ICMA

International Capital Market Association

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INSIDE:

LESSONS FROM COVID-19 FOR CAPITAL MARKETS

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ICMA

International Capital Market Association

The mission of ICMA is to promote resilient and well-functioning international and globally integrated cross-border debt securities markets, which are essential to fund sustainable economic growth and development.

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include public and private sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has some 600 members in more than 60 countries.

ICMA brings together members from all segments of the wholesale and retail debt securities markets, through regional and sectoral member committees, and focuses on a comprehensive range of market practice and regulatory issues which impact all aspects of international market functioning. ICMA prioritises four core areas – primary markets, secondary markets, repo and collateral markets, and the green, social and sustainability markets.

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Another test of functioning markets

By Jean-Marc Mercier

COVID-19: As I write this quarter's Foreword, all my thoughts go to the victims of the COVID-19 and to their grieving families. This plague has hit individuals, but it is also a truly global trauma. I cannot help but hope that this common suffering will help us connect for the better, behind our human differences.

COVID-19 has been a test in more than one way, and while it is too early to conclude where we will end – in terms of its lasting impact on economies, corporate and institutional balance sheets or simply how we go about our life on our planet – the two things that have stood out for me are our individual and collective resilience at large and the quick adoption and integration of technology and how successful working from home has proven to be.

We have seen extraordinary global central bank coordination to support the economies during the current unprecedented times, enabling the efficient functioning of the capital markets and keeping liquidity available. Hopefully, this will lay the foundation for a potentially strong recovery, once we exit the worst of the pandemic. I must acknowledge here that ICMA has played a key role in advocating for and keeping the capital markets functioning during what has been one of the toughest crises given its far-reaching impact. It goes without saying that an open market is key and is a critical gauge in today's time, without which a lot of the actions taken on the monetary and fiscal front would not have been able to trickle down more widely.

The orderly functioning of the markets is a testimony to further building the trust and transparency in the markets today and most importantly enabling sovereigns, corporates and financial institutions to efficiently raise capital. Sustainable and responsible financing have also found a greater appeal during this period and have been well received.

It is not an accident that, despite the widespread disruption on a global scale, we have witnessed what has been one of the busiest times in the capital markets. For example, as of end May the issuance volume of international bonds was up 44% globally versus 2019 and the US investment grade markets were up a massive 90%, crossing the psychological US$1 trillion level, well ahead of prior years. In the SSA space (excluding emerging markets), volumes were up 40% plus. Elsewhere, the sub-investment grade markets have continued to find appeal, with May being the biggest month in the US.

One may say that the markets currently are not reflective of the risks that may lie ahead of us and asset prices are inflated – the jury is out on that. But to me, what is key is that capital markets are playing the vital role of enabling issuers to fund their requirements, be it for new funding, refinancing or even liability management exercises. Alongside sovereigns supporting the economic agenda, ICMA has played an important role to make this all possible.

What is also encouraging to me is that I probably have seen more records being broken in recent weeks and months than in the past three decades of my career. I hope we all emerge stronger out of this pandemic, supported by markets that allow for all that ICMA strives for.

Stay safe and take care.

Jean-Marc Mercier *is Managing Director, Vice Chairman, Global Banking, HSBC, and Deputy Chair, ICMA.*

Lessons from COVID-19

By Martin Scheck

It is encouraging to see that, despite the ongoing pandemic, the debt capital markets are operating effectively and allowing capital to flow as they should. In the last Quarterly Report, I commented that the powerful central bank intervention had significantly helped restore the functioning of the primary and secondary markets. Since then we have seen a very active primary market, broadening out to include a wider range of credits, including bank capital transactions, some high yield and EM also. Secondary markets have largely recovered from the dislocation during the depth of the crisis, and the repo market, faced with high volume, has been operational throughout, albeit with some dealer constraints and supply concerns. We discuss repo and the secondary markets further inside, drawing upon two recent ICMA studies exploring how they operated during the crisis (The-European-repo-market-and-the-COVID-19-crisis) and (The-European-investment-grade-corporate-bond-secondary-market-and-the-COVID-19-crisis).

A lesson we have all learned is just how successful remote working has proven to be. Our members have been able to undertake their business very successfully with split teams at disaster recovery sites, in the office and at home. And at ICMA we were able to be effective with all of our staff working from home. This is still largely the case although it is great to see our offices led by Hong Kong and then Switzerland starting to reopen on a selective basis depending on how the restrictions are easing in their various countries. I am pleased to say that our staff are all well and have been so throughout the crisis.

The immediate priorities of refocussing our work to deal with the most pressing issues thrown up by the crisis were discussed at length in the last Quarterly Report, and much is still ongoing: our COVID-19 hub is updated daily and has received many thousands of visits; and our work with the regulatory community has also been important to ensure that deadlines for new legislation, and deadlines for consultation papers, are lengthened where necessary. To a large extent the official sector has made adjustments in response (including in the case of certain prudential measures). This has been welcome.

The most imminent implementation remains the SFTR, where ESMA granted three months regulatory forbearance. Our work continues unabated with the very large SFTR task force leading the market to ready itself to be compliant on time on the go-live date of 13 July. However, concerns from all market segments in the context of the mandatory buy-in aspect of the CSDR continue to rise, with the elevated level of fails in the crisis serving to re-emphasise starkly the difficulties inherent in this legislation. We continue to discuss the situation in depth with the European Commission and ESMA, asking them to assess the implementation in the light of the lessons learned from the crisis. Perhaps the most important lesson is the centricity of dealer capacity to secondary market functioning. We are pleased to receive the recent ESMA "Survey of CSDR topics to review", and will certainly be providing our suggestions, and also note that the UK has decided *not* to implement the CSDR Settlement Discipline regime in 2021. There are more details inside this Quarterly Report.

On a positive note, we are pleased to see that the crisis has proved to be a catalyst for the issuance of social and sustainability bonds aligned with the Social Bond Principles and Sustainability Bond Guidelines. Issuance has been accelerating and additional guidance on use cases provided by the Green and Social Bond Principles. The proceeds of these bonds are being put to good use for a variety of social objectives, such as improving access to healthcare and providing support to ease economic hardship caused by the crisis. A further exciting development in the sustainable finance area was released at the AGM we organised for the Green and Social Bond Principles in early June – namely the launch of Sustainability-Linked Bond Principles. This is a tremendously versatile funding instrument which will facilitate access to the sustainable bond markets for a much greater range of issuers than is currently the case.

ICMA's work on other important workstreams, from MiFID II/R to benchmark reform to Capital Markets Union (where we recently provided our preliminary thoughts on the High-level Forum Report), remains intensive and is covered in more detail inside. As far as the post-Brexit negotiations are concerned, the prospects for an agreement and the consequences if there is no agreement by the end of 2020 are still unclear. This issue is rising up the agenda of many of our members again as we move into the summer. Accordingly, we are helping our members to prepare for all eventualities.

The crisis has also been the catalyst to ramp up our online learning offering as part of ICMA Executive Education. All of the introductory level courses are now available on our new online platform and we are looking forward to delegates registering for these courses. Successively over the summer more and more courses will be available online – and we will also be live-streaming classes.

This year we are having to hold our AGM as purely a written non-physical AGM – papers went out to members recently and the AGM date is 22 July 2020. This is far from ideal and we are hoping that next year's AGM and Conference can be held in Vienna as was originally planned this year. We are presenting a motion that AGM attendance by members can be both physical or virtual in the future and, assuming this motion is passed, would be able to have an interactive AGM whatever the circumstances.

Similarly, our events have moved online, with a full series of webinars, online panels, virtual conferences and podcasts, and it remains to be seen when physical events will resume.

Many of the developments I have referred to were already in motion prior to the crisis but their progress has been massively accelerated by the situation. We, and I think most of our members, are now reviewing what lessons we take from the crisis, and how we should operate when we emerge. I set out the following lessons we are evaluating in my CEO address sent out with the AGM papers.

1. One is that we are able to work effectively even when all our staff are working remotely – so we will need to review our working from home policy in the future.

2. Secondly, now that we are all used to using Microsoft Teams and Zoom, it is clear that many meetings can effectively be held without needing to be in the same room. Coupled with the environmental benefits of limiting travel, I am sure we will be thinking even more carefully about when travel is essential and when it is not – and this will also lead to cost and time efficiencies.

3. Thirdly, I think we have understood more than ever the importance of good two-way communication between our staff internally and with our members, and this will continue to be a focus, using a wider range of technologies than previously.

4. Whilst we want to resume our conferences, round tables and seminars – we do believe there is real value in physical meetings – the experience we have gained from the use of videoconferences, webinars, podcasts and social media will be an enduring feature of ICMA's future offering.

5. The crisis has been the catalyst to move much of our education programme online. After the crisis we do expect in-house courses and classroom-based courses to resume – and we want this to happen since there are clear benefits in face to face teaching with a top trainer. But there will also be a sophisticated online offering for those who find this more convenient.

6. The social issues arising from the pandemic are likely to be with us for a while and this will most likely lead to a greater focus on sustainability – which will be more multifaceted than it was in the past. ICMA will play as full a role in driving this forward as possible.

7. The move towards the paperless office was already in progress but has accelerated during the crisis with very few of our staff choosing to print documents – we expect this trend to continue further even when we are back in our offices.

In conclusion I would like to thank our members for your support in these trying times. We have welcomed your participation in our committees and working groups and it is gratifying to see how many have listened to our podcasts and webinars. Thank you for your ideas and comments, and I look forward to receiving more.

Martin Scheck
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From LIBOR to SONIA in the bond market

By Paul Richards

Summary

The transition from LIBOR to near risk-free rates is a global challenge affecting financial markets as a whole.[1] As part of ICMA's campaign to raise market awareness, this Quarterly Assessment considers progress in the transition from LIBOR to near risk-free rates in the bond market, using the transition from LIBOR to SONIA as an example, and covers: new SONIA issuance; the SONIA Compounded Index; the legacy sterling LIBOR bond problem; fallbacks in legacy LIBOR bond contracts; the adjustment spread and successor rate; consent solicitations; tough legacy bond contracts; regulatory dependencies; supervision of firms' preparations; and international coordination.[2]

Introduction

1 In a statement on the impact of the coronavirus (COVID-19) pandemic on firms' LIBOR transition plans published on 25 March 2020, the FCA, Bank of England and the Working Group on Sterling Risk-Free Reference Rates (RFRWG) said: "The central assumption that firms cannot rely on LIBOR being published after the end of 2021 has not changed and end-2021 should remain the target date for all firms to meet.[3] The transition from LIBOR remains an essential task that will strengthen the global financial system."[4] As part of ICMA's campaign to raise market awareness, this Quarterly Assessment considers the progress that has been made in the sterling bond market towards meeting the objective that the end of 2021 should remain the target date for all firms to meet.[5]

New SONIA issuance

2 All new sterling bond issues in the form of FRNs and most securitisations have for some time been referencing SONIA rather than LIBOR. From the first SONIA bond issue by the EIB in mid-2018 until the end of the first half of 2020, new issuance referencing SONIA amounted to

1. In all the main jurisdictions, the near risk-free rates chosen are overnight rates: SONIA in the UK; SOFR in the US; €STR in the euro area; SARON in Switzerland; and TONA in Japan.

2. ICMA is a member of the Sterling Risk-Free Rate Working Group, and chair of the Bond Market Sub-Group, an observer on the Euro Risk-Free Rate Working Group, and a member of the Swiss National Working Group.

3. In parallel, in the US, the Chair of the Alternative Reference Rates Committee (ARRC) said: "It is critical that market participants continue to make progress on executing a complete transition away from LIBOR by the end of 2021: ARRC, *Best Practices for Completing the Transition from LIBOR,* 27 May 2020.

4. A further statement from the RFRWG setting out revised interim timelines for the transition in loans was published on 29 April. In addition, on 7 May, the Bank of England stated: "Recent market volatility has highlighted the long-standing weaknesses of Libor benchmarks, which remain in widespread use. Libor rates – and hence costs for borrowers – rose as central bank policy rates fell, and underlying market activity was low. This has reinforced the importance of completing the transition to alternative rates by end-2021." *Interim Financial Stability Report,* May 2020.

5. In July 2017 the FCA, as regulator of LIBOR, stated that it would not persuade or compel banks to submit quotations for LIBOR beyond the end of 2021.

£88 billion in 181 transactions, including £21 billion in 56 transactions in the first half of 2020 despite the impact on the market of the coronavirus (COVID-19) pandemic.[6]

3 All bond market transactions referencing SONIA so far have used a backward-looking overnight compounded rate. The use of a compounded overnight risk-free rate wherever possible is the authorities' preference, as overnight rates are the most robust, with robustness measured primarily by the volume of underlying observable transactions.[7] Given the authorities' preference for compounded SONIA and the use of compounded SONIA in the bond market to date, it is not currently expected that a forward-looking term rate will be widely used for new transactions in the SONIA bond market when it becomes available in due course, though it may be used in some legacy transactions and in some other market sectors.[8]

4 Until January 2020, all new SONIA bond issuance used the same market conventions: overnight SONIA compounded in arrears over the interest period with a five-day lag, and with the margin added. In February, the EBRD issued the first new SONIA issue using the shift method. Whereas the lag method calculates interest according to the number and weighting of days in the interest period, the shift method calculates interest according to the number and weighting of days in the observation period.

The SONIA Compounded Index

5 The RFRWG welcomed the Bank of England announcement on 26 February that the Bank will publish a SONIA Compounded Index on a daily basis that is free to use. This is due to start on 3 August. Like the SOFR Compounded Index published daily by the Federal Reserve Bank of New York since 2 March, the SONIA index will be compatible with the shift method rather than the lag method. It is expected that new SONIA bond issues will increasingly reference the SONIA Compounded Index, once it is published. This is because it should standardise and simplify the method of calculating SONIA-linked instruments and could be referenced in documentation. It should also reduce operational risk by making it easier to reconcile interest amounts between market counterparties. This should encourage an increase in the scale of compounded SONIA used across different products.

6 A move from the lag method to the shift method for new SONIA issues would involve adapting IT systems and revising documentation, but this is not regarded as a major change for the bond market. If issuers want to continue to use the lag method for new issues, they can do so, and previous SONIA issues using the lag method should not be affected. But if the shift and the lag methods are to co-exist, it will be important for investors to be able easily to identify which approach is used for each individual bond.[9]

The legacy sterling LIBOR bond problem

7 A good start has been made in addressing the legacy sterling LIBOR bond problem. As new issues in the bond market are now referencing SONIA rather than LIBOR, fallbacks from LIBOR to SONIA are no longer needed in new bond contracts. The problem relates to legacy LIBOR bond contracts maturing beyond the end of 2021, when LIBOR may no longer exist.

8 The latest estimates of legacy sterling LIBOR bonds maturing after the end of 2021 are of the order of 315 FRNs and 170 securitisations with 560 tranches, with a total value of around £110 billion.[10] Maturing bonds will reduce the scale of the problem in time, but it has been estimated that only around 30% of legacy bonds by value fall due for maturity in 2022 and 2023. A significant proportion of legacy bonds mature beyond 2030, and some bonds are perpetual, with no maturity date.[11]

9 Permanent cessation of LIBOR is due to take place at or after the end of 2021. If permanent cessation does not take place until after the end of 2021, it is already clear that some banks will withdraw from submitting quotations for LIBOR, when they are no longer obliged to do so.[12] In those circumstances, the FCA may declare that LIBOR is no longer representative of its underlying market. Such a declaration would mean that LIBOR could no longer be

6. In the US, the ARRC has set a deadline of the end of 31 December 2020 after which no new FRNs are to be issued using LIBOR and maturing after the end of 2021: *Best Practices for Completing the Transition for LIBOR,* 27 May 2020.

7. See, for example: RFRWG Statement on *SONIA Conventions and Summary of Responses on Conventions for Referencing SONIA in New Contracts,* August 2019; and Statement on *Bond Market Conventions and Use Cases of Benchmark Rates: Compounded in Arrears, Term Rate and Further Alternatives.*

8. A forward-looking term rate would incorporate a derivative of the risk-free rate. As with term LIBOR, and unlike compounded SONIA, each interest payment referencing term SONIA would be known at the start of the interest period.

9. RFRWG Statement on *Lags, Shifts and the SONIA Compounded Index,* 9 March 2020.

10. Source: HSBC Bank plc and NatWest Markets (March 2020).

11. Source: RBC Capital Markets (October 2018).

12. FCA Chief Executive: speech in New York, June 2019.

used for new transactions. Whether, and on what basis, LIBOR would continue to be used in legacy transactions is addressed in a legislative proposal by HM Treasury and the FCA on 23 June.[13]

Fallbacks in LIBOR bond contracts

10 Before the announcement in July 2017 by the FCA, as the regulator of LIBOR, that it will no longer persuade or compel banks to submit quotations for LIBOR after the end of 2021, the permanent cessation of LIBOR was not contemplated in sterling bond contracts, which only took account of LIBOR being temporarily unavailable. Many of these LIBOR bond contracts contain fallback clauses which will fall back, on the permanent cessation of LIBOR, to the last available LIBOR fix (ie the floating rate will become a fixed rate for the remaining life of the bond). This would not have been the original intention of the parties when the contracts were written with a floating rate. For convenience, these are referred to as "Type 1" fallbacks. They are estimated to represent the largest proportion – at least 70% – of the total of legacy sterling LIBOR bonds.

