These issues have ranged from a benchmark in US dollars to plain vanilla bonds in British pounds sterling and Australian dollars. Most often, IFFIm has raised funds in the Japanese uridashi market, where private investors have purchased the equivalent of about US$2 billion in IFFIm bonds sold by distributors throughout Japan.

IFFIm's financial strength is based on the legally binding payment obligations of its donors and its conservative financial policies as implemented by the World Bank. Disbursements for GAVI programmes from IFFIm are limited by both a prudent gearing ratio and also an annual maximum disbursement capacity. IFFIm mitigates market risks through a minimum liquidity policy equal to its cumulative contracted debt service payments for the following 12 months, and conservative asset-liability and liquidity management.

IFFIm has enabled GAVI to nearly double its spending on immunisation programmes, saving an estimated US$21 billion in health costs. It is an example of an effective use of the capital markets for a worthy cause, as GAVI has helped vaccinate more than 325 million children and helped save more than 5.5 million lives since its creation in 2000. And, with IFFIm's support, GAVI will assist countries to immunise another quarter billion children by 2015.

IFFIm is not the only public-private initiative at the cutting edge. The newest innovative finance product is the GAVI Matching Fund**,** a three-way philanthropic programme in which donors match contributions from corporations, foundations and other organisations, as well as from customers, members, employees and business partners.

The British Government and the Gates Foundation have pledged about US$130 million to it. This must be matched by the end of 2015. To date, seven private companies and foundations have helped raise US$52.4 million through the GAVI Matching Fund, including three connected to the financial industry: an investment bank (J.P. Morgan), plus foundations for a retail bank ("la Caixa" Foundation) and a hedge fund (Children's Investment Fund Foundation). The other partners are Anglo American, ARK Foundation, Comic Relief and LDS Charities.

These companies and foundations – like IFFIm – are successfully enhancing the model of how global development is achieved. They are proof that innovative finance tools like IFFIm can impact a whole range of challenges during difficult times. And they provide a proven way for ICMA members to use their skills to make a positive difference in the world.

For further information, contact GAVI through http://www.gavialliance.org and IFFIm through http://www.iffim.org .

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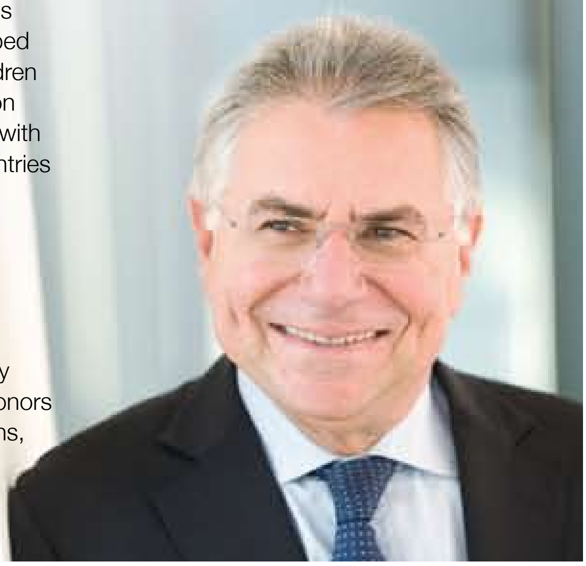

by John Serocold

Secondary Markets

MiFID II and MiFIR

This article provides a brief update on the progress of the proposed revised EU Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR), focusing on the areas of particular interest to ICMA members. It seeks to take account of reports of recent events in Brussels, though the implications of the latest draft texts that are emerging at the time of writing will need further study and consideration by business experts. ICMA also provided briefing on a conference call, hosted jointly with AFME and ISDA; members can hear the recording on the members' section of the ICMA website.

Intensive discussion continues apace in the Council under the Cypriot Presidency on the basis of compromise proposals. At the time of writing, the text of the Presidency's compromise proposals for MiFID and MiFIR dated 19 September 2012 are publicly available and we expect updated texts to be discussed intensively at working level in Council in the coming weeks; we understand open policy questions include open access to market infrastructure, design questions on OTFs and the possible inclusion in MiFID II or MiFIR of a requirement for the "flagging" of short sales for transaction reporting purposes. In the European Parliament, the Economic and Monetary Affairs Committee (ECON) established an initial position with a vote on 26 September and this is due to be confirmed in plenary later in the autumn. The aim remains to finalise the legislation by the end of 2012, though the Trilogue process, aiming at reaching agreement of a final text between the Council, European Parliament, and European Commission is likely to continue into early 2013, (with Ireland taking over the Council Presidency in January).

Once the Level 1 Directive and Regulation are finalised, much further work is required, some of it in parallel. There is a commitment to consultation built in to these processes:

- first, the process of drafting and agreeing detailed Level 2 implementing legislation (which can take the form of a Directive or a Regulation);
- second, the development of European Securities Markets Authority (ESMA) binding technical standards and accompanying guidance; and,
- third, the process of transposing Directives into national law.

Further, the market will need to develop, build and test technical solutions to a number of regulatory requirements, some at industry level or product level, some at the level of the firm.

The process of drafting and agreeing detailed Level 2 implementing legislation, and European Securities Markets Authority (ESMA) standards, is expected to last up to two years. Importantly, ECON has proposed 12 months between the finalisation of all the legislation and the deadline for firms to implement it operationally.

Third country (ie non-EU) firms

The Commission has proposed to harmonise diverse national regimes by requiring third country firms either to establish an EU branch (if they deal with retail clients) or register with ESMA if they deal in wholesale markets. In both cases, participation by third country firms in the EU Single Market, other than on an unsolicited basis, would depend on the relevant third country's regulation being judged to have "equivalent effect" to the EU's, and its reciprocal recognition of EU prudential regulation. The Council's latest draft compromise would retain the requirement to establish a branch for retail business (but without a passport for the EU Single Market, so a different branch would be needed in each country).

The Council's draft compromise would however impose no new rules on business conducted with third country firms in wholesale markets. In contrast, the European Parliament's ECON vote broadly retains the Commission's proposed regime, though it includes a more practical transitional regime under which the new regime would not come into effect for any third country until the Commission had made a judgement of "equivalence".

It remains to be seen how the wide divergence between the stance of the Council and European Parliament on this important issue for ICMA will be resolved. By way of background, it is important to recall that the Council agreed to consider this issue afresh under MIFID II, independently of its treatment in the European Market Infrastructure Regulation (EMIR). ICMA's objective remains to ensure that the EU continues to be an open and integral part of the international capital market, without undue obstacles to third country participation. We understand that all the EU legislators share this aim.

Market structure and transparency

The Commission has proposed to extend EU regulation of market structure and transparency, currently focused on equity markets, to fixed income and other non-equity markets. In particular, it proposed pre-trade transparency and trade reporting rules for business done on Regulated Markets (RMs), Multilateral Trading Facilities (MTFs), and a new category of Organised Trading Facilities (OTFs), to include other forms of organised multilateral trading interaction. And it proposed to introduce a modified form of the Systematic Internaliser (SI) quoting obligation, which currently applies in equity markets, for firms that deal in bonds bilaterally; under this, in specified circumstances, when firms offer a quote to a client as SI, they would be required to offer the quote, at the same price and size, to all their clients. The Council's stance remains uncertain at the time of writing.

It is difficult to accommodate the needs of users of often illiquid bond markets with rules that depend on clear demarcation between multilateral and bilateral trading and propose a high degree of market transparency – both of trading interest before the trade and of completed trades afterwards. While there is some recognition, particularly in the SI regime and in proposed waivers from transparency rules, of the need to focus MiFID II and MiFIR requirements on smaller trades in more liquid instruments, it remains uncertain how far the Council will allow dealers operating an OTF to deploy their firm's own capital to help clients when a larger and illiquid trade cannot be placed in the wider market. The European Parliament similarly recognises the need to limit transparency of large illiquid trades, but also seeks to minimise OTC trading, and like the Council envisages clear demarcation between and tight regulation of multilateral and bilateral trading. While the differences between the Council and the European Parliament on the regulation of market structure and transparency, at least in the fixed income area, are perhaps not as great as on the third country issue, the precise resolution of these points remains to be seen.

While ICMA recognises the political drive towards more transparent markets, much will depend on technical detail (some of which will need to emerge in later stages of the MiFID II / MiFIR legislative process, or through ESMA standards), and on a pragmatic balance between transparency and SI quote obligations on the one hand, and on the other the need for investors to be able to access the OTC markets when organised trading or transparent dealing is unable, because of absence of liquidity or the risk of adverse price movement, to serve their best interests in the particular secondary market trade that they need to execute.

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CSD Regulation

This article reports on ICMA's work on the CSD Regulation (CSDR), which is being guided by the ICMA European Repo Council (ERC) Committee and its Operations Group and ICMA Secondary Market Practices Committee (SMPC). It provides an update on the ICMA position, an analysis of the European Parliament (EP) Committee report and explains our approach to the Presidency compromise text. A background note is included in the box.

The main areas in the CSDR that affect the markets in which ICMA' s members are involved are:

- shortening the settlement cycle;
- settlement discipline, including mandatory buy-ins and daily penalties for late settlement; and
- the regulation and governance of ICSDs, particularly their ability to operate in commercial bank money.

We met DGMARKT on 21 May 2012 to explain our concerns and identify areas where the text could beimproved. On 2 July we wrote in parallel to the European Parliament and the European Commission concerning the proposed CSD Regulation; the letters have also been copied to Steven Maijoor and Verena Ross, the Chairman and the Executive Director of ESMA.

We have discussed the issues with committees, other interested parties and the official sector; we also presented the proposals at conferences in Paris and Zürich. The ICMA SMPC noted that, in the light of the fact that the legislative text was not yet stable, it might be premature to press forward with large-scale re-writing of the ICMA Secondary Market Rules and Recommendations in this area.

We met MEPs following a meeting of RPC to reinforce our concerns. We continue to work closely with AFME, ISLA and EACH as well as the ICSDs. We have written to the ICSDs, seeking confirmation that the proposals in relation to the business model of the ICSDs will not adversely affect the safety and efficiency of the repo and tri-party markets; ISLA co-signed this letter.

The last Council Working Group was held on 21 September; the Economic and Monetary Affairs Committee (ECON) discussed Dr Swinburne's European Parliament report on 19/20 September and the current deadline for amendments to the Swinburne report is 18 October.

The remainder of this note discusses the principal provisions of the Swinburne report and the latest Presidency compromise text, which deliberately omits proposals on matters thought to be controversial.

European Parliament report

The Swinburne report, which was published on 17 July 2012, was discussed by the ECON Committee on 20 September. The main points in the report are as follows:

- Most controversially, the *rapporteur* has deleted Article 52, the proposed "derogation" for the ICSDs to continue settling in their own commercial bank money. We understand that she is unconvinced by their arguments. This will clearly be a key issue; members will recall that the proposal was only inserted at a very late stage in the production of the Commission proposal, following much work by the ICSDs behind the scenes.
- T+2 is still included, but limited to trading venues as defined in MiFIR Article 25(2) (exchanges/MTFs/OTFs) (new Article 2(1) 31e and Article 5(2)); this may create operational risk when one "leg" of a trade is on-exchange and the other OTC.
- Article 5(2) on settlement discipline now also excludes trades entered into bilaterally and subsequently reported to a regulated market, MTF or OTF.
- In the explanatory statement, (5th paragraph on page 63) the *rapporteur* suggests T+2 "seems an appropriate first step that could perhaps be shortened in future".
- Trade date confirmation is included (new article 6(1a)).
- The obligation on CSDs to require participants to settle on intended settlement date (ISD) has been replaced by a requirement that *participants should have in place procedures to ensure their clients are able to settle* on ISD (Article 6(3)).
- Repo is out of the penalty regime (Article 7(2)) except where CCP-cleared (Article 7 (1)); this may limit the benefits of the exclusion.
- Mandatory buy-in has been replaced by buy-in at the option of the buyer (Article 7(3)); those to be bought in are restricted to participants to trading venues except where the Short Selling Regulation applies;

- On fails generally, provision is made for fails to be reported to regulators and regularly disclosed to the public on an aggregated basis (Article 7(1) and explanatory statement).
- Mandatory dematerialisation has been put back from 1 January 2020 to 1 January 2025 (Article 70(3)1).

In addition, the *rapporteur* has included a large number of new Recitals. While these are generally thought to be less important than the Articles, note that Article 288 of the Treaty on the Functioning of the European Union provides that: "A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States."

Presidency compromise text

The principal points for members to note in the Presidency compromise text are:

Settlement periods

- For OTC transactions, use wording such as: For transactions which are agreed off-order book but conducted under the rules of a trading venue, participants can agree to extended settlement cycles where the rules so allow. For transactions which are agreed bilaterally and executed outside a trading venue, participants can agree to extended settlement cycles.
- Exclude securities financing transactions.