11 After the FCA's announcement in July 2017, fallback clauses in sterling LIBOR bond issues began to take account of the permanent cessation of LIBOR in future by providing for the issuer or an independent adviser to select a successor or alternative rate, and an appropriate adjustment spread, which would apply at the permanent cessation of LIBOR, or in the event of a pre-cessation trigger. A pre-cessation trigger would take place before permanent cessation of LIBOR if the FCA, as regulator of LIBOR, declares that LIBOR is no longer representative of its underlying market. For convenience, these fallbacks are referred to as "Type 2" (cessation) and "Type 3" (pre-cessation) respectively. Type 2 and Type 3 fallbacks typically provide that a relevant nominating body (eg the RFRWG) should nominate a successor rate and an appropriate adjustment spread. It is important to note that the three types of fallback clause outlined are common examples, but do not describe every case.

Adjustment spread and successor rate

12 In the case of legacy sterling LIBOR bond contracts, there are two issues that need to be resolved in order to clarify how Type 2 and Type 3 fallbacks to SONIA would work.

- The first is that a credit adjustment spread is needed to take account of the economic difference between LIBOR and SONIA. In response to a recent RFRWG consultation on the credit adjustment spread in the cash markets, the overwhelming majority of market participants recommended the use of a fixed credit adjustment spread aligned with ISDA's proposals for a five-year median approach in the derivatives market: ie the median of the spread between LIBOR and risk-free rates over a five-year look-back period.[14] In line with the market's response to the consultation on the credit adjustment spread in the cash markets, the method for calculating the credit adjustment spread would be expected to be the same at pre-cessation and at permanent cessation of LIBOR.
- The second issue is what the successor rate in Type 2 and Type 3 fallbacks should be. In the case of sterling LIBOR bonds in the form of FRNs and securitisations, most bond market participants would prefer the successor rate to be compounded overnight SONIA (by reference to the SONIA Compounded Index to be published by the Bank of England). But that is not necessarily the case with other cash products (eg in the loan market), where market participants might prefer a term rate; and a term rate is at the top of the ARRC's waterfall of potential fallbacks in the US.

Consent solicitations

13 How should the remaining legacy sterling LIBOR bond contracts be addressed, particularly those with Type 1 fallbacks which are due on permanent cessation of LIBOR to fall back to the last LIBOR fix (ie a fixed rate)? The UK authorities' approach has been to encourage the market to transition as many bonds as possible from LIBOR to SONIA as soon as possible to avoid the risk that, while LIBOR is certain to end, it is not possible at this stage to rely on legislation to solve the legacy LIBOR bond problem. Consequently, the best way to avoid LIBOR-related risks is to move off LIBOR altogether.[15]

13. See paragraphs 17-19 below.

14. "The consultation identified a strong consensus in favour of the historical 5 year median approach … as the preferred methodology for credit adjustment spreads across both cessation and pre-cessation fallbacks for cash products maturing beyond end-2021.": Summary of response to the RFRWG *Consultation on Credit Adjustment Spread Methodologies for Fallbacks in Cash Products Referencing GBP LIBOR,* [March] 2020.

15. Edwin Schooling Latter: *Next Steps in Transition from LIBOR:* London, 21 November 2019.

14 In the sterling bond market, the most straightforward way for market participants to transition from LIBOR to SONIA is to use consent solicitation, which is a process envisaged in most bond contracts.[16] This involves issuers seeking the consent of investors to convert their bonds from LIBOR to SONIA. (Cash tender offers, exchange offers or open market repurchases are a potential alternative, but they risk leaving a rump of unconverted LIBOR bonds and could have accounting and other implications.) Initial progress has been made through the successful use of consent solicitations in 18 bond market transactions, with a market value of £11 billion, up to the end of the first half of 2020. All these transactions have used a credit adjustment spread based on a market rate[17] at which to convert bonds from LIBOR to SONIA. Over the period between now and the permanent cessation of LIBOR, the market rate for consent solicitations is expected to converge on ISDA's proposal for a fixed credit adjustment spread.

15 But there are two reasons why it is not expected to be practicable to convert the bond market *as a whole* through consent solicitations by the end of 2021. First, some bonds are expected to be too difficult to convert: eg because the thresholds for consent from investors are too high: in the US, consent thresholds are commonly 100%.[18] Second, there are too many bonds to convert by the end of 2021. The process of seeking consent is voluntary, costly and time-consuming: bond contracts have to be amended bond by bond: it is not possible to use protocols to convert the bond market as a whole. In addition, the transition has been complicated by the market impact of the coronavirus (COVID-19) pandemic. While the end-2021 deadline by which market firms need to be ready for the cessation of LIBOR remains the same, there is less time available in practice to meet it.

Tough legacy bond contracts

16 So it is expected that there will be legacy sterling LIBOR bonds outstanding at the end of 2021 which will fall back to a fixed rate on the permanent cessation of LIBOR unless the authorities decide to intervene. The arguments for exploring the feasibility of official intervention, which would be intended to provide legal certainty about the treatment of tough legacy contracts, are:

- first, *fairness:* the permanent cessation of LIBOR was not contemplated when LIBOR contracts were written to fall back to the last LIBOR fix: instead, the LIBOR rate will become a fixed rate for the remaining life of the bond, which would not have been the original intention;
- second, *clarity:* there may be other contracts where the fallbacks are unclear or there are no fallbacks at all;
- third, *feasibility:* it would not be feasible to convert all legacy sterling LIBOR bonds (eg because the consent thresholds are too high);
- fourth, *shortage of time:* there would also be too many legacy sterling LIBOR bonds to convert by the end of 2021, as bond contracts need to be amended bond by bond and consent solicitation is a time-consuming process; and
- finally, *international consistency:* in the US, where consent solicitation is not expected to be practicable, as consent thresholds are commonly 100%, legislative relief is being sought under New York law: it would be beneficial internationally if US dollar LIBOR legacy bond contracts under New York law and US dollar LIBOR legacy bond contracts under English law are treated in a consistent way (See Box on page 11.)

17 In the UK, following the conclusions of the Tough Legacy Task Force, a market-based group chaired by the FCA, the RFRWG has recommended that "there is a case for action to address tough legacy exposures in the bond market" and has proposed that the British Government "considers legislation to address tough legacy exposures in contracts governed by English law that reference at least sterling LIBOR, and ideally other LIBOR currencies, that are still in operation when LIBOR is expected to cease on or after the end of 2021." The Task Force also "considers that a similar approach [to the ARRC approach in the US] for contracts governed by English law would, assuming the ARRC work continues, help to bring about international consistency in the treatment of tough legacy contacts."[19]

18 The British Government responded on 23 June. In a written statement, HM Treasury said that the Government recognises that legislative steps could help deal with the narrow pool of "tough legacy" contracts that cannot transition from LIBOR. Unlike many jurisdictions, the UK has an existing regulatory framework for critical benchmarks such as LIBOR. The Government therefore intends to legislate to amend and strengthen that existing regulatory framework, rather than directly to impose legal

16. In the case of consent solicitations to convert legacy bond contracts with Type 1 fallbacks from LIBOR to SONIA, a credit adjustment spread and successor rate are relevant as well.

17. This has been defined as the linear interpolation for the relevant tenor of LIBOR versus SONIA basis swaps, which is then added to the original margin of the legacy bond.

18. In addition, in the case of some securitisations, there is no longer a decision maker, nor a party willing to assume the costs of amendment. See also RFRWG: *Paper on Identification of Tough Legacy Issues,* May 2020.

19. RFRWG: *Paper on the Identification of Tough Legacy Issues:*29 May 2020.

ARRC proposal for legislative relief under New York law

The Alternative Reference Rates Committee (ARRC) proposal for legislative relief is designed to minimise the risk of costly and disruptive litigation by providing legal certainty for the issues that are likely to arise under New York law. Under the proposal, a statute would permit the application of an ARRC-recommended SOFR fallback rate and spread adjustment to US dollar LIBOR instruments governed by New York law across all asset classes. Instruments with fallbacks to rates other than LIBOR would not be subject to the legislation. The key components of the proposed statute and its effects on contractual provisions are as follows:[20]

Mandatory versus permissive application of the statute

Mandatory: If the legacy contract is silent as to fallbacks.

Mandatory: If the legacy language falls back to a LIBOR-based rate (such as the last quoted LIBOR).

Permissive: If the legacy language gives a party the right to exercise discretion or judgment regarding the fallback, that party can decide whether to avail itself of the statutory safe harbour.

Degree of override of legacy contract fallback provisions

Override: Where the legacy language falls back to a LIBOR-based rate (such as the last quoted LIBOR).

Override: If the legacy language includes a fallback to polling for LIBOR or other interbank funding rate, the statute would mandate that the polling not occur.

No override: Where the legacy language is silent as to fallbacks or gives a party the right to exercise judgment to override and the statute would apply the recommended benchmark replacement.

No override: The statute would not override legacy language that falls back to an express non-LIBOR based rate (such as Prime).

Mutual "opt-out"

Parties would be permitted to mutually opt out of the application of the statute, in writing, at any time before or after the occurrence of the trigger event.

Trigger events

The statute would become applicable or available (as described in "mandatory" versus "permissive" above) upon the occurrence of statutory trigger events.

Scope

No exclusions: No product would be categorically excluded from the statute. Parties can opt out as described above.

Conforming changes

The statute would be drafted to provide safe harbour protection for parties who add conforming changes to their documents to accommodate administrative/operational adjustments for the statutory endorsed benchmark rate.

20. ARRC: *Proposed Legislative Solution to Minimize Legal Uncertainty and Adverse Economic Impact Associated with LIBOR Transition:* 6 March 2020.

changes on LIBOR-referencing contracts that are governed by UK law. The legislation will ensure that, by end-2021, the FCA has the appropriate regulatory powers to manage and direct any wind-down period prior to eventual LIBOR cessation in a way that protects consumers and/or ensures market integrity.[21]

19 In an accompanying statement, the FCA said that the new powers proposed will be available where the FCA has found that a critical benchmark is not representative of the market it seeks to measure and representativeness will not be restored. The FCA and other authorities have been clear that those who can amend their contracts so that they move away from LIBOR at or before this point, should do so. The legislation would empower the FCA to protect those who cannot amend their contracts in this way by directing the administrator of LIBOR to change the methodology used to compile the benchmark if doing so would protect consumers and market integrity. Although this would not make the benchmark representative again, it would allow the FCA to stabilise certain LIBOR rates during a wind-down period so that limited use in legacy contracts could continue, if suitable robust inputs to support such a methodology change are available.[22] In this context, the FCA has noted the market consensus that has emerged internationally and in the UK on how to calculate fair alternatives to LIBOR in some important markets, notably derivatives, bonds and some parts of the loan market, using the risk-free rates chosen by each LIBOR currency area, adjusted for the relevant term of the contract, and with a fixed credit spread adjustment added.[23]

Regulatory dependencies

20 Regulatory dependencies resulting in obstacles to the transition from LIBOR to SONIA have been identified in letters from the Chair of the RFRWG to the FCA and the PRA so that these obstacles can be addressed. In the case of prudential regulation, it is important that the change of benchmark does not result in existing securities being re-classified as new securities. In the case of conduct regulation, it is important that any conduct risks associated with the change of benchmark are managed appropriately.

Supervision of firms' preparations

21 In the UK, the Bank of England, PRA and FCA have sent "Dear CEO" letters to the chief executives of the banking and insurance firms – and more recently the asset management firms – they supervise to raise awareness of the need to prepare for the transition from LIBOR to risk-free rates. The UK authorities are also gathering information on progress in the transition through a regular data collection exercise to provide feedback on risks and to share good practices.[24] Supervisors in other jurisdictions do not necessarily use the same mechanisms as the UK, but their objective is the same. That is to check on a regular basis that the firms they supervise are identifying and quantifying their LIBOR exposure and planning ways to reduce it by transitioning to risk-free rates, taking account of prudential and conduct risks during the transition to risk-free rates and at the cliff-edge when LIBOR is discontinued. Firms also have a responsibility to train their staff and communicate with their clients.

International coordination

22 The transition to risk-free rates internationally is coordinated by the Official Sector Steering Group (OSSG) of the Financial Stability Board, which has also been considering legacy contracts globally and how they should be addressed. In addition to the OSSG's work in overseeing the transition generally, it is clear that international coordination of any official intervention on the replacement of LIBOR would be important as well so as to ensure consistency of treatment internationally. For example, in addition to financial contracts denominated in sterling, English law is used in financial contracts denominated in a number of other currencies (eg US dollars) internationally. LIBOR legacy bond contracts denominated under New York law and under English law would benefit from being treated in a consistent way.

23 International coordination of the timing of any official intervention (eg through legislation) on the permanent cessation of LIBOR is also likely to be important. As permanent cessation of LIBOR is due to take place at or after the end of 2021, market firms need to be ready for permanent cessation by the end of 2021. But if official intervention is required (eg through legislation) to override legacy LIBOR contracts in multiple jurisdictions, and this cannot be achieved in all these jurisdictions by the end of 2021, the question would arise whether LIBOR would continue to be needed in some form for a wind-down period before permanent cessation.[25]

24 There are some differences of approach to the transition between national jurisdictions. For example, some risk-free rates are secured (like SOFR in the US and

21. HM Treasury: Financial Services Regulation, Written Statement: 23 June 2020.

22. FCA Statement on Planned Amendments to the Benchmarks Regulation: 23 June 2020.

23. FCA: Benchmarks Regulation – Proposed New Powers: Q&A. 23 June 2020.

24. Andrew Hauser, Executive Director, Markets, Bank of England: *Turbo-charging Sterling LIBOR Transition:* London, 26 February 2020.

25. See RFRWG: *Paper on the Identification of Tough Legacy Issues,* 29 May 2020.

SARON in Switzerland); and some unsecured (like SONIA in the UK and €STR in the euro area). And while the focus in the US and the UK is on replacing LIBOR, the focus in the euro area is currently on replacing EONIA by €STR, and implementing fallbacks to €STR for EURIBOR rather than replacing it, at least at this stage. So there is not a "one-size-fits-all" approach to the transition in different national jurisdictions. But the direction of travel towards risk-free rates is much the same and, despite the market impact of the pandemic, considerable progress is being made, including in the bond market.

ICMA's contribution to the transition to risk-free rates

ICMA is contributing to the transition to risk-free rates in a number of complementary ways:

ICMA is participating in the Sterling Working Group on Risk-Free Rates and chairing the Bond Market Sub-Group. ICMA is also participating in the Euro Risk-Free Rate Working Group (as an observer) and the Swiss National Working Group; and ICMA is in regular contact with the FRN Group Chair on the Alternative Reference Rates Committee in the US.

ICMA has set up a risk-free rate webpage on the ICMA website with hyperlinks to official publications and speeches globally, as well as to ICMA's own work and joint work with other trade associations.

ICMA has published regular updates on the transition to risk-free rates in the ICMA Quarterly Report, including a global summary (with hyperlinks) in the Quarterly Report for the Second Quarter of 2020.

ICMA has held regular calls to brief members on progress in the transition to risk-free rates.

And ICMA moderated official sector panels on the transition to risk-free rates at the Conference after the ICMA AGM in Madrid in 2018 and Stockholm in 2019 and a virtual official sector panel in June 2020. This latest panel included senior representatives from the UK FCA, the Federal Reserve Bank of New York, the European Central Bank, the Swiss National Bank and the European Investment Bank. A recording of the panel is available on the ICMA website.

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Transition to risk-free rates in the euro area

By Katie Kelly

EONIA to €STR

Following an announcement by EMMI, the administrator of EONIA, that EONIA would not be compliant with the EU Benchmarks Regulation, the Working Group on Euro Risk-Free Rates (Euro RFRWG) endorsed recommendations to market participants regarding the transition from EONIA to €STR in March 2019. Since 2 October 2019, EONIA has been published daily on the basis of a reformed determination methodology, which is €STR + 8.5 basis points (as calculated by the ECB). EMMI will continue to publish EONIA every TARGET day until 3 January 2022, the date on which EONIA will be discontinued.

€STR reflects the wholesale euro unsecured overnight borrowing costs of euro area banks, in contrast to EONIA that measures interbank lending. The €STR rate is published for each TARGET business day, based on transactions conducted and settled on the previous day (reporting date T) with a maturity date of T+1.

According to the ECB, the launch of €STR was successful from both a technical and a market perspective: neither the launch of the rate nor the change to the EONIA methodology resulted in any serious disruptions, and the process for producing €STR on a daily basis has worked smoothly and reliably. Major CCPs started clearing swaps indexed to €STR towards the end of 2019, and approximately €4bn of FRNs[1] linked to €STR have been issued.