Settlement penalties

- Penalties should apply to OTC transactions that do not meet their intended settlement date.
- Focus measures on preventing settlement fails to CSDs providing functionality for CSD participants to match, monitor and manage their securities settlement transactions.
- Differential penalties for different transactions (securities financing transactions) and less liquid securities based on MiFIR liquidity regime. However, the same penalties should be applied for the same transactions/securities across the EU.
- Exclude securities financing transactions.
- The receiving counterparty should receive the proceeds for settlement fails (there is strong support for this).

"One of the main areas that affects ICMA members is the regulation and governance of ICSDs, particularly their ability to operate in central bank money.

Buy-ins

- The receiving party should be the ultimate decision-maker for whether a buy-in is initiated.
- Buying and receiving counterparties can mutually agree to close and cancel a transaction without a buy-in.
- The CSD should apply a daily penalty for each day after the intended settlement date. Separately, the failing participant should be charged the administrative cost of the buy-in and cash compensation.
- Cash compensation should be provided with the final buy-in.
- CCPs should be exempted from buy-ins.
- Buy-ins should not apply in the event of an insolvency of the selling participant.
- Different buy-in arrangements should apply for different transaction types and securities.

An open issue is how buy-ins might apply to OTC transactions not traded on a trading venue or cleared on a CCP. The Commission has suggested that the CSD participants would require the selling party to arrange the buy-in; the draft EP report exempts bilateral trades and allows other buy-in processes to be initiated at the option of the buyer.

ESMA should set the regulatory technical standards for how these arrangements apply in practice.

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CSDR: market concerns

This box provides background on ICMA's work on the CSD Regulation (CSDR), which is being guided by ICMA ERC Committee, ERC Operations Group and ICMA Secondary Market Practices Committee (SMPC).

We have two main concerns, which are widely shared across the industry. First, the difficulties related to the proposal for daily penalties for late settlement and mandatory buy-in. We perceive that the burden is disproportionate. Our second main concern is the mandatory separation of securities settlement and banking services, which we fear will increase cost and risk in the ICSDs, in relation to cash market trades and especially in relation to the triparty repo service. We consider that whatever model is chosen, for the involvement of CSDs in the provision of securities settlement and allied cash settlement services, must fully allow for the robust application of delivery versus payment (DVP) settlement.

Overall we favour moving to T+2 within a short time, followed by T2S implementation; and only then, if significant fails continue, determining the case to legislate for a proportionate buy-in regime.

The European Commission wants to impose fail penalties as a way of making the market more efficient. However, this is highly problematic because of the lack of sufficiently robust and efficient settlement infrastructure and accordingly, the CSD Regulation could be very disruptive to the way markets operate. Some of the national CSDs are unable to cope with cross-border trades, which results in a significant number of settlement fails. Imposing penalties on market participants using such CSDs will not address the real issue of unsatisfactory settlement infrastructure. Instead, the regulators should make clear to the national CSDs that if they are unwilling or unable to improve the services they provide the market should migrate to the ICSDs.

In relation to mandatory buy-ins and penalties for late settlement, the ERC notes that the problem with the CSD Regulation is the same one that the Committee had had with the Short Selling Regulation. Accordingly, an unrelated third party may unilaterally decide to buy in the bonds, irrespective of whether the parties to the trade may wish such an outcome. This is seen as an undesirable outcome for market makers, hedge funds, asset managers etc. The imposition of daily fines for late settlement will also destroy the economics of the trade and the suggested proposal for a single settlement cycle of T+2 and mandatory buy-in two days later on T+4 does not fit into the T+5 provisions currently set out in the GMRA. The Chairman raised these concerns with the Commission.

The ERC has agreed that, by adopting a more robust market practice for negative repos and fails, the industry might be able to mitigate the more acute elements of the CSD Regulation. It would be important that any fails penalty procedure adopted by the ERC would have to work for both the repo and cash markets as well as CCP participants otherwise basis risk could be created. The Chairman has also discussed this proposal with the ECB.

The Secondary Market Practices_ Committee believes that the effect of the various measures taken together will significantly and adversely affect the operation of the secondary bond market. They are currently considering the effect of the proposed regulation on the ICMA's Secondary Market Rules and Recommendations.

Recent and expected future timetable

Swinburne report	July 2012
ECON receives draft report	September 2012
Deadline for amendments	October 2012
ECON vote on amendments	18 December 2012
Trilogue begins	January 2013
ESMA technical standards	Mid-2013
Implementation	From 2014

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For ERC, a more robust practice for negative repos and fails might mitigate the more acute elements of the proposal.

Asset Management

by Dr. Nathalie Aubry-Stacey

UCITS VI

On 26 July 2012 the European Commission launched a public consultation entitled *UCITS Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-Term Investments* on a number of regulatory issues related to money market funds, eligible assets, the use of derivatives, and depositary passports. At this stage, it appears that the consultation will form the basis for "UCITS VI", so as to build on the recent UCITS IV Directive and the upcoming UCITS V Directive. The Commission has requested responses to the consultation from interested parties by 18 October 2012.

In the consultation, the Commission has posed a series of broad, open questions relating to eight different areas of the UCITS regime:

- *eligible assets and use of derivatives*: evaluation of the current practices in UCITS portfolio management and assessment of certain fund investment policies;
- *efficient portfolio management techniques*: assessment of current rules regarding certain types of transactions and management of collateral;
- *OTC derivatives*: treatment of OTC derivatives cleared through central counterparties, assessment of the current framework regarding operational risk and conflicts of interest, frequency of calculation of counterparty risk exposure;
- *extraordinary liquidity management rules*: assessment of the potential need for uniform guidance in dealing with liquidity issues;
- *depositary passport*: assessment of whether or not to introduce a cross-border passport for the performance of the depositary functions set out in the UCITS Directive;
- *money market funds*: assessment of the potential need to strengthen the resilience of the MMF market in order to prevent investor runs and systemic risks;
- *long-term investments*: assessment of the potential need for measures to promote long-term investments and of the possible form of such measures (including investments in social entrepreneurship);
- *addressing UCITS IV*: assessment of whether or not the rules concerning the management company passport, master feeder structures, fund mergers and notification procedures might require improvements.