The market conventions used in these €STR FRNs to date are aligned with those typically used to date in the SONIA bond market: ie €STR compounded in arrears over an interest period, with a margin added and a "lag" of five days. It is worth noting that these SONIA bond market conventions may change as a result of the announcement of the publication of a SONIA Compounded Index by the Bank of England which is compatible with, and might steer the SONIA bond market towards, a "shift" approach rather than a "lag" approach (as more fully described in the Q2 2020 edition of this Quarterly Report). As there are no indications as yet of the publication of an €STR index, this might result in a divergence of conventions.

In terms of EONIA legacy transactions, EONIA is not typically referenced in bonds, but any contracts with EONIA as the underlying rate that mature before December 2021 would be covered by the ongoing publication of EONIA until the end of 2021. However, any legacy EONIA contracts that expire after the end of 2021 will have to be amended before then to replace EONIA as the underlying rate, or to include fallback provisions.

There has been some limited usage of EONIA in the European repo market. In July 2019 (later updated in September 2019), the ICMA European Repo and Collateral Council Committee produced recommendations for the repo market in relation to the transition from EONIA to €STR. This has significantly reduced the volume of such repo activity, easing the necessary process of transition from EONIA to €STR for the remainder.

EURIBOR

EURIBOR is not currently scheduled to be discontinued. EU authorities anticipate that the use of EURIBOR will persist for the foreseeable future following a period of reform that has now been completed.

However, authorities have also highlighted that users of EURIBOR should be prepared for all scenarios, including the possible disappearance of EURIBOR. The Euro RFRWG therefore recommends that market participants incorporate fallback provisions in all new contracts referencing EURIBOR; and where no specific fallback provision is recommended, a generic EURIBOR fallback provision should be incorporated instead.

To this end, the Euro RFRWG is identifying €STR-based fallbacks for EURIBOR in the event that EURIBOR permanently ceases to exist, and expects to release two related public consultations in the course of 2020. The first will cover the preferred EURIBOR fallback rates for a variety of financial products, and the preferred spread adjustment to avoid potential value transfers upon activation of the fallback. The second public consultation will cover a set of trigger events for the application of the respective fallback rates.

The Euro RFRWG has established a sub-group to identify and recommend an €STR-based forward-looking term structure for use as a EURIBOR fallback. The Euro RFRWG has already recommended a preferred forward-looking methodology using the future €STR-based OIS firm quotes observed in trading venues to build term rates, and has yet to work on possible backward-looking methodologies that could be used for some EURIBOR-linked products.

In the meantime, some guiding principles have already been published by the Euro RFRWG on how to introduce €STR-based fallbacks to EURIBOR in contracts, including the risk management and financial accounting implications of their introduction.

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1. Source: Bloomberg

The economic impact of COVID-19 and implications for capital markets

By Bob Parker

In contrast to previous crises, which have largely been created by debt defaults, whether in the sovereign, corporate or financial sectors or by overvalued markets deflating, the coronavirus crisis has had profound demand and supply effects on economies with concomitant shocks to capital markets. Whereas in early 2020, the economic impact was largely confined to China and other Asian countries, the shock to Europe, the US and many other countries only occurred in March and April.

The effect on the Chinese economy was demonstrated by the data for January and February showing year on year declines of 20.5% in retail sales, 17.2% in exports and 13.5% in industrial production with Chinese GDP contracting by 6.8% year on year in the first quarter of 2020. The yield on the 10 year Chinese Government bond declined from approximately 3.2% at the beginning of 2020 to less than 2.5% in early April, while in equity markets the CSI 300 had two major setbacks, one in late January and a second more pronounced decrease of 16.1% in early to mid-March.

Although US GDP fell by 5% annualised in Q1 2020 with euro area GDP decreasing by 3.1% year on year, the major shock to the US and EU economies extended into April and early May. Unemployment in the US jumped from a low 3.5% in February to close to 15% in April, with a 16.2% year on year decline in industrial production, and April saw a 19.9% year on year fall in retail sales. The pressure on the US service sector was shown by the services PMI falling to a record low point of 26.7 in April. In the euro area, the data was equally dire, with April industrial production falling by 28% year on year, exports down by 29.3% year on year and retail sales decreasing by 19.6% year on year. After exceeding 50 in February, the services PMI collapsed to a record low of 12.

In January and February, US and European credit and equity markets rallied to near record high levels, but then rapidly reversed in late February and March. The Bloomberg Barclays Global Aggregate bond index fell by 8.8% from 9 March to 20 March with a spike in both investment grade and high yield spreads. From 19 February until 23 March, the S&P 500 declined by 34% with a 37% fall in the EuroStoxx over the same period. From 7 February until 19 March, the Nikkei decreased by 30%. Although the declines in equity markets were less pronounced than in the last two major crises of 2000-03 and 2007-09, the speed of the market moves was unprecedented, as shown by the sharp increase in the VIX from less than 15 in late February to over 80 on 16 March, a level only previously seen at the time of the Lehman bankruptcy in 2008. Surveys of investor behaviour demonstrated a rapid reduction in exposures to equity and credit markets with positions being switched into perceived " safe havens", ie government bonds and gold.

The economic consensus amongst investors is broadly in line with the OECD and World Bank projections: the OECD projects that the economies of its member countries will decline by 6% in 2020, with the US contracting by 7% and the euro area by 9%. The World Bank forecasts that the advanced economies will decline by 7% in 2020. The forecasts are made with a degree of forecasting error given the uncertainty as to whether there will be repeated waves of the coronavirus and also on the timing and distribution of an effective vaccine.

Whereas, in the financial crisis of 2008, the policy responses were primarily focussed on the banking and financial sectors, with an expansion in monetary policy, in 2020 the response has been in taking both monetary and fiscal action. Central banks have cut interest rates with, for example, the Federal funds rate being reduced to 0-25 basis points and with the ECB extending selected credit to the banking sector at minus 100 basis points. However, the more profound policy action taken by central banks has been in expanding their balance sheets. The Federal Reserve balance sheet increased from US$4.2 trillion at the beginning of 2020 to US$7.1 trillion at mid-June, with purchases of US Treasuries and MBS being extended into a range of other asset classes, including direct lending to corporates and public sector entities. The Bank of Japan balance sheet is approaching 110% of Japanese GDP, while the ECB balance sheet (consolidated Eurosystem assets) rose to €5.6 trillion in late June from €4.7 trillion at the end of 2019. Globally, central bank asset purchases, at the time of writing, show an increase of approximately US$10 trillion in 2020. Indicators of liquidity and monetary conditions, which had tightened in early 2020, started to show a trend improvement from mid-March onwards.

Fiscal expansion programmes worldwide now exceed US$11 trillion, approximately 13% of global GDP. So far, most of the fiscal support has been in preventing the rise in unemployment and corporate defaults while attempting to support healthcare and welfare systems and underpinning consumption and investment spending. It is evident that, in the absence of these monetary and fiscal programmes, the extent and duration of the global recession would have been significantly more pronounced. However, even with economic recovery starting to accelerate in the first half of 2021, consensus projections are for budget deficits of 10% of GDP in the US , above 5% in the euro area and 7% in the UK, potentially exerting upward pressure on government bond yields at a time when expectations are building of central banks decelerating their asset purchase programmes.

In response to the extent of monetary and fiscal action, credit and equity markets formed a base in late March and have seen major rallies subsequently. From late March to the end of June, the S&P, EuroStoxx and Nikkei indices have all risen by close to 40%, while areas of extreme market pressure such as emerging currencies and bond markets have experienced renewed investor capital flows. Investment grade and high yield credit spreads have narrowed from the elevated levels seen in March, although they have not returned to the tight spreads seen in February. While there is debate amongst investors over the speed to which the coronavirus can be curtailed and over the speed and extent of economic recovery, it is clear that investors are "looking through" the likely increase in corporate defaults in the second half of 2020 and the decline in earnings per share. Current forward price earnings ratios on global equity markets are close to 20, while Moody's is predicting that high yield default rates could approach 12% in late 2020, and the expected decline in global earnings per share in 2020 is anticipated to be over 18%.

The asset management industry has faced a number of challenges so far in 2020. Given the increase in market volatility in March, less liquid securities became more difficult to value and therefore meeting client redemptions notably in mutual funds became problematic. However, a number of industry-agreed techniques meant that any liquidity problems were relatively short lived and notably equity funds and major market ETFs experienced limited disruption. The problem areas of real estate funds, distressed debt and certain derivatives, notably in credit markets, while under pressure in March benefitted from the market recoveries in April and May. An interesting feature of the asset management industry in 2020, in contrast to 2008, was the limited amount of forced selling and therefore few asset managers were "whip sawed" by the market rebound in the second quarter of 2020.

One obvious question is what longer term changes will the coronavirus cause? Changing working practices will underpin demand for tech and communications products, while the fear of future viruses will boost investment spending in the healthcare and biotech sectors. Commercial real estate will be under pressure and future demand for business travel has negative implications for the airline, aircraft and travel sectors. Elevated unemployment levels for the next 2-3 years may curtail discretionary spending. A number of governments in their fiscal programmes want a strategic focus on environment and sustainable investment and the coronavirus has probably acted as a catalyst for further investment in these sectors. The final open-ended question is whether the inevitable high levels of debt to GDP in most countries will act as a constraint in the longer term.

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Regulatory responses to the market impact of COVID-19

By Charlotte Bellamy

Introduction

International, EU and UK supervisors, market authorities, central banks and other official sector bodies have continued to pursue a range of measures in response to the crisis caused by the COVID-19 pandemic since we reported on the official responses to the market impact of COVID-19 in the last edition of this Quarterly Report.

Undoubtedly a central part of the response has been a suite of monetary and fiscal policy actions. ICMA's COVID-19 monetary policy webpage, first published in March and updated on a daily basis, summarises the key monetary policy actions taken by a range of different central banks and other bodies. In addition, ICMA made available a podcast on central bank support for the economy during the crisis, which also touches on fiscal responses from governments in mitigating and containing the economic fallout from the COVID-19 pandemic.

Complementary to this, ICMA's COVID-19 regulatory responses webpage provides links to regulatory-related announcements from various authorities, organised geographically.

This article seeks to provide a flavour of some of the key regulatory actions taken by international, EU and UK official bodies in Q2 2020 in response to the crisis caused by the COVID-19 pandemic, with a focus on the international bond market. It is not an exhaustive list, but seeks to provide an overview of regulatory responses and identify key themes, namely: (a) international cooperation; (b) adjustments to deadlines, work programmes and other timelines; and (c) actions in the area of prudential and accounting regulation. We also briefly summarise certain other relevant actions and announcements taken by international, EU and UK bodies outside of these key themes.

This article does not focus on the support measures introduced by governments in many jurisdictions to alleviate the financial and economic impact of COVID-19, including government guarantee programmes for bank loans and payment moratoria.

International cooperation

Global responses to the crisis continue to be coordinated via bodies such as the G20, the FSB, IOSCO and the Basel Committee on Banking Supervision (BCBS). In the EU, ESMA and other EU bodies have played an important role in coordinating across EU countries and national competent authorities. In addition, there has been coordinated messaging on certain key issues by central banks, regulators and other authorities.

In mid-April, the G20 set out an Action Plan for supporting the global economy through the COVID-19 pandemic, setting out the key principles guiding the G20's response. Among other things, this included support for a time-bound suspension of debt service payments for the poorest countries that request forbearance. Related to this, the FSB reported on the financial stability implications and policy measures taken in response to the COVID-19 pandemic on 15 April, setting out five principles underpinning the official community's response. In summary, the principles are: (i) to monitor and share information on a timely basis to assess and address financial stability risks from COVID-19; (ii) to recognise and use the flexibility built into existing financial standards to support the response; (iii) to seek opportunities to temporarily reduce operational burdens on firms and authorities; (iv) to act consistently with international standards and not to roll back reforms or compromise the underlying objectives of existing international standards; and (v) to coordinate on the future timely unwinding of the temporary measures taken.

The FSB also coordinated with trade associations (including ICMA) and later with the private sector, emphasising that it is supporting international coordination and cooperation on the COVID-19 response in three ways: (i) information exchange, (ii) risk assessments and (iii) coordinating global policy responses. The G20 and FSB have continued to provide a forum for policy discussions and information sharing since then.

IOSCO has also played an important role in coordinating actions and guidance on various matters. In Q2 2020, this included: (a) announcing jointly with the BCBS a deferral of the final implementation phases of the margin requirements for non-centrally cleared derivatives; (b) issuing a statement on the application of accounting standards during the COVID-19 outbreak; and (c) encouraging fair disclosure of COVID-19 related impacts by issuers.

Similarly, the BCBS took a series of actions to support coordination of efforts in responding to COVID-19, following those reported in the last edition of this Quarterly Report. This involved, among other things, a review of the domestic regulatory and supervisory measures taken by its members in response to the crisis. Other actions taken by the BCBS are summarised in the section entitled *Prudential and accounting regulation* below.

In the EU, ESMA has played an important role in coordinating EU national competent authorities' responses to the crisis and cooperating with the other EU supervisory authorities (EBA and EIOPA) across various different areas. ESMA's announcements related to COVID-19 are compiled on its COVID-19 webpage and some of its actions that are most relevant for the international bond market are summarised in the section entitled *Selected other regulatory developments* below.

There have also been several examples of coordinated or aligned action by central banks, regulators and other bodies in the EU and the UK. The FCA, for example, is working closely with the UK Government, the Bank of England and other relevant bodies and several of its statements related to COVID-19 align with or support statements by EU bodies such as ESMA. Some specific examples of this coordination can be seen below.

Adjustments to deadlines, work programmes and other timelines

General re-prioritisation: Many official sector bodies announced re-prioritised work programmes for 2020 and beyond in order to reflect the impact of COVID-19. For example:

- IOSCO announced on 8 April that it was re-prioritising its work and that substantial resources would be devoted to areas impacted by COVID-19. This would include examining investment funds and margin and other risk management aspects of central clearing for derivatives and other securities. A limited number of other workstreams that are close to completion or align with FSB work would continue, but other work, for example in relation to artificial intelligence and the impact of the growth of passive investing, will be de-prioritised.
- The European Commission adjusted its work programme for 2020, noting that the priorities that were set at the beginning of the mandate and presented in January 2020 (including the European Green Deal and the European Digital Strategy) remain valid in addressing the current challenges, but the Commission's adjusted work programme responds to the coronavirus pandemic by prioritising the actions needed to propel Europe's recovery and resilience. Amongst other things, the Commission delayed the adoption of both its Action Plan on the Capital Markets Union and its Renewed Sustainable Finance Strategy from Q3 to Q4 2020.
- ESMA published a revised version of its *2020 Annual Work Programme* on 15 June, including additional work on its immediate reaction to the crisis and indicating potential deprioritisation regarding ongoing and future mandates.
- In the UK, the FCA's business plan for 2020/21 issued on 7 April 2020 was heavily influenced by COVID-19 and it announced at the end of April that it was reviewing its work plans to delay or postpone activity that is not critical to protecting consumers and market integrity in the short term.
- The PRA also announced a re-prioritisation of its work in light of COVID-19. The re-prioritisation entailed, among other things, postponement of various PRA activities in relation to climate change, LIBOR transition and the Insurance Stress Test 2019.

Consultation deadlines: Various consultation deadlines were extended. For example, the European Commission delayed deadlines for several open consultations, ESMA extended all deadlines for consultations with a closing date on or after 16 March and deadlines for several open FCA consultations were extended to 1 October 2019.

MiFID II/R: In particular, deadlines for open consultations on MiFID II/R were extended. This included the European Commission MiFID II/MiFIR review consultation and ESMA's consultation on the non-equity transparency regime. ICMA responded to both consultations. ESMA also postponed the publication dates for annual non-equity transparency calculations and quarterly SI data. For further information, see Elizabeth Callaghan's articles in the Secondary Markets section of this Quarterly Report. In addition, ESMA encouraged national competent authorities not to prioritise supervisory action against execution venues and firms in respect of the deadlines for best execution reports.

SFTR: An important delay for many ICMA members was the Statement made by ESMA on 19 March announcing a three month delay to the first phase of the SFTR go-live, and then a subsequent announcement on 26 March giving forbearance on backloading. ICMA published a summary of the ESMA statements offering clarity on this after discussions among the ICMA SFTR Taskforce and then released an updated version of its SFTR recommendations. See further the update on SFTR implementation by Alexander Westphal in this Quarterly Report.

Margin requirements for non-centrally cleared derivatives: The BCBS and IOSCO announced a deferral of the final two implementation phases of the framework for margin requirements for non-centrally cleared derivatives by one year. The FCA welcomed the delay and announced it would be considering, together with other authorities, how to implement it in the UK. The ESAs subsequently proposed joint draft Regulatory Technical Standards on amendments to the bilateral margin requirements under EMIR on 4 May.

IBOR transition and benchmarks: The FCA supplemented its statement of 25 March that the central assumption that LIBOR will cease to be published at the end of 2021 remains, by announcing adjustments to interim milestones. The Bank of England also pushed back the dates from which haircut add-ons would be applied to LIBOR linked collateral. The Working Group On Euro Risk-Free Rates also agreed to delay certain deliverables due to COVID-19 and postponed the CCP discounting switch date from around 22 June to around 27 July. On 9 April, ESMA issued a Public Statement to promote coordinated action by NCAs regarding the timeliness of fulfilling external audit requirements for interest rate benchmark administrators and contributors to interest rate benchmarks in the context of the COVID-19 pandemic. For other articles relating to IBOR transition and benchmarks in this Quarterly Report, see *From LIBOR to SONIA in the Bond Market*, by Paul Richards, and *Transition to Risk-Free Rates in the Euro Area* by Katie Kelly.

Filing financial reports: Following its public statement recommending NCAs to apply forbearance powers towards issuers who need to delay publication of financial reports beyond the statutory deadline in light of the pandemic at the end of March, ESMA acknowledged on 20 May that some issuers may consider setting the timing of publication of their half-yearly financial reports later than usual within the available time-span, without prejudice to compliance with the Market Abuse Regulation. Similarly, the FCA extended deadlines for the filing of annual company accounts and half yearly financial reports for listed companies in the UK.

Publication of investment funds' periodic reports: ESMA issued a public statement on 9 April directed at fund managers concerning their obligations to publish yearly and half-yearly reports, noting that it expects NCAs to adopt a risk-based approach and not prioritise supervisory actions against these market participants in respect of reporting deadlines. In the UK, the FCA extended deadlines to publish fund reports and accounts.

Supervision and regulatory reporting for financial institutions: The ECB, EBA, EIOPA, the Bank of England, PRA and FCA made various announcements in Q2 2020 relating to extensions to submission deadlines for reports due under prudential or resolution regulation applicable to banks, insurers and pension funds. However, on 26 June, the PRA announced that it would expect, in general, on-time submission for future regulatory reporting going forward, and that the publication timeline for Pillar 3 disclosures should not be affected by COVID-19 in most cases, because firms have now had time to adjust to new ways of working. The FCA made a similar announcement in respect of certain regulatory returns on 26 June. At a global level, the BCBS announced that it will conduct the 2020 G-SIB assessment exercise as planned based on end-2019 data, but it agreed not to collect certain additional data. The BCBS also decided to postpone the implementation of the revised G-SIB framework by one year, from 2021 to 2022, to provide additional operational capacity for banks and supervisors.

Prudential and accounting regulation

Some of the early and important actions taken by EU and UK authorities when the virus started to spread in Europe were to (i) encourage the use of capital and liquidity buffers to support the economy, (ii) provide guidance on the application of accounting rules and (iii) provide flexibility in the application of prudential requirements, with a view to supporting banks to continue lending to businesses through the crisis caused by the COVID-19 pandemic.

Linked to this, there were several calls for banks and other financial institutions to refrain from paying dividends or making distributions in order to ensure that all available capacity was targeted at lending to businesses.

Certain key actions taken by international, EU and UK bodies in this area in Q2 2020 are summarised below.

International bodies

In early April, the BCBS took additional measures to alleviate the impact of COVID-19 such as issuing: (i) technical clarifications designed to ensure banks reflect the risk-reducing effect of governments' extraordinary support measures to alleviate the financial and economic impact of COVID-19 when calculating their regulatory capital requirements; (ii) an encouragement to banks to use the flexibility inherent in expected credit loss accounting frameworks to take account of the mitigating effect of the extraordinary support measures related to COVID-19; and (iii) adjustments to transitional arrangements for the regulatory capital treatment of expected credit loss accounting. Other international organisations, such as IOSCO, made similar statements in relation to the application of accounting standards during the COVID-19 outbreak.

In May, the IMF Managing Director called for bank dividends and buybacks to be halted, suggesting that shareholders who sacrifice now will prosper when growth restarts.

In mid-June, the BCBS met again to discuss the impact of COVID-19. The BCBS (i) reaffirmed its expectation of full, timely and consistent implementation of all Basel III standards based on the revised timeline agreed in March and (ii) confirmed its view that a measured drawdown of banks' Basel III buffers as both anticipated and appropriate in the current period of stress and highlighting that supervisors will provide banks sufficient time to restore buffers taking account of economic and market conditions and individual bank circumstances.

EU

In the EU, Ministers of Finance issued a press release in mid-April noting that it is crucial that banks continue financing households and corporates, including SMEs experiencing temporary difficulties amid the COVID-19 pandemic and, to this end, making full use of the flexibility provided for in the prudential and accounting framework is essential at a time when sufficient financing to cover financial pressures is vital for the economy. They also welcomed actions taken in relation to regulatory and accounting requirements for financial institutions in the current exceptional circumstances and in the area of supervision, and urged all banks that have not already decided to do so to refrain from making distributions and to use the freed capital and available profits to extend credit or other urgent financing needs arising from the ongoing crisis. This statement followed a similar statement that had been made at the end of March by the Chair and political coordinators of the European Parliament's Economic and Monetary Affairs Committee. It was also released on the same day that ECB Banking Supervision announced that it would temporarily allow lower capital requirements for market risk, in a move aimed at maintaining market-making activities and market liquidity. The Chair of the Supervisory Board of the ECB also encouraged banks to use liquidity and capital buffers and said there should be no stigma associated with that in an interview published on 20 April. That message has been repeated in other interviews and publications by the ECB.

Shortly afterwards, on 28 April, the European Commission published an *Interpretative Communication* confirming the statements on using flexibility within accounting and prudential rules made by various EU bodies and encouraging banks and supervisory authorities to make use of the flexibility in the EU's accounting and prudential frameworks. The Commission also proposed a set of "quick fixes" to the CRR, which were adopted by the European Parliament and Council in mid-June and took effect on 26 June following publication in the *Official Journal*.

In an interview with Il Sole 24 Ore on 23 June, Andrea Enria, Chair of the Supervisory Board of the ECB, stated, among other things, that: (i) the relaxation of prudential requirements in response to the COVID-19 crisis, in combination with timely support measures on the part of monetary policy and banking supervision, appeared to be effective; (ii) the ECB would allow sufficient time for banks to re-build their capital positions and the ECB would likely give an indication of the path to post-crisis adjustment in July; and (iii) the suspension of dividends and share buy-backs are temporary and exceptional measures that are designed to be removed as soon as there is greater certainty.

The EBA also took a series of actions including introducing (and subsequently extending) guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis, guidance on the use of flexibility in certain areas related to the impact of COVID-19 such as supervisory approaches in relation to market risk, the Supervisory Review and Evaluation Process, recovery planning, digital operational resilience and the application of the guidelines on payment moratoria to securitisations. It also introduced guidelines to address gaps in reporting data and public information in the context of measures introduced by authorities in the EU banking sector in the context of COVID-19 in early June.

The European Systemic Risk Board took two sets of actions in May targeted at five priority areas: (i) implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy; (ii) market illiquidity and implications for asset managers and insurers, (iii) impact of large scale downgrades of corporate bonds on markets and entities across the financial system; (iv) system-wide restraints on dividend payments, share buybacks and other pay-outs; and (v) liquidity risks arising from margin calls. The ESRB's actions were supported by ESMA.

UK

In the UK, the PRA published a variety of statements and information regarding various aspects of prudential and accounting regulation in Q2 2020 including the usability of liquidity and capital buffers and various other aspects. It also welcomed decisions by the boards of the large UK banks to suspend dividends and buybacks on ordinary shares until the end of 2020, and to cancel payments of any outstanding 2019 dividends in response to a request from the PRA and published various related publications relevant to insurers as well as banks.

The PRA announcements were supported by updates to an FCA statement regarding its expectations on financial resilience for FCA solo-regulated firms in which the FCA emphasised, amongst other things, that it expects firms to plan ahead, conserve capital and to consider whether discretionary distributions of capital for the purposes of dividends, share buy-backs or remunerations are prudent. The FCA stated that firms may use capital and liquidity buffers to support the continuation of their activities if needed but must keep the FCA or named supervisor informed. It also reminded non-bank lenders subject to IFRS9 that the standard requires that any forward-looking information used in expected credit loss estimates is both reasonable and supportable, and that they should take into account the impact of the coronavirus crisis and state support.

Selected other regulatory developments

In addition to the actions taken under the key themes identified above, a number of other relevant regulatory actions have been taken in Q2 2020.

Alternative Performance Measures: On 17 April, ESMA issued a Q&A to provide guidance to issuers on the application of the ESMA Guidelines on Alternative Performance Measures (APM Guidelines) in the context of the COVID-19 pandemic.

Expectations of funds: Throughout April, the FCA communicated its expectations of funds, including issues relating to virtual general meetings, ensuring compliance with VaR limits and various other points.

MiFID II conduct of business obligations and retail investors: On 6 May, ESMA reminded firms of their conduct of business obligations under MiFID II when providing services to retail investors, issuing a statement on the risks for retail investors when trading under the highly uncertain market circumstances due to the COVID-19 pandemic.

CLO ratings: On 13 May, ESMA highlighted the challenges associated with rating CLOs in a thematic report on CLO credit ratings in the EU.

Disclosure: On 29 May, IOSCO published a statement highlighting the importance to investors and other stakeholders of having timely and high-quality information about the impact of COVID-19 on issuers' operating performance, financial position and prospects. Related to this, ESMA called for transparency on COVID-19 effects in half-yearly financial reports and the FCA's *Primary Market Bulletin No. 28* of 27 May had included, among other things, a statement on market practice on going concern assessments.

Market conduct and transaction reporting issues: The FCA's *Market Watch 63*, published in May, set out the FCA's expectations of market conduct in the context of increased capital raising events and alternative working arrangements due to coronavirus.

MiFIR open access: On 11 June, ESMA issued a public statement to clarify the application of the MiFIR open access provisions for trading venues and CCPs in light of the recent adverse developments related to COVID-19. The FCA supported the ESMA statement.

Conclusion

The actions taken by official sector bodies in response to the market impact of the COVID-19 pandemic have been numerous and wide ranging. It has been encouraging to see international coordination, as well as coordination between central banks, regulators and other bodies within jurisdictions, and alignment on some of the key themes such as adjustments to deadlines and timetables and prudential and accounting regulation. The speed with which certain adjustments have been proposed, agreed and implemented (eg adjustments to the EU Capital Requirements Regulation) is also interesting to note. As noted recently by the Secretary General of the FSB, it is still too early to draw definitive conclusions on the effect of these actions with the pandemic still unfolding, although the financial system seems to have proven more resilient and better placed to sustain financing to the real economy as a result of the G20 regulatory reforms in the aftermath of the 2008 global financial crisis.

Going forward, as the immediate shock of the outbreak of the COVID-19 pandemic subsides and lockdown restrictions ease, it will be important to see whether regulatory measures in areas that are not directly related to the COVID-19 pandemic such as sustainable finance, the EU's Capital Markets Union initiative and digitalisation will be further impacted. ICMA will continue to monitor and discuss regulatory and other developments that impact international bond markets with members. ICMA welcomes feedback from members on our activities in this area. In addition, the ICMA COVID-19 webpages will continue to be updated.

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Sustainability-Linked Bonds: a promising addition to the ESG debt markets

by Nicholas Pfaff and Valérie Guillaumin

In March 2019 and with ICMA's support, the Loan Market Association (together with the Loan Syndications and Trading Association in the US and the Asia Pacific Loan Market Association) launched the Sustainability-Linked Loan Principles (SLLP). This guidance very likely underpinned the remarkable growth of the global sustainability-linked loan market that year, with issuance of USD122 billion (+168%, source: BNEF).

It also created a blueprint for the bond markets to consider, with innovative transactions being issued on a "sustainability-linked" model. Most notably in late 2019, ENEL, the Italian energy company, paved the way by issuing a series of SDG-linked bonds. These were characterised among other things by a contingent coupon step-up linked to ENEL's performance against predefined sustainable development targets. The transaction linked ENEL's sustainability strategy to these targets while allowing the funds raised to be used for general corporate purposes while in their pursuit.

Considering the potential of this product and to further develop the key role that debt capital markets can play in funding and encouraging companies that contribute to sustainability, the Executive Committee of the Green Bond and Social Bond Principles with ICMA's support launched in early 2020 a dedicated working group to draft guidance and best market practices for future issuers of sustainability-linked bonds (SLBs). Thanks to the enthusiasm of the 40 organisations forming the working group and the dedication of its coordinators, the Sustainability-Linked Bond Principles (SLBP) were rapidly developed and published on 9 June 2020.

Defining Sustainability-Linked Bonds

Sustainability-Linked Bonds (SLBs) are defined as any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ESG objectives. In that sense, issuers are thereby committing explicitly to future improvements in sustainability outcome(s) within a predefined timeline. SLBs are bonds aligned with the five core components of the SLBP (See Box).

Overview of the five core components of the SLBP

1. Selection of Key Performance Indicators (KPIs)

The KPIs should be:

- relevant, core and material to the issuer's overall business, and of high strategic significance to the issuer's current and/or future operations;
- measurable or quantifiable on a consistent methodological basis;
- externally verifiable; and
- able to be benchmarked, ie as much as possible using an external reference or definitions making the ambition assessment of SPTs possible.

2. Calibration of Sustainability Performance Targets (SPTs)

The SPTs should be ambitious, ie:

- represent a material improvement in the respective KPIs and be beyond "business as usual" trajectory;
- where possible be compared to a benchmark or an external reference;
- be consistent with the issuer's overall strategic sustainability/ESG strategy; and
- be determined on a predefined timeline, set before (or concurrently with) the issuance of the bond.

The target setting should be benchmarked on (i) the issuer's own performance over time, (ii) its peers and (iii) scientific references.

3. Bond characteristics

The bond's financial and/or structural characteristics can vary depending on whether the selected KPI(s) would reach (or not) the predefined SPT(s), ie the SLB will need to have a financial and/or structural impact involving trigger event(s).

The variation of the bond's financial and/or structural characteristics should be commensurate and meaningful relative to the issuer's original bond financial characteristics.

4. Reporting

Issuers of SLBs should publish and keep readily available and easily accessible:

- up-to-date information on the performance of the selected KPI(s);
- a verification assurance report relative to the SPT;
- any information enabling investors to monitor the level of ambition of the SPTs.

Reporting should be published regularly, at least annually, and in any case for any date/period relevant for assessing the SPT performance leading to a potential adjustment of the SLB's financial and/or structural characteristics.

5. Verification

Issuers should seek independent and external verification of their performance level against each SPT for each KPI by a qualified external reviewer with relevant expertise.

The verification of the performance against the SPTs should be made publicly available.

Post-issuance verification is a necessary element under the SLBP.

SLBs are notably forward-looking performance-based instruments. The issuer's sustainability performance is measured using sustainability key performance indicators (KPIs). Such outcomes are then assessed against agreed sustainability performance targets (SPTs). Within these parameters, SLBs can be used for general purposes.

The process for calibration of one or more SPT(s) per KPI is key to the structuring of SLBs since it will be the expression of the level of ambition that the issuer is ready to commit to, and thus considers realistic. Issuers are encouraged to position this information within the context of the issuer's overarching objectives, strategy, policy and/or processes relating to ESG.

Main differences from Green, Social or Sustainability Bonds

Green, Social and Sustainability Bonds represent a highly successful funding instruments for companies that can identify eligible sustainable projects or assets for financing or refinancing. They also concentrate on green and social objectives that are directly linked to these projects and assets. These projects and objectives can be benchmarked against external taxonomies and wider goals such as the SDGs, and positioned within the issuer's sustainable strategy, but remain connected to what has specifically been identified for financing or refinancing.

SLBs, on the other hand, can be used by the issuer to aim holistically for a wider variety and combination of sustainability targets and objectives, as well as ESG criteria, for its organisation and business. An SLB can have, for example, both climate transition and social targets, while referring to SDG goals and/or governance objectives. They can be applied to the sustainability objectives of corporate organisations, as well as to the climate policy objectives of sovereigns.

SLBs are intended to be used for general purposes in pursuit of agreed sustainability performance targets. This focuses the attention of investors and the market on the overall sustainability performance of the issuer, and not its projects, assets or other expenditures that are to be funded by a bond's proceeds. An SLB creates incentives for the issuer generally to transition to a more sustainable business model.

The advantages of Sustainability-Linked Bonds

SLBs incentivise issuers to achieve material, quantitative, pre-determined, ambitious, regularly monitored and externally verified sustainability (ESG) objectives through KPIs and SPTs. As mentioned above, they are also highly versatile instruments that can be applied to many sustainability topics and themes.

Issuances aligned to the SLBP aim to provide an investment opportunity with transparent sustainability credentials.

Specifically, the SLBP aid investors by promoting accountability of issuers in their sustainability strategy and the availability of information necessary to evaluate the performance of SLB investments.

The SLBP leave the door open to issuer innovation when determining the potential variation of an SLB's financial and/or structural characteristics against its performance in relation to its sustainability targets. To illustrate, Korian issued on 19 June 2020 €173 million of Sustainability-Linked Euro Private Placement notes aligned with the SLBP. Korian indicated that, should the embedded coupon step-up be triggered by a failure to meet its targets, half of the increase would be allocated to internal remedial measures and/or paid to one or more external partners (such as associations or NGOs), with the other half being paid to investors.