In its press release, the Commission specifically mentions that this consultation is to be seen as complementary to its on-going shadow banking work. The consultation aims to further clarify the interaction between the debate on shadow banking and the role of investment funds.

The consultation considers a wide range of topics that will influence the development of the UCITS regime. The Executive Committee of the ICMA Asset Management and Investors Council (AMIC) decided at its quarterly meeting in September to respond to the consultation.

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Recallability of repo and reverse repo arrangements

The consultation paper by ESMA assessed the appropriate treatment of repo and reverse repo arrangements in the context of the guidelines on ETFs and other UCITS issues. In particular, ESMA proposed a distinct regime for repo and reverse repo arrangements which, unlike securities lending arrangements, would allow a proportion of the assets of the UCITS to be non-recallable at any time at the initiative of the UCITS. Once adopted by ESMA, the guidelines on repo and reverse repo arrangements will be integrated into the guidelines on ETFs and other UCITS issues in order to have a single package of rules.

In its response, the AMIC noted that ESMA guidelines were setting principles on a key issue already in discussion at other international or European bodies levels. For instance, the FSB is due to make by the end of 2012 its own recommendations on securities lending and repos based on the extensive work the FSB has undertaken under the G20 work programme. The UCITS VI consultation will also look into some of the aspects of collateral management. In its response, the AMIC explained that there was a need for coherence and consistency in the approach to this issue at all regulatory levels.

AMIC members also voiced their concerns about the limitations proposed in the guidelines, which will affect the UCITS' access to the repo market. Restricting the ability of a UCITS to enter into non-recallable repo transactions, for instance, would ultimately increase frictional cost, reduce the number of counterparties willing to take on the additional risk of fully recallable repo transactions and suppress activity in the repo markets. End-investors benefit most when the capital transfer mechanism is as efficient as possible; indeed efficient capital transfer mechanisms create liquidity and liquidity ultimately reduces costs for end-investors.

The AMIC was concerned by the wording of paragraph 40.e. on "collateral diversification" of the guidelines on ETFs and other UCITS issues – referred to in point 3.c of the proposed guidelines. The new guidelines from ESMA could be interpreted as requiring such managers to accept collateral which is riskier and may not be as liquid in comparison to their own collateral management policy – and create new market risks.

Finally, the impact of the proposed guidelines would need to be considered in the context of the increased demand for cash that will result from implementation of the European Market Infrastructure Regulation (EMIR) as currently drafted. If variation margin collateral requirements under EMIR are not expanded to include highly liquid securities as well as cash, the buy side will have to increase its use of the repo markets to raise the necessary cash to meet the CCPs' variation margin requirements. Any proposed restrictions on repo transactions would therefore impact the ability of market participants to meet the variation margin requirements under EMIR, and could lead to forced sales of assets to generate alternative sources of cash.

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Margin requirements for non-centrally-cleared derivatives

In 2009, the G20 Leaders initiated a reform programme for the over-the-counter (OTC) derivatives markets. In particular, a number of measures were agreed to enhance the transparency and regulation of OTC derivatives, including mandatory central clearing. However, mandatory clearing requirements are only intended to capture standardised OTC derivatives. Non-standardised products will thus continue to be non-centrally cleared and will remain subject to bilateral counterparty risk management.

In 2011, the G20 Leaders agreed to add margin requirements on non-centrally-cleared derivatives to the reform programme. These requirements are expected to further mitigate systemic risk in the derivatives markets. In addition, the G20 believes it would encourage standardisation and promote central clearing of derivatives by reflecting the generally higher risk of non-centrally-cleared derivatives. The consultative paper published jointly by the BCBS and IOSCO lays out a set of high-level principles on margining practices and treatment of collateral, and proposes margin requirements for non-centrally-cleared derivatives.

These policy proposals are articulated through a set of key principles which primarily seek to ensure that appropriate margining practices will be established for all non-centrally-cleared OTC derivative transactions. These principles will apply to all transactions that involve either financial firms or systemically important non-financial entities.

The AMIC Executive Committee believes that the consultation paper is key to the development of the market, and that it will shape the market for the buy side. In addition to specific and technical responses to the questions posed by the paper, AMIC members made some general comments that they hope will be taken into consideration:

- As provided for in EMIR, existing derivatives instruments should not be retroactively concerned by new regulation as their economic benefits may just be impossible to maintain within the constraints of the new collateral requirements; a grandfathering clause is absolutely necessary to exempt existing transactions from collateral requirements even in case of reset lowering risk (to clear excess counterparty risk or to diminish notional amount, for example).
- There may be a rush of all stakeholders on collateral due to the fact that all operations will have to be collateralised at once and to a higher degree than eventually required, simply by lack of recognised CCPs. A staged implementation calendar is therefore required.
- The current wider regulatory agenda is requiring ever more (high quality) collateral, at a time when there is the downgrade of a substantial part of previously reasonable good collateral, and it is widely perceived that the market will suffer from a shortage of high quality collateral.
- A broad universe of assets as eligible collateral is therefore needed.
- An international framework is desirable to avoid market fragmentation and regulatory arbitrage.

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Solvency II reporting requirements

Following EIOPA's consultation papers on the Quantitative Reporting Templates to which the ICMA Solvency II Working Group responded, EIOPA has now published its final report on the *Draft Proposal on Quantitative Reporting Templates and Draft Proposal for Guidelines on Narrative Public Disclosure & Supervisory Reporting, Predefined Events and Processes for Reporting & Disclosure* and updated reporting templates.

Working Group members were particularly interested in the following key wording of the draft proposal:

"102. The granularity of [reporting] Assets [in template] D1 was kept as the template is a crucial tool for the supervision of the prudent person principle.

103. Applicability to unit linked, including the look-through template, was kept as it is understood that the prudent person principle applies also to the investments underlying these products and this should be supervised as risks, such as the reputational risk, could be faced.

104. The frequency of [reporting] Assets [in template] D4 was kept, however the threshold was increased from 20% to 30%. EIOPA highlights that the [...] [reporting in D4] only requires look-through [...] [by]: asset category, three geographical zones and currency identification (as local or foreign), not a full look-through of investment funds as required for SCR (Solvency Capital Requirement) calculation".

Since the publication of the draft proposal, some Solvency II Working Group members have had the opportunity to meet EIOPA and raise their concerns. The meeting held in Frankfurt in early September is part of the on-going dialogue facilitated by ICMA between the Solvency II Working Group and regulators. During the meeting, some issues, such as the proportionality of the proposal in comparison to the cost, the look-through reporting approach and the Complementary Identification Code (CIC) classification were discussed.

On the proportionality aspect, Working Group members are concerned that insurance companies' reporting frequency would vary from one year to the next, which would add cost to their own reporting requirements, depending on how insurance companies calculate the threshold of minimum exposure. EIOPA explained that the final technical standards that are due to be issued by EIOPA should bring more clarity on this point.

As regards the look-through approach, the final report brings a more detailed description of the requirements, which is not a line-by-line requirement but based on three categories: the asset category, geographical and currency exposures. Replication of the line-by-line reporting requirements for SCR calculation is not expected.

As far as the CIC is concerned, the regulator's view is that that the aim of the code is primarily to identify the risks on investments which insurance companies hold. Supervisors already have their own CICs, which cover probably 90% of existing assets; this is the reason why harmonisation of the codes is not envisaged in the short term. The use of the CIC by supervisors to perform cross-sector and market analysis is a secondary aim. The insurance companies will be responsible for the CICs they use. They will coordinate with their respective supervisor to agree on a codification for the remaining assets which do not have a CIC code. If asset managers want to harmonise a CIC code table at European level, EIOPA will support the initiative but does not believe this is required.

The dialogue between the regulator and our Working Group will continue, and EIOPA is keen to receive feedback from the asset management industry.

As far as the regulatory timetable is concerned, the European Commission, Council and European Parliament held a Trilogue on 18 September 2012. Recent media coverage has reported on Commissioner Barnier's comment about the possibility of a delay of implementation of one year. However, no new timetable has been confirmed; the current timetable remains with transposition by 30 June 2013 and implementation from 1 January 2014.

The date for the European Parliament's vote on Omnibus II seems now to have been postponed to the November plenary session. The vote of Omnibus II will enable, amongst other measures, the publication of the Level 2 texts as well as the finalisation by EIOPA of the Binding Technical Standards.

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AIFMD: delegations

In November 2011, ESMA published its technical advice on the implementation of the Alternative Investment Fund Managers Directive (AIFMD). Despite some changes, the advice did not fundamentally alter the Level 1 framework approved by the European Parliament in 2010.

The European Commission will release its implementing measures shortly in anticipation of the July 2013 deadline for transposition into national law. One particularly contentious issue under consideration has been the ability of AIFMs to delegate investment management. The AMIC has already shared its concerns on the issue of delegation and the fact that the rules under UCITS and the proposed AIFMD are different. In its proposals in relation to "letter box" entity provisions, there is a real fear that the Commission may go further in restricting the delegation of investment management beyond the protections and preconditions to delegation of investment management already embedded in the Level 1 Directive. Preventing delegation of day-to-day portfolio management would mean that investment decisions could not be taken by local experts in local markets, and that access for European investors to global expertise and products would be significantly impacted. Under UCITS, all functions can be delegated. This ability has been used by global fund managers to access local markets and global expertise, and the ability to do so is key to the product ranges available to the European fund market.

Although the Commission appears focused on the need to regulate portfolio management by the AIFM, the concepts of acting as the "manager" and being the "portfolio manager" of an alternative investment fund are different. There are broad ranging responsibilities of "management" of an AIF by the AIFM under the Directive (ie in relation to all the operations and other aspects of managing an AIF), of which "investment management" is only one part. As such, provided that the AIFM retains "management" responsibilities and there is adequate oversight by the AIFM for the delegated activities, there would not appear to be any requirement to prevent the delegation in full of day-to-day investment decision-taking assuming the pre-conditions and protections already embedded in the Directive are complied with.

There is further concern for fund management groups that may wish to delegate outside the EU, as indicated in the first draft of the Level 2 text, that the European Commission expects third country co-operation agreements to be legally binding.

If these points are not resolved, it will be unclear how EU funds will be able to continue to make full use of non-EU expertise, which will be to the detriment of services and products available to European investors. The European Commission Level 2 text is expected to be published shortly.

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Shadow banking

As part of their regulatory response to the crisis, the world's regulators and central banks, led by the Financial Stability Board, are focusing on "shadow banking" as well as banks. The Financial Stability Board is committed to delivering a reform package by the end of this year that is being developed by the FSB's Committee on Supervisory and Regulatory Co-operation.

The European Commission has published its own Green Paper on shadow banking whose purpose is to take stock of current developments, and to present on-going reflections on the subject. The AMIC has responded to the Green Paper. Shadow banking is seen as key in providing alternative funding in current market conditions, although enhanced transparency is also needed. In this context, two papers are already important in shaping this debate at European level: the ESMA consultation on repo in UCITS and the UCITS VI consultation (both explained in separate articles in this section).

We understand that DGMARKT is intending to discuss proposals deriving from the Green Paper consultation period with Commissioner Barnier in the coming weeks. A feedback statement is expected in the coming weeks and a Commission Communication will be published before the end of the year; in the coming months the Commission will launch some targeted technical consultations (including a securities law regulation and a paper specific to MMFs); and the European Parliament report should be available in October.

European authorities are also starting to highlight in this context the issue of collateral management as key for 2013.

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ICMA Private Wealth Management Charter of Quality

A successful ICMA/ABBL Private Banking Workshop was held in Luxembourg on 4 October 2012. The event provided the opportunity for private bank professionals to explain how the industry operates in a challenging environment and how they can enhance their attractiveness and competiveness by delivering high quality wealth management services to their clients. In today's uncertain and fast changing world, regulation and standards of compliance for the banking industry continue to evolve and play an increasingly important role in client relationships.

The focus of the event was on the practical application of current best practice in the industry and on promoting high standards of integrity, transparency and professionalism. The ICMA Private Wealth Management Charter of Quality, which brings together in a single document the guiding principles of best practice adopted by the private banking industry, was presented at the event in Luxembourg.

The Charter is designed to be consistent with relevant regulation at both the EU and national level, and to complement principles such as the Wolfsberg Principles on anti-money laundering and the global recommendations of the Financial Action Task Force. This is the first initiative of its kind where the private wealth management industry has joined together voluntarily to commit to common standards of quality, compliance and good market practice as set out in the Charter.

The three main principles which are of paramount importance to the nature of business relationships with clients are the foundation of the Charter, namely:

- *Integrity*: in business relationships; of markets, financial products and services; and of staff;
- *transparency:* towards clients, and regarding the regulatory environment;
- *professionalism:* regarding the primacy of clients' legitimate interests and efficiency.