The role of external reviews and verification

In addition to disclosure and reporting recommendations, the SLBP clearly recommend that, in connection with the issuance of an SLB, issuers appoint an external review provider to confirm the alignment of their bond with the five core components of the SLBP (eg through a Second Party Opinion). In their pre-issuance report, external reviewers are encouraged to assess the relevance, robustness and reliability of selected KPIs, the rationale and level of ambition of the proposed SPTs, the relevance and reliability of selected benchmarks and baselines, and the credibility of the strategy outlined to achieve them, based on scenario analyses, where relevant. Post-issuance, in case of any material change to the perimeter/KPI methodology/SPT(s) calibration, issuers are encouraged to ask external reviewers to assess any of these changes.

Issuers are required to seek independent and external verification by a qualified external reviewer of their performance level against each SPT. This verification must occur at least annually, and in any case as required for assessing SPT performance in relation to potential trigger event(s) leading to an adjustment of the SLB's financial and/or structural characteristics. In contrast to the pre-issuance external review, post-issuance verification is not optional but a necessary element of the SLBP.

Additional guidance

The SLBP already provide a glossary of the key terms and a detailed non-exhaustive checklist for elements that are recommended or required to be disclosed in SLB issuances. As a next step, the GBP SBP Executive Committee aims to publish a Q&A document to provide additional guidance.

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COVID-19: secondary market study

By Andy Hill

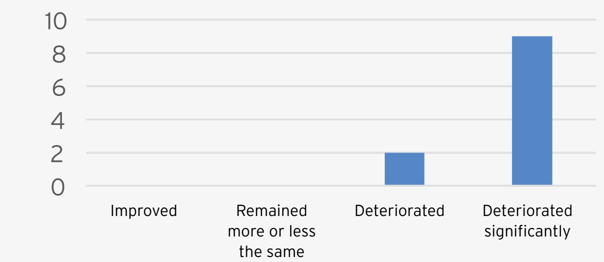
Overview

The market moves and dislocations experienced during the onset of the recent global COVID-19 pandemic are unprecedented in recent times, and arguably surpass those seen during the Global Financial Crisis of 2007-09. In May 2020, ICMA's Secondary Market Practices Committee published *The European Investment Grade Corporate Bond Secondary Market and the COVID-19 Crisis*, which documents how the European investment grade (IG) corporate bond secondary market performed during the last weeks of February through March and April 2020. Drawing on interviews and surveys of sell-side and buy-side market participants, as well as market data and analysis, it attempts to identify the key themes and dynamics of the "COVID-19 crisis", the challenges faced by market participants, and the extent to which the market was able to adapt and respond. The report also looks to provide some potential *lessons learned* from the recent turbulence.

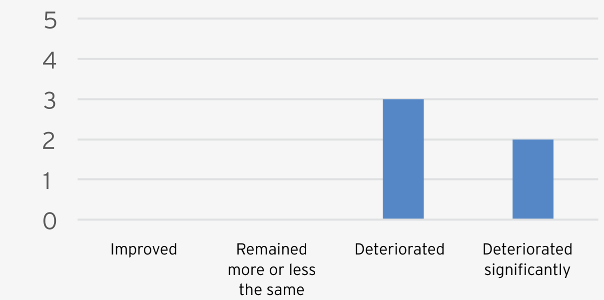
Liquidity

Liquidity in the European IG credit market became severely impaired during the period of late February and early-to-mid March, and by 18 March, considered to be the nadir of the "liquidity crisis", some report that the market had become dysfunctional. Furthermore, there are suggestions that liquidity in the week following 18 March was perhaps even worse than the week leading into it.

General market liquidity conditions (buy-side)

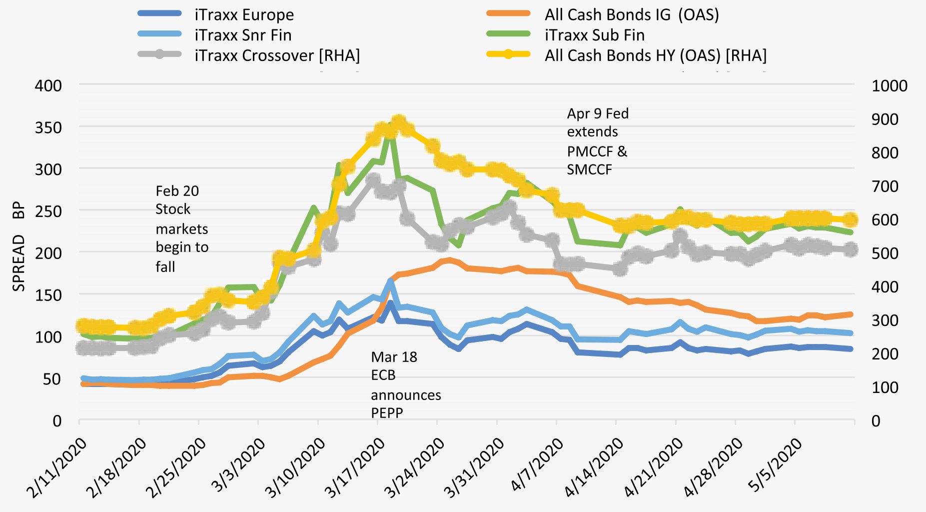


General market liquidity conditions (sell-side)



Source: Survey of ICMA members

Chart: EUR credit spreads

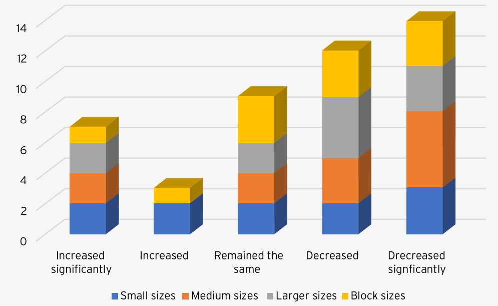


Source: ICMA analysis using Bloomberg data

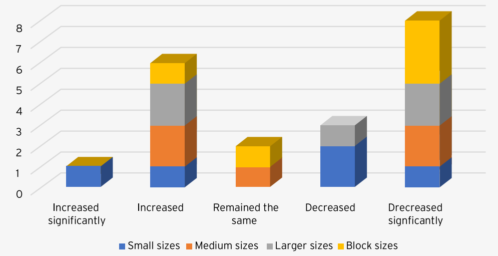
Market moves

One of the most vivid representations of the crisis is the rapid and acute widening of credit spreads, followed by their subsequent extensive retracement. Respondents report that, largely as a result of years of assertive central bank monetary policy, IG credit had become a technically driven market, where fundamental valuations had come to take second place. The COVID-19 crisis has to some extent corrected this aberration, returning to a more fundamentals-based repricing of risk.

Trading activity on venues (buy-side)

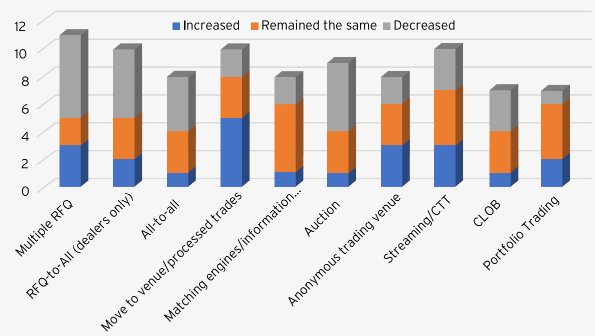


Trading activity on venues (sell-side)



Source: Survey of ICMA members

Change in use of e-trading protocols (buy-side)



Source: Survey of ICMA members

Market structure

During the peak of the crisis, for the most part electronic trading in the European corporate bond markets broke down as participants resorted to voice trading. This was not so much due to technological challenges, but rather because the market became too volatile and too illiquid for dealers to risk providing pricing across electronic platforms. However, while overall e-trading volumes reduced dramatically relative to voice, overall volumes on venues seemed to have remained high, registering record volumes at certain points. Meanwhile, some protocols appear to have fared better than others.

While many banks did "step up to the plate" to continue providing liquidity and making markets for their clients, albeit with significantly wider bid-offer spreads, this was not the case for all market makers, and overall dealer capacity appears to have shrunk at a time when it was needed most.

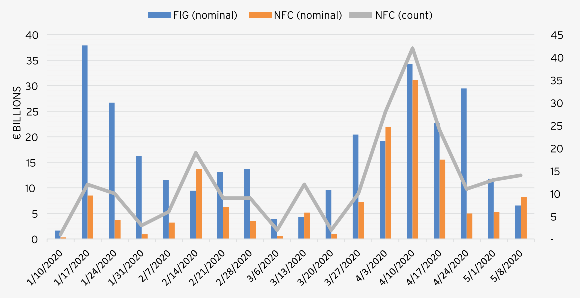
Central bank intervention

Central bank intervention, particularly the announcement of the ECB's PEPP on 18 March, is viewed as critical in ensuring that the European secondary bond markets continued to function. Not only did this provide a backstop bid for a large section of the market, more importantly it restored confidence. There is a counterview that this could be more problematic in the longer term as it creates a market dependency on central bank intervention in order to function effectively, particularly in times of stress.

New issuance

One of the key factors in bringing some stability to the corporate bond secondary market seems to be the surge in new issuance following the ECB's 18 March intervention. Not only did this new supply help to satisfy pent-up demand, it also helped to provide a point of reference for secondary valuations.

EU IG Corporate New Issuance (€ equivalent)



Source: ICMA analysis using Bloomberg data

Settlement fails

It is reported that there was a sizeable, albeit temporary, increase in settlement fails during the height of the crisis, which is largely attributed to operational challenges. This increase in structural settlement fails has accentuated concerns about the EU's CSDR mandatory buy-in provisions and raises questions as to how this would have impacted the market if it had been in place during the COVID-19 turbulence.

Trading under lockdown

Respondents suggest that, despite some initial challenges, the physical relocation and separation of trading teams and associated functions has worked successfully. While many seem to have enjoyed working from home, the most common complaint relates to the loss of information flow and the immediacy of human interaction that come from being on a trading floor, which inevitably impacts overall efficiency, and market liquidity.

Lessons learned

Perhaps the main lesson learned from the crisis is to be reminded how corporate bond secondary markets function and how liquidity is created, with market makers at their core. Constraining the ability of market makers to take prudent and appropriately priced and capitalized risk will inevitably impact market liquidity and, potentially, efficiency, particularly in times of market stress. Whether the screens are switched on or off, it is the dealer-client relationship that ultimately holds the market together.

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From evolution to revolution: the arrival of the new fixed income market

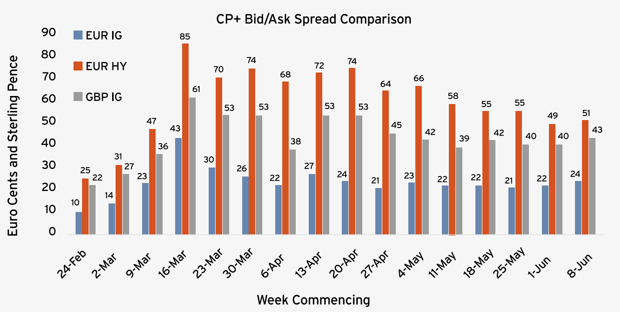
By Christophe Roupie

Financial markets have been tested before and will be tested again. However, in my 20+ year career, I have never seen the level of engagement from such a diverse pool of participants as I witnessed during the recent financial market crisis. The evolution of fixed income trading has been marching forward in recent years and has increased momentum. The pace of change, demand for data and adoption of technology reached a new level of commitment during the recent market stress that ultimately marks a revolution in market structure.

Connectivity despite volatility

The COVID-19 pandemic sent shockwaves across the world as the global health crisis triggered financial uncertainty and widespread business shutdowns. Until the end of February, European bid/ask spreads were among the tightest across major markets. At the height of the crisis in March, though, European price spreads saw increases of +177% in EUR IG (€0.09 to €0.43), +325% in EUR HY (€0.20 to €0.85), and +190% in GBP IG (£0.21 to £0.61). This level of volatility was reminiscent of the 2008-09 financial crisis, but this time round it was, incredibly, condensed to a few short weeks versus months and years in the prior decade.

CP+ Bid/Ask Spread Comparison



Despite the intense volatility across the credit markets, it appears the last few months have been a further catalyst for change among many trading firms. Instead of the bond market coming to a halt, as we saw in 2008, traders remained connected through the use of technology as they quickly migrated to a work-from-home environment. As an example, our client service teams arranged remote, secure access to our web-enabled technology for over 10,000 individual users to help them stay engaged with the market. Traders were able to continue fulfilling client orders and managing risk with the support of well-connected and well-functioning trading ecosystems.

Diversity generates alpha

A diverse, global liquidity pool is more important than ever now that one-to-one, in-person interactions are limited. By seamlessly connecting participants and allowing any firm to either make or take liquidity, natural buyers and sellers could opportunistically find one another during the crisis. Our all-to-all Open Trading marketplace was able to provide that environment and serves as a case study for how market structure has shifted. During the first quarter, investment managers reached a new volume record for providing liquidity on MarketAxess, and dealers reached a new volume record as liquidity takers. Participants were taking on new roles and creating a vast liquidity pool in the process. Over 30,000 daily institutional client orders were available to both dealers and investors in Open Trading in the first quarter, totaling $16 billion in notional value on average per day. This is in stark contrast to the 2008-09 financial crisis when an all-to-all environment did not exist and therefore market volumes deteriorated, demonstrating a fundamental trading behaviour revolution.

Although bid/ask spreads were elevated and the cost of execution was therefore higher, alpha generation opportunities were available during the crisis. Within March, cost savings opportunities grew dramatically when traders acted as liquidity takers. In euro-denominated credit, cost savings increased 110% in just a few short weeks via Open Trading.

	1/1 - 2/21		2/24 - 3/13		Pct.
	AVG/BOND	AVG/$MM	AVG/BOND	AVG/$MM	Chng.
US Invest. Grade	2.29 bps	$1,200	4.67 bps	$2,900	104%
US High Yield	$0.25	$2,500	$0.54	$5,400	120%
Emerg, Mkts, USD	$0.22	$2,200	$0.40	£4,000	84%
EUR Eurobonds	€0.13	€1,300	€0.28	€2,800	110%

Market participants were also able to realize alpha generation opportunities as liquidity providers throughout the crisis. By participating proactively in responding to anonymous inquiries, traders saw a 167% increase in costs savings for euro-denominated credit.

	1/1 - 2/21		2/24 - 3/13		Pct.
	AVG/BOND	AVG/$MM	AVG/BOND	AVG/$MM	Chng.
US Invest. Grade	2.08 bps	$1,800	3.62 bps	$2,600	75%
US High Yield	$0.29	$2,900	$0.43	$4,300	48%
Emerg, Mkts, USD	$0.26	$2,600	$0.41	£4,100	58%
EUR Eurobonds	€0.15	€1,500	€0.40	€4,000	167%

Astonishingly, estimated client transaction cost savings on MarketAxess reached $288 million in aggregate, exceeding our revenues for the quarter. As price dispersion in credit markets exploded in March, traders were still able to realize transaction cost savings by taking on new roles.

Data is the engine of the credit market

After years of building a global network, Open Trading was put to the test and performed as designed. Yet none of that would be possible without data. Predictive pricing tools and near real-time trade tapes, in addition to price discovery inherent within an electronic trading system, are now required tools to allow new participants to engage with the market and make prices. Our Composite+ pricing algorithm generates over 30 million prices per day with inputs from our trading system, our post-trade reporting and trade confirmation engine as well as TRACE. This level of sophisticated pricing information is driving strategies for the next-generation trading desk and is the backbone of our automated trading protocols.

While TRACE has existed in the United States for many years, Europe has yet to see the promise of market-wide transparency. Many people hoped that MiFID II would be the catalyst for transparency but it has only created more disparate and inconsistent pricing sources through a complex system of caps and waivers. The closest solution for near real-time transparency is our Axess All trade tape, which was introduced several years prior to MiFID II. With intra-day pricing data on over 3,000 fixed income instruments, Axess All was built in conjunction with investors and dealers and takes a measured approach to shedding light on an otherwise opaque market. As the debate on a consolidated tape progresses, there are clear examples of how it can work effectively.

The revolution will continue

Opportunities have emerged as market dynamics have changed and market participants have moved quickly to adapt. Now we see automation as the next frontier of this revolution. While automated trading strategies were put on hold during the peak volatility period as more traders became more engaged with manual price formation, we have continued to observe increased adoption over the first half of the year. Testament to this shift in behaviour, automated trading volumes on MarketAxess rose to over $31 billion in the first quarter, up from $12.5 billion in the first quarter of 2019. The use of dealer algorithms also grew, with approximately 3 million algo responses in the first quarter, up 37% year-over-year, resulting in 249,000 trades.

Automation, either as auto-executed trades or algo-driven price provision, allows traders to become more efficient. By freeing up precious time to focus on more complex or larger orders, traders are able to deliver better cost savings for their clients.

The new normal post the financial crisis is still evolving but early lessons have shown us that technology facilitated the market's need to remain connected and informed. The adoption of automation, coupled with more diverse liquidity provision and improved pricing content has created the perfect storm for a revolution in the fixed income markets.