Keynote speakers included Luc Frieden, Minister of Finance, Luxembourg, and Jean Guill, Director General Commission de Surveillance du Secteur Financier (CSSF)

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Regulatory reforms

Personal view by Godfried De Vidts, Chairman of ICMA's European Repo Council

Many regulatory initiatives have resulted from the G20 call for global regulatory reform of the financial sector. While nobody would deny that reform of our financial system was needed, new regulation should be about improving the safety and efficiency of financial markets. To do this the input of market professionals is needed on all regulatory initiatives – effectively poachers must supply their expertise to gamekeepers.

In a decade as Chairman of the ERC a lot of my energy has gone in helping convey the message of prudent, well thought out reforms. I have also been privileged to be a member of the Giovannini Group in the late 1990's; and to have been a member of many groups such as CESAME and COGESI. My terms as President of ACI Belgium and Global President of ACI The Financial Market Association – and my on-going work with ICMA – have provided numerous further insights into the many jobs we, as a financial community, need to finish. What follows is a brief personal view of how these unfinished projects should be tied into current regulatory reform efforts.

Proposed CSD Regulation

The European Commission's proposed CSD Regulation calls for mandatory buy-ins after four days if settlement fails. Yet it has been known since the identification of the Giovannini barriers that fails in European settlement are not because counterparties like to negate their obligation. Rather they arise because of domestic market rigidities or the overall lack of investment in a pan-European settlement infrastructure. These buy-in proposals are also of particular significance, as they seek to mandate that an unrelated party (market infrastructure) will conduct the buy-in.

ICMA has created a legal framework for repo trading, the GMRA, which contains a mini close-out procedure for dealing with delivery failures, under which individual transactions may be closed out. In practice it is found that by the next morning most failed-to-deliver repo trades have cleared up, so the mini close-out does not often need to be utilised. Work is currently in hand at ICMA to promote a smoother alignment of the applicable provisions of the GMRA with ICMA's Secondary Market Rules and Recommendations (for cash securities trading), which provide for the possibility of buy-ins upon the incidence of settlement failure.

Another key element of the CSD Regulation proposal concerns the harmonisation of standard settlement periods (ie the time between the conclusion of a transaction and settlement) at T+2. The proposed CSD Regulation is an important plank in the overall building of a sounder financial system; and market participants welcome the proposal to shorten the standard settlement cycle, but this is a major technology initiative and needs to be complemented by practical steps to ensure the possibility of same-day real-time settlement for necessary funding and collateral trades.

Meanwhile another major technology initiative, the ECB's TARGET2 Securities (T2S) project, aims to have all CSDs/ICSDs within the single euro currency to exchange settlement of cash and collateral within a real-time framework, fully coherent with the existing TARGET (cash) system. Only when T2S is accomplished in 2015/16 can same-day settlement happen for all actors in the euro area.

So at this point a compromise is needed. Since their on-going existence continues to give rise to technical fails, work should be urgently advanced to ensure the elimination of already identified infrastructural inefficiencies and other, non-infrastructural, problems. At the same time, whilst already overburdened by global regulatory initiatives, European market participants will move to provide shorter settlement cycles as demanded by the CSD legislation; and will embrace T2S. Let us deliver on these two major IT initiatives and when they bear fruit we should take stock. If it is then found that there are still fails in the fixed income market the time will be right to dig deeper and identify why. In case it is then found that abusive shorts are a problem, there would then be an appropriate case for mandatory buy-ins to be suitably performed.

“Work should be urgently advanced to ensure the elimination of already identified infrastructural inefficiencies and other, non-infrastructural, problems.

Financial Stability Board proposal for shadow banking

The FSB has identified the “shadow banking industry” as a potential major problem for stability of our financial markets. It estimates the activity of the shadow banking industry at 50% of global finance flows. Repo and securities lending are identified as carrying risks that may contribute to a future crisis at the same time that positions by insurance companies, pension funds, hedge funds, asset managers are taking a bigger share of global financial activity. Nobody will disagree that these flows are important and will increase as banks go through a major deleveraging.

Hence the calls of central banks and securities regulators for repo /security lending /collateral swaps repositories are the topic of debates within the industry. The ERC endorses the creation of such a “global” trade repository and hopes to be able to contribute in concrete terms to this effort. Let us build one, but let us have discussions with all those concerned to create a lean but effective monitoring system for our markets. Unfortunately the example of the fragmented OTC derivatives trade repository initiative currently being created is not a very helpful one.

Shortage of collateral

Well before the 2007 financial crisis the use of collateral to protect against counterparty risk was common practice in the repo markets. Helped by Basel II reducing the practice of unsecured interbank lending, the repo markets had been created by central banks in France and Belgium; and throughout the late 1990’s all other central banks in Europe endorsed and encouraged repo transactions. Since then the use of various types of collateral has developed and the central bank community’s range of eligible collateral for the purpose of liquidity provision within the euro area has expanded to marketable and non-marketable assets (including credit claims). The list is in fact still growing.

The importance of collateral has thus grown over many years, but has accelerated significantly since the advent of the financial crisis in mid-2007. This reflects both a shift in the risk appetite of market participants and the demands of official policy makers as they have advanced steps to make markets more robust, to reduce systemic risk and help mitigate the risks of any future financial crises. Numerous studies have given estimates of the potential collateral shortfall which these changes are leading to, although inevitably nobody actually has the exact answer. It is therefore essential that high-quality collateral is managed as a scarce resource. At the same time, although collateral is a good mitigating tool to reduce counterparty risk, there ought also to be focus on how to reduce the risk in the system. Netting through fixed income CCPs is such a measure. Risk reduction tools, like compression in the OTC derivatives markets, are another.

Conclusion

Policy initiatives have a few more years to run. Reglatory oversight will tighten. Financial market actors will submit to the calls for reform while continuing to look for opportunities. Too much haste in the implementation of new regulation will lead us to as yet unknown bottlenecks; the feared shortage of collateral exacerbated by regulatory initiatives is an example. We should pre-empt those potential dangers by introducing well thought out measures – industry working with policy makers. The real economy cannot support any further shocks of the magnitude we have witnessed in recent years. We owe it to future generations to create a well-balanced, fit for future, regulatory framework that will encourage entrepreneurs to create jobs for our children and growth in the global economy.

Market infrastructure developments

ECB: TARGET2 Securities (T2S)

30 June 2012 was the deadline for European CSDs to indicate whether or not they would sign the T2S Framework Agreement (T2S FA). The T2S FA is the contract which governs the legal relationship between the Eurosystem and each CSD participating in T2S, the future IT platform of the Eurosystem for the settlement of securities transactions in central bank money. The signing of the T2S FA is a key milestone in the T2S project, which is set to go live in June 2015. In addition to a first group of nine CSDs which had already signed up for T2S in May 2012, another 15 CSDs announced that they will join T2S (although subsequently it did not prove possible for Central Depository AD, the Bulgarian CSD, to sign the T2S FA at this stage, despite its initial intention to do so). This therefore brought to a total of 23 the number of CSDs participating in T2S, including almost all euro area CSDs as well as five CSDs based outside the euro area.

As announced on 19 July, the ECB Governing Council appointed the members of the T2S Board, the new management body replacing the former T2S Programme Board. The T2S Board is composed of 13 members: a Chairman from the ECB, Jean-Michel Godeffroy; a Deputy Chairman, Pierre Beck; and 8 members from Eurosystem central banks, 1 member from a non-euro central bank and 2 non-central banks members. A streamlined management body in charge of developing proposals to the Governing Council on key T2S strategic issues, the T2S Board is responsible for the day-to-day management of the T2S project as well as for the relations with market stakeholders and the 4CB. The CSD Steering Group (CSG) is responsible for articulating and coordinating the views of participating CSDs within the T2S Governance; and is the successor of the CSD Contact Group. Following the establishment of the new T2S governance structure and the approval of the new mandate of the AG, the T2S Advisory Group (AG) met on 18-19 September (and will next meet on 27-28 November).

“This therefore brought to a total of 23 the number of CSDs participating in T2S.

The T2S Harmonisation Steering Group (HSG), which is supporting the AG in formulating its harmonisation agenda, next meets on 18 October. For deriving common best practices the TFAX (Task Force on adaptation to cross-CSD settlement in T2S) first decided on a list of issues to tackle based on the issue list created by the Task Force on smooth cross-CSD settlement. The topics in the issue list were prioritised into priority 1 and 2 topics, depending on their relevance for the adaptation process and potential impact. The first TFAX mini-consultation, on the priority 1 topics, was closed at the end of April. Subsequently, the second TFAX mini-consultation then focused on the priority 2 topics: CCP instructions; issuance practices; message fields; and non-standardised securities – on which solution outline papers were drafted by the TFAX. The aim of these mini-consultations is for the markets to verify that the papers fully cover the topics tackled in terms of content as well as to identify major barriers in terms of applicability (eg compatibility with national legislation). Based on the results of the mini-consultations, the draft solution outlines will be revised and detailed before being issued as TFAX deliverables.

On 30 July the Summer 2012 issue of *T2S OnLine* was published by the ECB. For the most part, this issue is dedicated to the new T2S governance structure, in particular to the establishment of the new T2S Board and the CSG. There is also an insight article by Mehdi Manaa, which explains the benefits of one of the key functionalities of T2S, which is the auto-collateralisation service, and announces the forthcoming publication of a paper from the T2S

Special Series on this topic. The second T2S Access Rights Concept Workshop was held in Frankfurt on 20 July. A T2S "Info Session" took place on 5 October in Vienna, with presentations covering T2S Project status update and next steps; 4CB project status update; and the new T2S governance, together with insight sessions in respect of T2S auto-collateralisation; and T2S User Testing and Migration.

European Commission: Post-trading

The August 2012 *Info-Letter on Post-Trading* has been prepared by the European Commission. Besides an introductory overview, this provides short updates covering work on the CSD Regulation; EMIR (CCPs & Trade Repositories); Fiscal Compliance; Close-Out Netting; Securities Law; CPSS/IOSCO Standards for FMIs; Crisis Management of FMIs; Shadow Banking; and UNIDROIT/the Geneva Securities Convention.

Global Legal Entity Identification numbers

On 3 July 2012 the FSB issued a call for interest from private sector experts from around the world in joining the FSB Legal Entity Identifier (LEI) Private Sector Preparatory Group (PSPG) to support the launch of a global LEI system by March 2013. Subsequently, on 3 August the FSB announced the formation and launch of the PSPG. Representatives from well over 100 institutions from some 25 countries have joined the PSPG, which held its inaugural meeting in New York on 25 July. The meeting included question and answer sessions and small group discussions where private sector participants provided insight into important issues and raised points that will be considered by the FSB's LEI Implementation Group in the future work. Work is now being taken forward in three workstreams: (1) governance and legal; (2) operations; and (3) ownership and relationship data.

On 10 August the FSB Secretariat announced that it was seeking views regarding the appropriate jurisdiction for establishment of the Global LEI Foundation and Central Operating Unit (COU) of the global LEI system. The proposed COU will support the federated nature of the LEI system via the establishment of a not-for-profit global LEI foundation (or similar body) by private sector participants. The latter will be directed by a Board of Directors who would operate under the supervision of a Regulatory Oversight Committee (ROC) which has ultimate authority over the system. Under the supervision of the ROC, the COU will be the pivotal operational arm of the LEI system; with responsibility for ensuring the application of uniform operational standards and protocols around the world and supporting the maintenance of a "logically" centralised database of identifiers and corresponding reference data. The COU is anticipated to be the contracting and operational body of the system and will have legal personality.

On 23 August the FSB published a progress note on the Global LEI Initiative. This is the first of a series of such notes, which will be prepared approximately every three weeks. It includes paragraphs in respect of: Implementation Group; Private Sector Preparatory Group (PSPG); charter for the ROC and other governance issues; operations; ownership and hierarchy data; and early movers. Then, dated 20 September, the FSB published its second such LEI progress note. This includes paragraphs in respect of: charter for the ROC; location and legal form of the global LEI foundation; and number allocation scheme for the global LEI system.

Additionally on 22 August the FSB issued an invitation to a global LEI system operational solution demonstration day. This sought expressions of interest from external experts to participate in and contribute to the global LEI system operational solution demonstration day, taking place on 15 October in Basel. Participants are invited to present and explain operational proposals and solutions which will advance the implementation and development of the global LEI system.

Collateral Initiatives Coordination Forum (CICF)

On 27 September 2012 the CICF held its third meeting; and agreed on a number of further steps to advance its efforts, including the publication of a white paper, anticipated in the fourth quarter of 2012, on the topic of "collateral fluidity"; and of a simple paper describing "collateral fundamentals". A further CICF meeting is anticipated in early 2013.