Christophe Roupie *is Head of EMEA and APAC, MarketAxess.*

Asia ex Japan G3 bond markets: 2020 so far

By Ashish Malhotra

2020 may forever be remembered as the year of the coronavirus pandemic. As the world grapples to contain COVID-19, the global bond markets have been extremely active, on track to be a record year with USD4.5 trillion issued globally so far in the first half of the year[1]. Sovereigns, corporates and financial institutions have all been significantly drawing down on their credit lines and tapping the bond markets to bolster their cash positions as we ride through the uncertainty arising from the virus's aftermath.

For Asia ex Japan G3 (AEJ), the year started very strongly, but as fears grew over the virus, the market practically shut down for the whole of March before gradually opening in Q2 and has shown no signs of abating since. Despite March monthly volume of USD8.2 billion being the lowest since August 2015, AEJ volumes for the first half of the year are at USD173 billion, down only 8% year on year. All sectors, except for South and South East Asia High Yield, have re-opened since the March shutdown – sectors including China real estate, which had a record year last year, and subordinated bank capital issuances. However, while Asia has seen a moderate drop in volumes, G3 volumes from US borrowers are at an all-time high of USD1 trillion so far in the first half of the year, almost double of last year's, largely driven by Fed's intervention.

In North Asia, the frenetic start to the year was curtailed by the emergence of the virus. Supply for January and February combined hit a new record, but March was impacted by increasing fears over the spread of the virus before markets recovered in Q2 to reach USD125 billion in North Asia G3 issuance in the year to date, down 16% year on year. Apart from the virus, another key reason for the drop in G3 issuance has been the robust and abundant domestic liquidity for Chinese issuers, while Korea G3 issuances are at a similar pace compared to last year. In South Asia, issuers continue to tap offshore markets after a record 2019, albeit at a slower pace with USD9.2 billion issued in H1, down 47% year over year. Tight onshore funding conditions and an increasing demand from yield-hungry international investors have spurred Indian borrowers to increasingly rely on bank financing as well as onshore funding windows enabled by the Reserve Bank of India. In ASEAN, volumes have grown 73% year on year to USD39 billion, with the oil and gas sector particularly active, buoyed a jumbo deal of USD6 billion in size.

In high yield markets, the supply glut seen in 2019 has not been forthcoming this year so far, with the sector down 41% for H1. However, with improving market conditions, the expectation is for supply to pick up. Local currency issuance outside of onshore China/Korea has been significantly slower as well, especially ASEAN, which was lower across all markets. The Formosa market has been red hot this year though, up more than 2.5 times to reach USD41 billion for H1, with American and Middle Eastern banks dominating volumes. Dimsum bonds supply has seen a healthy growth as well, up 13% year over year.

One key area that has surfaced since the virus outbreak has been bonds with sustainability themes. In 2019, of the

1. H1 and year to date figures are as of 26 June 2020.

USD271 billion raised globally for sustainable bonds, only 32% had a social aspect to it. Prior to 2019, it was always under 20%. This year, it has grown to over 50% in H1, with the virus accelerating many aspects of sustainable financing. In Asia ex Japan, 52% of the USD19.4 billion issued so far involving a social aspect. The investor base has been very enthusiastic in the support of pandemic relief efforts as well. Besides social bonds, transition bonds are also increasingly becoming a theme as more companies look to move from "brown" to "green".

In terms of market practice, there have been refreshing changes to the way bonds are being arranged. With a large proportion of the bond market participants homebound, there has been a surge in the usage of video conference tools to conduct virtual roadshows, as compared to flying to another city for physical roadshow meetings. In many ways, issuers and investors can get more contact than before, as it is far easier to arrange video conferences compared to the traditional route. And it actually works, with debut issuers being able to price deals without the traditional roadshow. Also noteworthy is that new issue concessions in Asia are decreasing rapidly since the markets reopened in March, with many deals moving into negative territory.

For the remainder of the year, it is increasingly likely that markets will continue to see elevated volatility as the virus situation develops. As more Asian companies contend with the uncertainty, and with sovereigns and supranationals looking to finance COVID-19 efforts, funding via the international bond markets will likely continue to rise and result in a busy summer.

Ashish Malhotra *is Managing Director, Head of Capital Markets, Asia Pacific, Standard Chartered Bank.*

Funding via the international bond markets will likely continue to rise and result in a busy summer.

Summary of practical initiatives by ICMA

This contribution summarises recent and current practical initiatives by ICMA with – and on behalf of – members.

Market impact of coronavirus (COVID-19) pandemic

1 ICMA has worked with, and on behalf of, members in response to the COVID-19 pandemic in a number of complementary ways:

- ICMA has continued regularly to update, on the ICMA website, the COVID-19 resource page on the market impact of the COVID-19 pandemic and the response, and produced a series of podcasts for members.
- The ICMA Quarterly Report for the Second Quarter of 2020, published in early April, focused on the market impact of the COVID-19 pandemic and the response, and the ICMA Quarterly Report for the Third Quarter includes contributions on the lessons to be learned in capital markets from the pandemic.
- ICMA has continued to hold all its Market Practice and Regulatory Policy Committees with members during the COVID-19 pandemic remotely (eg via Microsoft Teams, Zoom or conference calls).
- ICMA has continued to set standards of good market practice: eg making freely available its standard form ECP documentation for the purposes of accessing the Bank of England's COVID Corporate Financing Facility; and producing a note on the ICMA *force majeure* clause in the context of the COVID-19 pandemic.
- ICMA has engaged with regulators and central banks to discuss the market impact of the pandemic (eg through the ECB Bond Market Contact Group and ESMA Securities and Markets Stakeholder Group). While recognising that there should not be a general rollback of regulation in response to the COVID-19 pandemic, ICMA has sought and secured regulatory forbearance in the form of delays, where needed, to regulatory implementation deadlines (eg on SFTR implementation) and consultation deadlines, and drawn attention to proposed regulation which, if implemented, will have an adverse market impact (eg CSDR mandatory buy-ins).

Post-Brexit

2 There are a number of key post-Brexit developments affecting capital markets since the last Quarterly Report:

- Following its departure from the EU on Brexit on 31 January 2020, the British Government formally notified the EU on 12 June that the UK will not agree to an extension of the transition period beyond the end of 2020. The deadline for agreeing on an extension for a further period of up to two years would have been at the end of June.
- The deadline set in the Political Declaration attached to the EU/UK Withdrawal Agreement for UK assessments of equivalence with EU capital market regulations was the end of June. In the case of the UK, equivalence has been assessed on the basis of whether EU and UK "outcomes" are the same. But decisions will not be taken by the European Commission until later in the year and may be caught up in the trade negotiations between the EU and the UK. Although the assessments are technical, the decisions are essentially political.
- In the UK, the Temporary Permissions Regime (TPR) will apply as planned for EU firms in the UK from the end of the transition period for a maximum of three years. The Temporary Transitional Power (TTP) will give firms until March 2022 to comply with EU legislation "on-shored" into the UK at the end of 2020. There are limited exceptions where firms will need to make changes earlier. (These are listed on the FCA website). It is not yet clear how "in flight" EU legislation over the year-end will be treated in the UK.
- There is no equivalent at EU level to the UK TPR, though there are transitional arrangements at national level in some Member States. It cannot be assumed at this stage that bilateral agreements reached between the EU27 and the UK to address cliff-edge risks before Brexit will necessarily still apply post-Brexit at the end of 2020, when passporting rights cease. But the authorities are well aware of the importance of addressing certain cliff-edge risks.

- Having had to prepare for cliff-edge risks on three previous occasions before Brexit, the financial services industry – located both in the EU and in the UK – should be better prepared for another cliff-edge post-Brexit when passporting rights cease at the end of the transition period. Large international sell-side and buy-side firms are authorised to operate in both the EU and the UK, and are as well prepared as they can be, though it is less clear how well prepared some smaller firms will be.
- The issues that arise, and the implications for international capital markets, were set out in the Quarterly Assessment for the ICMA Quarterly Report for the Second Quarter, published in early April: *Post-Brexit: Should the Transition Period Be Extended?*

EU Capital Markets Union

3 In response to the Report of the High Level Forum on EU Capital Markets Union, ICMA published on 12 June some preliminary thoughts on the CMU HLF Report, focusing on: sustainable finance; banks' withdrawal from market making activity; encouraging retail investment; encouraging long term investments; STS securitisation; the European Single Access Point for company data (ESAP); building stronger and more efficient market infrastructure; and legal certainty and clear rules for the use of crypto/digital assets. ICMA subsequently submitted before the end of June a response to the Commission's related consultation.

Transition to risk-free rates

4 ICMA continues to participate in the Working Groups on Risk-Free Rates in the UK, the euro area and Switzerland; and ICMA is chairing the Bond Market Sub-Group in the UK, working with the FCA and Bank of England, and is in regular contact with the equivalent group in the US Alternative Reference Rates Committee (ARRC), which is working with the Federal Reserve. In this edition of the Quarterly Report, the Quarterly Assessment is on *From LIBOR to SONIA in the Bond Market.* There is also an accompanying contribution on *The Transition to Risk-Free Rates in the Euro Area.*

Primary markets

5 *MiFID II/R*: ICMA worked with members on primary market aspects of investor protection as a contribution to ICMA's response to the European Commission consultation on reviewing MiFID II/R, which was submitted on 15 May.

6 *Prospectus Regulation:* ICMA is continuing to work with members on the implementation of the Prospectus Regulation regime and has published revisions to the ICMA Primary Market Handbook. ICMA is also considering potential disclosure requirements relating to green bonds (and intends to respond to the European Commission's consultation on the renewed sustainable finance strategy on this point) and ESG more generally, as well as new requirements relating to machine-readable data.

7 *Deal announcement and new issue processes:* ICMA has been facilitating industry discussions among buy-side and sell-side market participants on new issue processes and in this respect has published a form of deal announcement in the ICMA Primary Market Handbook, which it is now planning to update.

8 *Post-trade:* ICMA is working on the primary market implications of various emerging post-trade initiatives, including: the ECB AMI-SeCo Collateral Management Harmonisation Task Force consultation on corporate action harmonisation; and reforms to the ICSD syndicated closing process following CSDR implementation.

9 *Primary markets technology mapping directory:* ICMA's directory covers existing and emerging platforms and technology solutions in primary markets and was initially launched in December 2018. The latest version was published in September 2019 and updated in February 2020. The purpose is to help inform ICMA members and thereby create greater transparency. The directory is available on ICMA's website.

10 *Primary markets and Brexit:* ICMA has updated its Primary Market Handbook to reflect the transitional phase of the UK's departure from the EU.

Secondary markets

11 *The European Investment Grade Corporate Bond Secondary Market and the COVID-19 Crisis:* On 28 May, ICMA published this report, prepared by Andy Hill with the ICMA Secondary Market Practices Committee, on how the European investment grade corporate bond secondary market performed during the COVID-19 crisis. The report has been shared with a broad range of regulators, who have responded with keen interest.

12 *CSDR mandatory buy-ins:* ICMA has written to the European Commission and ESMA outlining industry concerns relating to timely implementation of the CSDR mandatory buy-in provisions. The letter highlights the ongoing lack of regulatory clarification required by the industry to facilitate successful implementation, as well as asking the authorities to review the design and application of the buy-in framework in the light of recent market events.

13 *CSDR cash compensation:* A briefing note outlining the deficiencies identified in the CSDR provisions for cash compensation in the case of bond markets, as well as highlighting some of the potential market solutions

under discussion, including the significant challenges associated with these, has been produced in conjunction with the ICMA dedicated CSDR Cash Compensation Workstream, part of ICMA's CSDR Settlement Discipline Working Group.

14 *ICMA Secondary Market Rules & Recommendations (SMR&Rs):* ICMA is in the process of finalising a member consultation framework for updating its Buy-in and Sell-out Rules (part of the ICMA SMR&Rs) to align with and support implementation of the CSDR mandatory buy-in provisions. The consultation is expected to be launched this summer. The revised Rules will become effective from the launch of CSDR mandatory buy-ins, expected to be in February 2021.

15 *Consolidated tape for EU bond markets:* ICMA has published a report into considerations surrounding the establishment of an EU consolidated tape for bond markets. This report was prepared in response to a request from DG FISMA in the European Commission for a bespoke study assessing the feasibility of implementing a consolidated tape for EU post-trade raw bond data.

16 *European Commission MiFID II/R review:* On 15 May, ICMA responded to the European Commission's consultation on the review of the MiFID II/MiFIR regulatory framework; and on 12 June, ICMA responded to ESMA's consultation on the transparency regime for non-equities. ICMA is also monitoring the phasing of the MiFID II/R review, and in particular "quick fixes".

17 *ICMA Secondary Markets Newsletter:* ICMA has launched a new *Secondary Markets Update* which provides a quick summary of ICMA's current initiatives and workstreams, pertinent news and regulatory updates affecting the secondary bond markets. It is to be published on a bi-monthly basis.

18 *Bond market transparency directory:* A new overview of current reporting obligations across multiple jurisdictions from Europe, the Americas and Asia Pacific, provides a consolidated view to compare both regulatory rules and best practice guidance on bond transparency regimes, as well as details on reporting fields and exceptions.

19 *ETP mapping directory:* ICMA's mapping directory of Electronic Trading Platforms (ETPs) currently lists a total of 43 electronic execution venues, Order Management Systems (OMS) and information networks. It is intended to help market participants understand what execution and non-execution venues are available for cash bonds. The revised mapping is available on ICMA's website.

Repo and collateral markets

20 *ERCC Guide to Best Practice:* ICMA is in the process of updating the ERCC *Guide to Best Practice in the European Repo Market*. The new Guide is expected to be published in Q3 2020. It was last updated in December 2018.

21 *GMRA and CSDR mandatory buy-ins:* ICMA is in the process of developing an Annex to the GMRA to support implementation of the CSDR mandatory buy-in provisions, which are expected to come into force from February 2021.

22 *ESMA consultation on Clearing Solutions for Pension Scheme Arrangements:* The ICMA European Repo and Collateral Council (ERCC) responded to the ESMA consultation on clearing solutions for PSAs in June 2020. The ERCC is also represented in the European Commission's Expert Group on Pension Scheme Arrangements.

23 *ICMA proposals for reporting of central bank repos under MiFIR:* ESMA has provided some long-awaited clarification on the reporting of repos transacted with EU central banks, confirming some detailed proposals developed by ICMA's SFTR Task Force and submitted to ESMA in November 2019. Under SFTR, SFTs transacted with one of the 27 EU central banks that are part of the European System of Central Banks are exempted from the reporting obligation. However, these trades have in turn been included in the scope of MiFIR transaction reporting.

24 *Updated version of ICMA's SFTR recommendations:* On 30 June, ICMA's ERCC published a second update to the ICMA *Recommendations for Reporting under SFTR*. This detailed ICMA guide has been developed by the ERCC's SFTR Task Force over a considerable period of time and was initially published on 24 February. The document aims to help members interpret the regulatory reporting framework specified by ESMA and sets out complementary best practice recommendations to provide additional clarity and address ambiguities in the official guidance. The document continues to evolve to reflect the ongoing discussions ahead of the reporting "go-live" on 13 July.

25 *ICMA repo survey:* The 38th ICMA survey measured outstandings in the European repo market on 11 December 2019 based on the returns of 58 financial institutions. The baseline figure for the size of the repo market was a record €8,210.3 billion, compared with the total for June 2019, which was €7,761.4 billion, an increase of 7.1% and year-on-year rise of 5.9%.

26 *Report on market conditions during the COVID-19 pandemic:* This ICMA report concluded that, while the market performed relatively well, demand for repo

increased significantly during the height of the crisis in February/March and dealers' capacity to intermediate that demand was relatively constrained, limiting access to many firms that needed it.

27 *ICMA GMRA 2020 legal opinions:* The 2020 ICMA GMRA legal opinions which support the Global Master Repurchase Agreement (GMRA), the standard agreement for international repo transactions, were published on 16 April. They include a new opinion for Argentina.

28 *ERCC webinars on key repo an collateral market issues:* The webinars include presentations on the two important regulatory initiatives that are set to reshape the market, the EU SFT Regulation and CSDR mandatory buy-ins, a legal update highlighting developments in relation to repo documentation and the ICMA GMRA legal opinions, the results of the latest European repo survey, and a discussion on ICMA's ongoing collaboration with ISDA to extend the Common Domain Model (CDM) to SFTs, building a standardised digital representation of repos.

29 *ECB AMI-SeCo:* The ERCC is represented on the ECB's Advisory Group on Market Infrastructure for Securities and Collateral (AMI-SeCo) and is playing an active role on its Collateral Management Harmonisation Task Force (CMH-TF).

30 *CDM for repos and bonds:* ICMA is cooperating with ISDA to extend the development of the Common Domain Model (CDM) to include repo and, by extension, outright bond transactions. Further information, including supporting materials from workshops and a link to a recent webinar can be found on ICMA's website.

31 *FinTech mapping directory for repo and cash bonds:* ICMA has conducted a review of the directory which currently lists over 160 solutions across 10 categories comprising collateral management, corporate actions, exposure agreement, intraday liquidity monitoring and reporting, matching, confirmation and allocation, reconciliations but also ancillary areas such as static data and SSI, workflow and communication and KYC onboarding. The directory is available on ICMA's website.