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diary

19 OCT

European Regulation: An Introduction for Capital Market Practitioners, London, 19 October 2012

As a result of the financial crisis global regulation of the banking industry and the wider financial services industry has dominated the agenda for the past four years. For the banking industry the emphasis is on ensuring stability and ironing out the abuses of the past, through focusing on capital, liquidity and recovery and resolution planning.

This one day fast track course on European regulation for capital market practitioners will give them an understanding of the current regulatory environment in the context of their own business activities. It is aimed at sales people, traders, originators, syndicate personnel, and middle and back office staff who would benefit from a better understanding of the current regulatory landscape in the cross-border bond markets.

Register here

22 OCT

International Capital Market Association (ICMA) & Nordic Capital Markets Association (NCMF) Covered Bond Roundtable, Stockholm, 22 October

ICMA and the Nordic Capital Markets Association jointly present a roundtable in Stockholm reviewing the latest developments in the international and Nordic covered bond markets.

The event offers an opportunity to hear both covered bond issuers and investors give their perspectives on the main issues affecting the market, including changes to the regulatory environment and progress on transparency initiatives.

Register here

25 OCT

MiFID II Roundtable - Milestones to Implementation, Vienna, 25 October

The recent vote in the European Parliament's Economic and Monetary Affairs Committee on the updated Markets in Financial Instruments Directive and Regulation (MIFID II/MIFIR) is a further step in the legislative process for these proposals. Much further work is required; and the process of drafting and agreeing of detailed Level 2 implementing legislation, and European Securities Markets Authority (ESMA) standards, is expected to last up to two years. But the outline is becoming clear.

This roundtable is an opportunity to hear an up to the minute overview of how the MiFID proposals stand and what changes are likely during the process to completion.

Register here

05 NOV

ICMA Gulf Cocktail Reception, Dubai, 5 November

Capital market participants from the wider Gulf region are invited to an evening reception at the Capital Club in Dubai on November 5, 2012 to introduce members of the recently formed ICMA Gulf regional committee.

Register here

14-16 NOV

Global Master Agreements for Repo and Securities Lending Workshop, London, 14-16 November

The ICMA and the International Securities Lending Association (ISLA) workshop on the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA) includes a detailed review of both legal agreements and their application, including coverage of the GMRA 2011, together with case studies; and the operational and basic legal characteristics of the repo and securities lending markets.

The workshop will be delivered by Richard Comotto, the author of ICMA's Repo Survey together with legal and documentation professionals and representatives from ICMA, ISLA, Ashurst, Citigroup and Euroclear.

Register here

15 NOV

The 6th ICMA Primary Market Forum, London, 15 November

As in previous years the ICMA Primary Market Forum is a half day conference designed to bring together borrowers, arranging banks, investors and law firms, to discuss the business issues and regulatory developments affecting the issuance of international debt securities. Among the major themes of the event this year is a review of progress on the long-running Prospectus Directive Review and its likely practical effects, including reduced access of retail investors to the international capital market.

Register here

20-21 NOV

ICMA Professional Repo and Collateral Management Course 2012, London, 20-21 November

This two day course is organised by ICMA's European Repo Council with a focus on the needs of professional repo market participants. It has run successfully for almost 10 years, becoming the market benchmark. Combining presentations from experienced practitioners who are actively involved in the repo market on a day to day basis, with a sound theoretical explanation of the fundamentals of repo from ICMA Centre academics, the course gives unique insights into this method of financing. The uses of repo and collateral by central banks, the impact of the crisis on the repo market and the latest developments in clearing and settlement will also be addressed.

Register here

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

23 NOV

ICMA Asset Management and Investors Council (AMIC) Meeting, London, 23 November

The AMIC meeting is a unique opportunity to connect with the international asset management and wealth management industry and to hear leading industry figures outline their responses to the challenges of asset allocation in volatile markets and in a fast changing regulatory environment.

The meeting features expert sessions on: The future of asset allocation – market challenges: Do asset managers need to change their business models? How is the hedge fund industry reacting? Have regulators taken into account the impact of changes in asset allocation?

Investing in the real economy - The authorities in Europe level are concerned by the lack of investment in the real economy following the crisis – the European Commission has worked on two Directives – the Venture Capital Directive and the Social Business Directive. Have the authorities done enough? Is there a market solution?

Sovereign Wealth Funds – now welcome in Europe? – Sovereign wealth funds are increasing their investment in Europe, but what are the corporate governance challenges they face since the Santiago principles were drafted? How do they view the opportunities in Europe?

The event is offered free of charge.

Register here

27 NOV

ICMA Repo Market Course, Dubai, 27 November

A one-day repo market course, designed to cover the fundamentals of the repo product, discuss the reasons why it is the core funding tool in major financial markets, and consider what would be required to build a liquid repo market in the region. The course will be delivered by Richard Comotto, ICMA Centre academic and author of the highly-respected ICMA-European Repo Council European Repo Market Survey.

Register here

29 NOV

Understanding the ICMA Primary Market Handbook (IPMA Handbook), London, 29 November

The half-day session will deliver an overview of the scope and application of the recommendations in ICMA's Primary Market Handbook for the issuance of international debt and debt related instruments and will also review recent developments and changes.

Register here

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

ICMA Executive Education in 2012

Register now for these ICMA Executive Education courses in Q4 2012. See the ICMA website for the full 2012-2013 course schedule.

Part I: Introductory Programmes

Financial Markets Foundation Course (FMFC)
London: 26-28 November 2012

Securities Operations Foundation Course (SOFC)
Brussels: 12-14 November 2012

Part II: Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Sitges, Barcelona: 28 October – 3 November 2012

Primary Market Certificate (PMC)
London: 19-23 November 2012

Part III: Specialist Programmes

Collateral Management
London: 11-12 October 2012

Corporate Actions – An Introduction
London: 16-17 October 2012

Derivative Credit Risk
London: 30-31 October 2012

Derivatives Operations
London: 10-11 December 2012

Fixed Income Portfolio Management
London: 22-23 November 2012

Global Custody
Dubai: 28-29 November 2012

Inflation-linked Bonds and Structures
London: 22-23 October 2012

Securities Lending & Borrowing
Dubai: 25-26 November 2012

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

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

ICMA Executive Education – Skills Courses

Successful Sales
London: 8-9 November 2012

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Glossary

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

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

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