32 *Repo trading technology directory:* In light of increasing electronification of repo markets, ICMA has conducted a mapping exercise of electronic trading platforms. In its latest revision, the scope has been extended to include all technology solutions for repo trading such as order management systems. The directory is intended to help market participants understand what execution venues and other technology solutions are available for repo trading, product scope, as well as differences in trading protocols, clearing and collateral configurations. The directory is available on ICMA's website.

Sustainable finance

33 *High-level definitions for sustainable finance:* ICMA is proposing high-level definitions, building on current market usage and existing official sector terminology, for the most commonly used terms in the sustainable finance field: for example, climate finance, impact finance, green finance and social finance. The objective is to ensure that all participants and stakeholders are using a common and transparent vocabulary.

34 *The EU's sustainability disclosure regime:* New and amended EU legislation is introducing significant sustainability and ESG-related disclosure requirements that will impact all participants in the European capital markets, and arguably will lead to an "EU sustainability disclosure regime". This ICMA publication seeks to provide the market with an initial comprehensive and practical overview of these developments.

Asset management

35 *AMIC regulatory grid on the response to COVID-19:* ICMA's Asset Management and Investors Council (AMIC) has published a COVID-19 regulatory grid, which provides an overview of policy measures related to the buy side taken by several European securities regulators in response to the COVID-19 pandemic. The document is kept up-to-date regularly.

36 *AMIC podcasts on the response to COVID-19:* ICMA has streamed a series of weekly podcasts in which Robert Parker, Chair of AMIC, has reviewed market events in context of the COVID-19 pandemic, with a specific focus on central bank policy measures, economic data and the impact on investors.

37 *AMIC virtual event on lessons from COVID-19:* AMIC held on 18 June a virtual event on *First Lessons of the COVID-19 Crisis for the Asset Management Industry.*

38 *Non-Financial Reporting Directive Review (NFRD) consultation*: ICMA's AMIC and Corporate Issuer Forum (CIF) published on 11 June a common response supporting the review of NFRD in order to achieve a greater level of standardisation of reporting, provided that this is done at sectorial level and based on most commonly used standards. The response also highlights the potential practical and liability challenges arising from the European Commission's suggestion to combine NFR with annual reports.

39 *EU Ecolabel:* ICMA's AMIC has published its response to the EU consultation on the EU Ecolabel for financial products. While the AMIC supports the idea of a quality stamp for ESG retail investment funds, it also warns that some important changes are required to ensure the success of this new label. In particular, the AMIC recommends broadening the list of eligible assets for

diversification purposes, and also to further support companies transitioning to a lower-carbon business model.

FinTech in capital markets

40 *FinTech Advisory Committee (FinAC):* ICMA's FinAC held its third meeting on 26 May, bringing together front office, middle/back office, legal and technology expertise across ICMA's core areas. On the agenda were an update by the FSB on its current priorities in relation to FinTech, as well as member-led discussions on trends, new initiatives and electronification in primary bond markets and repo markets, amongst other points.

41 *ECB FinTech Task Force:* ICMA, through the ERCC Ops Group, continues to be represented on the ECB's FinTech Task Force, a sub-group of the AMI-Pay and AMI-SeCo, following the renewal of its mandate and extension to payments. ICMA contributes, for example, to the mapping exercise of post-trade technology solutions, as well as the report on tokenisation of securities in a DLT environment.

42 *FinTech (virtual) meetings or calls with regulators:* ICMA held calls with the Swiss National Bank on 8 April to discuss FinTech and the Bank of England on 5 May to discuss the consultation on transforming data collection from the UK financial sector. ICMA has subsequently been invited by the Bank of England to join the newly established Data Collection Review Wholesale Working Group, which is due to hold its first meeting in July.

43 *DLT regulatory directory:* ICMA has updated its DLT regulatory directory with several new regulatory and legislative developments, national blockchain initiatives, publications and consultation papers. The directory was initially published in December 2019 and seeks to provide a non-exhaustive overview of recent DLT regulatory guidance, legislative initiatives, as well as related strategy papers and publications in selected jurisdictions across Europe, North America, and Asia-Pacific.

44 *European Commission consultation:* ICMA submitted by the deadline of 26 June its response to selected aspects of the European Commission's consultation on a new digital finance strategy for Europe/FinTech Action Plan.

45 *FinTech Newsletter:* ICMA has launched a new *FinTech Newsletter* which provides a quick summary of ICMA's cross-cutting technology initiatives across its key market areas. It also provides insights into regulatory updates, consultation papers, news and other publications, and upcoming meetings and events. It is to be published on a 4-6 weekly basis, depending on content load.

Other meetings with central banks and regulators

46 *ESMA/ICMA Regulatory Policy Committee (RPC):* Verena Ross, Executive Director, ESMA, joined the ICMA RPC virtual meeting on 11 June for a discussion.

47 *ECB/ICMA Secondary Market Practices Committee (SMPC):* The ECB joined the virtual meeting of the SMPC on 16 June 2020 to discuss the impacts on the corporate bond secondary market of its CSPP and corporate bond purchases under the PEPP.

48 *Bundesbank/ICMA:* A small group of ICMA Board and Committee Chairs held another meeting with Dr. Sabine Mauderer, Executive Board member of the Bundesbank, and colleagues, on 29 June.

49 *Other official groups:* ICMA continues to be represented, through Martin Scheck, on the ECB Bond Market Contact Group and on the ESMA Securities and Markets Stakeholder Group; through Nicholas Pfaff on the European Commission Technical Expert Group on Sustainable Finance; through Charlotte Bellamy on the Consultative Working Group on ESMA's Corporate Finance Committee; and through Gabriel Callsen on the ECB AMI-Pay AMI-SeCo Joint Task Force on Innovation and FinTech (FinTech-TF) and the newly established Bank of England Data Collection Review Wholesale Working Group.

Primary Markets

by Ruari Ewing and Charlotte Bellamy

MiFID II/R review: investor protection in primary markets

On 15 May, ICMA submitted its response to the European Commission's public consultation on the review of the MiFID II/MiFIR regulatory framework.

Parts 1-4 of the investor protection aspects (at pages 36-56) and also Q.90 (at page 90) are addressed from the perspective of Eurobond primary markets, mostly in relation to MiFID's product governance and inducements regimes – but also touching on a proposed new semi-professional client category, a proposed EU database for comparing different investment types, certification for staff providing investment advice and allocation justification recording.

Product governance: scope

The response notes MiFID's product governance regime as conceptually flawed regarding commoditised funding products such as Eurobonds that are not "designed" as a "service" for investor "clients". Rather, bonds have been in existence for decades as a "product" for corporate and other borrowers to seek funding from the markets. Furthermore, the regime has in practice (in combination particularly with the PRIIPs regime and also partly with the EU prospectus regime's retail disclosure requirements) further diminished borrowers' appetite to offer to retail investors.

The response also notes bonds tend to be "non-complex" from a MiFID perspective, with some being only technically "complex" (eg being unlisted or including a call or put at or above par). This is because they do not include terms that would affect an investors' return expectation – ie the contractual rights to return of principal and (where applicable) to regular and non-deferrable interest payments – and so involve no additional risks that are difficult to understand.

The product governance regime's conceptual flaws arise also in requiring an underwriting syndicate, of several banks relating to a bond issue many years earlier, to periodically redefine the target market for the bonds concerned. This is both from a logistical perspective (underwriters being retained by borrowers for the initial issuance transaction only and then potentially significantly changing their corporate form and business models over time) and from a financial stability perspective (the risk of fire sales flowing from changed target markets).

In this respect, the response queries whether the product governance regime should apply at all to bonds (though acknowledging, if more expedient from a legislative drafting perspective, that the regime might just exclude "non-complex" bonds) and also noted bonds should be confirmed as not being PRIIPs (citing, at #7 of an ICMA September 2018 consultation response, an option to do so without the Commission having to rule on individual product features). However, many corporate borrowers have got used to seeking funding away from EEA retail and so administrative burden alleviation will not necessarily cause mass retail bond markets to return to Europe.

At the very least, from a practical perspective, it would seem pointless for the product governance regime to apply where professional investors are involved (whether acting on their own account, as discretionary managers or as advisers) – and so in any of the existing technical categories of (i) bonds with denominations of €100,000 or more, (ii) "qualified investor only" offers or (iii) bonds admitted to "qualified investor only" markets or market segments.

The response also references the "ICMA1" (all bonds/ qualified investors only) and "ICMA2" (simple listed bonds/ retail investor inclusive) approaches to target market definition, which may have helped mitigate some of the above in practice, at least for the institutional bonds markets that real economy borrowers rely on most.

Product governance: "negative" target market

Regarding the target market ("TM") concept, the response distinguishes:

(a) a "positive" TM of intentionally "targeted" investors for whom a product is theoretically compatible (compatibility being intrinsic to the characteristics of both product and investor and distinct from any other limitations, such as selling restrictions based on administrative formalities);

(b) a "neutral" TM of investors for whom a product might well be theoretically compatible, but who are not targeted; and residually

(c) a "negative" TM (if any) of investors for whom a product is theoretically incompatible.

In the Eurobond context, any underwriters who are technically "manufacturers" and the borrower (as the client and also potentially a "manufacturer" depending on its own MiFID authorisation status) will have expended significant effort to agree a manufacturer positive TM that is perceived to be robust and enduring over time. Consequently, they do not want to have to deal with any wider individual "distributor" TMs that do not concern them (the definition of "distributor" technically capturing a secondary markets trader many years later who has no connection with the borrower or the original underwriters). That said, it appears that typically MiFID entity secondary market sellers anyway do not define their TMs wider than manufacturer positive TMs (partly due to the operational burdens involved).

It is conceivable there could be rare circumstances in which it is in an investor's best interests to receive a product (excluding mere investor insistence), notwithstanding that it falls within a manufacturer's negative TM – eg for hedging purposes. In this respect, the product governance regime's current permission of sales in a negative TM is associated with regulatory guidance making clear that this should be a rare occurrence in need of significant justification. It thus seems that the regime already provides an appropriate degree of protection and that further restrictions on sale within any negative TM would be unnecessary.

Incidentally, in the context of syndicated Eurobond issuance, the ICMA1 and ICMA2 approaches note that a negative TM is unlikely for most bonds given diversification/portfolio considerations and absent the exercise of regulatory intervention powers, but that any such negative TM would be subject to consideration in the specific circumstances.

Product governance: adaptation to digital and online offers

In terms of any need to adapt the product governance regime to digital and online offers, the response notes that, as far as wholesale context is concerned, markets have for a long time been working remotely at speed (on the telephone). This underlying dynamic remains generally unchanged in the digitised/online context. So, to the extent MiFID's principles were already suited to remote working at speed, then this would seemingly continue to be the case.

New category of semi-professionals clients

Regarding the proposed new category of semi-professionals clients, the response notes that (retail) *client* scope is effectively superseded by the above overarching concerns around *product* scope. However, if the Commission nonetheless ultimately decides to widen access for retail clients that have some distinct knowledge and means, then it may be simpler (to avoid a significant, and potentially dis-incentivising, repapering consequence) to adjust the existing threshold tests for retail investors to be able to opt for professional status on request. (In this respect an investible portfolio measure seems more robust than an income-based test and knowledge/experience could be based on recognised third party certification as a further alternative option to an assessment of trading history.)

EU database for comparing different investment types

The response expresses caution about the purpose of a suggested EU database for comparing different investment types. If it is merely to serve as a quick "initial sorter" of products into specified classes ahead of further review (similarly to credit ratings helping "high yield" investors to avoid reviewing "investment grade" securities), that is one thing. However, such a standardised comparator is unlikely to be able to serve as "the" basis for "informed" investment decisions – as public commentary on the implementation of the PRIIPs regime has illustrated.

Inducements and costs & charges

In terms of MiFID's inducements and costs & charges regimes, the response notes ICMA having sought to assist firms with the concepts involved, but that practical application in the context of the remuneration of underwriters (generally involving combined fees for combined services to borrower clients, including placing/selling) has varied – depending on guidance from some national regulatory sources, the type of fees involved and how individual underwriters and/or how individual transactions are organised. However, such remuneration has at least remained possible.

The response emphasises that:

- characterising such remuneration as an inducement (per ESMA technical advice ESMA35-43-2126, #20-24); and
- separately proposing that inducements be banned (whether directly/explicitly as the consultation envisages or indirectly/implicitly because of any restrictive national interpretations/implementations of ancillary criteria), would prohibit real economy borrowers from being able to remunerate, and so presumably retain, anyone to manage their bond offerings.

Aside being unclear how this promotes investor access to independent advice (as the consultation suggests), losing such external support could jeopardise the success of borrowers' bond fundraising exercises – individually and then consequently on an aggregated, systemic, level for the European economy. This is because borrowers typically do not have the necessary expertise and resources internally to effectively manage such offerings alone.

As well as being damaging to Europe's real economy, characterising underwriter remuneration as banned inducements would be unnecessary from an investor protection perspective (at least to the extent the MiFID entity retained and remunerated by a borrower is not also providing, on an unsegregated basis, "investment advice" or "portfolio management" services to investor "clients" regarding the bonds concerned). This is, in the context of syndicated public offerings, because:

(1) it is unclear what investor-facing "client" service might be involved – (a) not "execution of orders" as underwriters are not "acting to conclude" (ie satisfy) investor bids on investors' "behalf", but rather allocating on their borrower client's exclusive behalf (as recognised under specific underwriting and placing provisions of Arts. 38-43 of the MiFID Delegated Regulation EU/2017/565); and (b) not "reception and transmission of orders" as there is no transmission to another entity/platform for such execution; Also, to the extent any "investment advice" or "portfolio management" is being provided on a segregated basis within the same MiFID entity, it would seem unfair that those investor clients be effectively prevented from participating in the corporate bond issues concerned;

(2) ESMA seems to acknowledge there may be no investor-facing "client" service or at least a need for further analysis – ESMA's technical advice is (a) partly conditional (noting disclosure of placing fees "where [...] also [...] service to the investor") though strangely also partly unconditional ("underwriting fees should be disclosed where [...] also sells [...] to investors" but without citing any supporting MiFID provisions) and (b) open to "further analysis" for share IPOs, indicating the advice is not definitive (presumably also the case then for new bond offerings, as it is unclear why IPOs would merit preferential treatment);

(3) underwriter remuneration is unrelated to investor outcomes – underwriters act on their borrower client's behalf to the best of their ability to execute a new issue further to conduct requirements, irrespective of remuneration from the borrower ("incentive"/"success" fees mechanically linked to outcomes are not in use anyway) and, in any case, syndicated issuances are iteratively tailored/priced to market reception (with indicative terms revised in line with investor bids – literal price "discovery"); and

(4) investors do not care – Eurobond investors have never really shown interest in underwriter remuneration (with non-inducement context reports of investor reminders on how to request fee information resulting in no substantive uptake), which is unsurprising given (3) above/pricing (spread to benchmark) and other material information being public on screens and pursuant to prospectus rules.

However, borrowers do care about their right to commercial privacy. There have been reports of borrower concerns regarding their rights to commercial privacy being sacrificed unjustifiably (in the absence of any actual countervailing investor protection concern): why should they advertise to the world, and so to all potential providers of underwriting services, how high they might be willing to pay to hire such service providers? It seems entirely rational for borrowers to wish to preserve their ability to negotiate the lowest possible remuneration commensurate with their specific servicing requirements.

The response also notes incidentally that there are distinct net proceeds disclosure requirements under the EU's Prospectus Regulation for both retail offerings (Delegated Regulation EU/2019/980, Anx.14, #3.2) and now, albeit strangely, institutional market listings (idem, Anx.15, #3.2).

Certification for staff providing investment advice

The response notes incidentally, regarding certification for staff providing investment advice, that any education requirements should be appropriately calibrated to the areas of advice/information being given (eg advisers in the fixed income space should not need granular certification relating to commodity investments).

Allocation justification recording

Lastly the response also notes broad consensus having been reached regarding how to apply MiFID's allocation justification recording regime (the experience so far having mainly been of added administration without meaningful benefits for borrowers or investors).

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Finding prospectus information online

Introduction: It has been suggested in ICMA group discussions that finding published prospectuses online is not as straightforward as it could be.

Publication requirements: Existing legislation usually requires regulator-approved prospectuses to be published prior to stock exchange admissions or non-exempt public offerings, for example under the EU's Prospectus Regulation. This may typically relate to either (i) a "standalone" prospectus (and any subsequent supplement) relating to specific, and usually imminent, bond issuance or (ii) a "base" prospectus (and any subsequent supplement) relating to general issuance under an issuance "programme" over a period stretching up to a year and completed by a "final terms" document relating to specific issuance. In the prevailing institutional (rather than retail) dynamic of the international bond markets, the standalone prospectus tends to be available to potential investors during an exempt offering in draft (notably excluding commercial terms such as issuance size, price and closing/redemption dates). It is then completed (importing the commercial terms from the final pricing announcement) for regulatory approval and publication in time for stock exchange admission on closing of the new issue (usually five business days after pricing). Approved base prospectuses are published up to a year prior to an exempt offering, with final terms then similarly completed for regulatory filing and publication in time for stock exchange admission.

Investor use: Institutional investors may choose to seek access to prospectus information *before* issuance as part of their investment decision analysis on specific

> **It has been suggested in ICMA group discussions that finding published prospectuses online is not as straightforward as it could be.**

issuance (in the case of a standalone prospectus) or generally on a issuance programme (in the case of a base prospectus). This may include a scenario where an investor may then approach an issuer to initiate a transaction as a "reverse enquiry". However, institutional investors have access to other information sources that they may choose to make additional or alternative use of. Investors may distinctly seek access to prospectus information for administrative purposes unrelated to investment decision-making (eg compiling data for settlement or internal reporting purposes). Investors may also seek access to prospectus information *after* issuance, again often for administrative purposes related to portfolio management.

Ideal data platform search functionality: The most efficient and timely way to access prospectus information then depends on the specific use context. In the context of a *draft standalone prospectus pre-issuance*, this is disseminated directly (as it evolves), to the investor bases of issuers' underwriting banks. In the context of a *published base prospectus pre-issuance*, ideal search functionality on a data platform (such as those of stock exchanges, ESMA's prospectus register and any EU single access point as envisaged by the CMU High Level Forum's June 2020 Final Report) would enable a search, based on just a handful of parameters (eg issuer LEI, with a "debt programme" filter), that would return the base prospectus (or sometimes where relevant several base prospectuses) and, importantly, any and all supplements related to a base prospectus – but maintain clarity by excluding other extraneous documents (final terms related to other issuances under the base prospectus, periodic reports under the EU's Transparency Directive, *ad hoc* announcements under the EU's Market Abuse Regulation etc – that should be separately searchable). In a *post-issuance* context, ideal platform search functionality would enable a search, based just on an ISIN, that would return, as applicable (and together with any related supplements), either the standalone prospectus or the final terms and its related base prospectus – but again maintaining clarity by excluding other extraneous documents. Whether post- or pre-issuance, data platforms should ideally enable searching at a European level at least.

Conclusion: ICMA will engage with ESMA, stock exchanges and any other relevant data platform providers to support efficient search functionality for prospectus information.

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Other primary market developments

There have been several other developments for ICMA's primary market members this quarter, the most significant of which are summarised below.

Machine readable data requirements under the EU Prospectus Regulation (PR)

Delegated Regulation 2019/979 includes obligations on NCAs to provide certain prospectus-related data (set out in Annex VII to the Delegated Regulation) to ESMA in XML format. ICMA understands that certain NCAs have contacted issuers and other market participants about their intention to start collecting such machine-readable data later this year (eg from October).

The obligations on NCAs at Level 2 of the PR appear to relate to the obligations on ESMA at Level 1 of the PR to prepare an annual report with statistics on prospectus approvals and notifications under Article 47 of the PR. It may also relate to ESMA's obligations to introduce a "notification portal" to facilitate communication of prospectuses and related documents between NCAs and ESMA under Article 25(6) of the PR and to publish prospectuses and related documents on its website under Article 21(6) of the PR.

The precise implications of NCAs seeking to "downstream" their obligations to issuers is not yet clear. Much will depend on the precise approach taken by individual NCAs, which could vary. ICMA is engaging with ESMA informally to try to understand the implications for ICMA members, and has noted that this is not an ideal time to introduce new requirements in this area given the significant challenges that many issuers are facing elsewhere and the importance of facilitating continued access to the EU's regulated markets during the COVID-19 pandemic.

Primary market aspects of ICMA's response to the European Commission consultation on an EU Digital Finance Strategy/FinTech Action Plan

As noted in the FinTech section of this Quarterly Report, ICMA submitted its response to the European Commission consultation on an EU Digital Finance Strategy/FinTech Action Plan on 25 June. There were two questions that were of particular interest to ICMA's primary market members, namely Q.27 and Q.28 relating to facilitating access to publicly available securities market information. ICMA's response noted that facilitating integrated access to documents by allowing investors to search for an issuer's LEI and then applying relevant filters on a centralized portal (akin to the US SEC's EDGAR) would be useful for investors. This appears to be what is envisaged by the proposal for a "EU Single Access Point" in the High Level Forum on Capital Markets Union *Final Report* of 10 June (see also below). However, careful thought would need to be given to the purpose and related consequences of any additional user features that could conceivably be added to such tool from the perspective of both investor protection and issuer liability. Furthermore, the introduction of any new requirements related to the machine-readable nature of securities market disclosures such as prospectuses could place a disproportionately high burden on market participants in the short-term and a thorough cost/benefit analysis would need to be conducted. Furthermore, some disclosures are more suited to being issued in a standardised, machine-readable format than others. Any drive to standardise the terms and conditions of, or disclosure for, securities in prospectuses in order to facilitate processing of securities market disclosure would be a significant disincentive for issuers to access Europe's capital markets. This would run counter the goals of CMU and be problematic in the context of the COVID-19 recovery.

Primary market aspects of ICMA's response to the High Level Forum on Capital Markets Union Final Report

The High Level Forum on Capital Markets Union published its *Final Report* on 10 June. Its coverage of topics related to primary markets (beyond crypto and ESG aspects) included notably: consumer financial literacy; official financial guidance; financial advisor certification; a new "knowledgeable investor" category (or loosening "professional investor" opt-up criteria); reviewing the PRIIPs regime (albeit not referencing regime purpose/scope); consumer non-engagement with disclosure; PR/disclosure length caps; digital comparison tools; the European Single Access Point (ESAP) for company data (a European EDGAR); inducements (in relation to investor advice); difficult withholding tax refund mechanisms; direct/ESMA supervision; "*de-minimis*" prospectus thresholds, the Market Abuse Regulation's broad MNPI definition and insider list contents, the EU post-trading landscape remaining fragmented along national lines (albeit not referencing long-standing international clearing in the ICSDs) and the definition of "shareholder". Following its preliminary thoughts, ICMA's response to the Commission's related consultation addressed many of these aspects (under the headings of Recommendations 1, 6g/h, 9a, 12e, 13a-e, 15, 16, 17a). Regarding the Market Abuse Regulation, the response noted (given the very short consultation period of just 20 days) that ICMA had been unable to consult on the proposed change regarding "significant price effect" at page 72 of the Final Report. It also noted, incidentally, that allowing issuers not to disclose "preliminary" inside information would not impact insiders (who would still treat it as any other inside information). It also noted harmonised, robust insolvency laws as more of a direct concern in the high yield bond space (given focus on "loss given default") than in the investment grade bond space (given focus mainly on "probability of default"). Otherwise the response (given the 2,000 character limit and the very short consultation period) mainly cited specific aspects of ICMA's existing public material: the ICMA Primary Market Handbook and nine ICMA consultation responses spanning 2009 to 2020 (on MiFID, PRIIPs, the Market Abuse Regulation, title to securities, Omnibus III and CMU).

ICMA informal language for Article 29(2) of the EU Benchmarks Regulation (BMR)

On 20 May, ICMA circulated and published on the *Other ICMA Primary Documentation webpage* (which is available to ICMA members and ICMA Primary Market Handbook subscribers) an updated version of its suggested language relating to Article 29(2) of the BMR. The main changes were refinements to the suggested explanatory statement that may be used in prospectuses where the administrator does not appear on ESMA's BMR registers. Other minor updates (related to the UK's departure from the EU, for example), were also made. Further details are available in the associated cover email to the ICMA Primary Market Documentation Group, which was also published on the *Other ICMA Primary Documentation webpage*.

Amendments to Level 2 Prospectus Regulation (convertibles and other minor corrections)

In early June, the European Commission adopted certain amendments to Level 2 of the Prospectus Regulation, namely amendments to Delegated Regulation 2019/980 and associated annexes and amendments to Delegated Regulation 2019/979 and associated annexes. The primary purpose of the amendments appears to be to restore the previous Prospectus Directive position on the prospectus disclosure and supplement-related requirements for certain convertible, exchangeable or derivative securities. There are also certain corrections to minor mistakes and changes to the EU growth prospectus regime (which has historically not been a core area of focus for ICMA's primary market members).

Although ICMA understands that the bulk of convertible/exchangeable issuance falls outside the scope of the Prospectus Regulation, and so these changes may not have a significant impact in practice, it is expected that these changes will nevertheless be welcome for ICMA members and indeed align with informal comments made to the European Commission previously by ICMA.

ICMA understands that the delegated regulations have been sent to the European Parliament and Council for a three-month scrutiny period (which would end in early September). This period can be extended for a further three months at the request of either the European Parliament or Council. If, at the end of the three-month scrutiny period, there have been no objections or requests for an extended scrutiny period, then the delegated regulations will be published in the *Official Journal*. The delegated regulations could be published in the *Official Journal* sooner if the European Parliament and Council confirm that they have no objections before the end of the three-month scrutiny period.

ICMA podcasts

ICMA has made available a large number of capital markets-related podcasts since the onset of the COVID-19 pandemic. The following podcasts are likely to be of particular interest to ICMA primary market members:

- *Importance of the Primary Debt Market and Current Conditions under COVID-19* (2 April 2020);
- *COVID-19: Practical Implications for European Primary Debt Capital Markets - a View from A&O* (28 April 2020); and
- *Electronic Signings: an English Law Perspective in the Time of COVID-19* (13 May 2020).

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Amendments to China's Securities Law: an offshore perspective

By Richard Mazzochi and Minny Siu

Introduction

The Securities Law of China (the "Securities Law") was enacted in July 1999. Recent amendments to the Securities Law to cater for the rapidly evolving market came into effect on 1 March 2020. The latest reform of the Securities Law is intended to promote the robust development of onshore capital markets by streamlining the process for completing securities offerings and enhances investor protection by tightening scrutiny over information disclosure and introducing class action rights.

We describe here some of the key revisions of the Securities Law, as well as the implications for foreign investors and issuers.

Scope of application

The Securities Law regulates shares, corporate bonds, depositary receipts and other securities approved by the State Council. Given the prevalence of wealth management products and asset-backed securities in the retail investor market, the Securities Law now covers these securities, although they will be subject to further specific and separate State Council measures which have yet to be enacted. Derivatives and futures are not captured by the Securities Law. Futures are regulated by the Futures Law.

Registration-based system

Traditionally, the key regulator of the Chinese capital market, the Chinese Securities Regulatory Commission (CSRC), employed an approval-based system, with the CSRC vetting and screening listing applicants. It often took several years for initial public offerings (IPOs) to be finally listed. Smaller-sized technology and innovative companies found it difficult to list publicly because one of the key requirements was for the issuer to generate profit on an ongoing basis.

The Securities Law now permits an offering to commence by registration with either of China's two stock exchanges. The registration-based system was modelled on the pilot experience with the Science and Technology Innovation Board of the Shanghai Stock Exchange (SSE STAR Market) launched in June 2019. Under the pilot registration system, over 90 IPOs were listed. The adoption of a registration-based system is a welcome change, as it introduces predictability and foreseeability as to when the regulator responds to, and completes, the processing of an application.

Approval for listing still has to be obtained under the registration-based system. However, vetting is now undertaken by the relevant exchanges rather than the CSRC. Detailed rules and implementation measures will be approved by the State Council.

The registration-based system will ultimately also apply to the debt capital market. There are currently two bond markets in China – the exchange-traded bond market and the China Interbank Bond Market (CIBM). The former is regulated by the CSRC and will transition to the registration-based system, while the latter is regulated by China's central bank, the People's Bank of China (PBOC) and National Association of Financial Market Institutional Investors (NAFMII). The CSRC, PBOC and National Development and Reform Commission agreed at the end of 2018 to transfer the enforcement power over corporate bonds listed on the CIBM from the PBOC to the CSRC. We hope to see a uniform implementation of the Securities Law across the two bond markets.

Enhanced disclosure requirements

The Securities Law imposes a higher standard in relation to information disclosure on issuers, securities companies, accounting firms and law firms. The role of intermediaries as gatekeepers to ensure the veracity of published information in offering documents has been emphasised. In particular:

- *Article 19:* the disclosure standard is to include that information necessary for investors to make an informed decision. The disclosed information must be true, accurate and complete.
- *Article 29:* securities companies are required to verify the accuracy of offering documents.
- *Article 85:* controlling shareholders, directors, senior management, sponsors, underwriters and any other person who has an ongoing disclosure obligation are liable for non-compliance unless they can prove that they are not "at fault".
- *Article 160:* the obligation to act with due diligence is imposed on accounting firms and law firms.

The definition of "fault" under Article 85 is unclear. Whilst the Securities Law does not expressly provide for a due diligence defence, we speculate that there will be "no fault" if a comprehensive due diligence process has been undertaken.

Class action rights

One of the most important developments is that investors who suffer loss due to the misrepresentation of, or misleading information disseminated by, the issuer, the intermediaries or other relevant persons, are now entitled to bring class action lawsuits to claim compensation.

A special class action mechanism can also be invoked pursuant to Article 95. Where an investor protection organisation, such as the China Securities Small- and Medium- Investor Service Centre Co., Ltd (a CSRC body), is engaged as the litigation representative by at least 50 investors, all investors with the same claim are considered as represented in the class action, as long as the investors have registered with the relevant People's Court and their interests in the securities have been confirmed by the relevant securities depositary and clearing institution. Individual investors may refuse to participate in the action. This effectively means that regulators will assist in the orderly resolution of disputes and provision of compensation for losses suffered by investors.

Conclusion

Enacted against the backdrop of the internationalisation of the Chinese capital markets, amendments to the Securities Law further align the regulation of China's capital markets with offshore markets. A key aim is better protection for investors. The detailed measures are likely to be implemented on an incremental basis with further guidance to follow.

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Secondary Markets

   

by Andy Hill, Elizabeth Callaghan, Gabriel Callsen and Rowan Varrall

CSDR mandatory buy-ins

Background

The implementation of the Settlement Discipline provisions of the CSD Regulation (CSDR-SD), in particular the mandatory buy-in (MBI) regime, remain a priority issue for ICMA's members, both buy-side and sell-side, active in the European bond and securities financing markets. Members' concerns include preparedness for compliance, practical challenges related to implementation, and the expected adverse impacts for market pricing and liquidity. ICMA is focused on addressing all of these concerns.

ICMA's work related to CSDR-SD is coordinated through the dedicated CSDR-SD Working Group (consisting of fixed income and repo traders, operations experts, as well as compliance officers), under the umbrella of the Secondary Market Practices Committee, and also through the CSDR Legal Workstream, which is a sub-group of the ERCC Legal Working Group (primarily lawyers).

CSDR-SD, including cash penalties for fails and mandatory buy-ins, is currently expected to go live on 1 February 2021.

Supporting implementation

ICMA is looking to support compliance and implementation for its members through revising the ICMA Buy-in Rules. (ICMA is also looking to support compliance and implementation with respect to the repo market by developing a CSDR-SD Annex for the GMRA – see Repo and Collateral section.)

The ICMA Buy-in Rules (part of the ICMA Secondary Market Rules & Recommendations) are a longstanding contractual buy-in framework relied upon widely in the international cross-border bond markets. They apply between ICMA members and/or are applied between members and non-members, or non-members and non-members, via incorporation by reference in their terms of business.

It is intended that the Buy-in Rules be revised ahead of SD go live to provide members and other industry users with:

(a) a contractual buy-in framework that can be initiated in the event of a settlement fail and completed before the CSDR MBI is required; and

(b) a contractual framework to help support execution of the MBI process in the event that this is required.

PEP Buy-in

The Rules that apply during the extension period (the time between the original intended settlement date of the transaction and when the MBI process is required) have been dubbed "the pre-extension period" (or "PEP") buy-in. This is expected to retain the features of the existing ICMA Rules, including symmetrical differential payments, a pass-on mechanism, no requirement to appoint a buy-in agent, guaranteed delivery, and the ability for parties to negotiate cash settlement – albeit within a much more condensed timeframe.

CSDR Buy-in

The Rules that apply after the extension period (where the transaction is in scope of CSDR-SD) will align with the provisions outlined in the Regulation. To the extent that it is possible, the intention is also to provide additional contractual features to help address many of the risks and anomalies arising from the Regulation, in particular symmetrical differential payments and a pass-on

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ICMA is looking to support compliance and implementation for its members through revising the ICMA Buy-in Rules.

mechanism. ICMA's ability to provide these enhancements will largely be contingent on Level 3 guidance, which is yet to be forthcoming.

ICMA intends to launch a formal consultation of its members on the proposed revisions to the Buy-in Rules in Q3 of 2020.

Advocacy

ICMA, guided by its members, has continued to advocate against implementation of the MBI framework. While ICMA fully supports initiatives to improve settlement efficiency, both regulatory and market-driven, including the concept of a penalty mechanism for late settlement, it has pointed to a number of flaws in the design of the MBI regime, not least the mandatory nature of the mechanism.

ICMA's advocacy work remains focused on three main objectives:

(i) Obtaining Level 3 guidance to support the proposed contractual enhancements intended to address the more problematic elements of the regulatory provisions (including symmetrical differential payments, a pass-on mechanism, and clarification of scope).

(ii) Highlighting the likely unintended consequences of the MBI regime with respect to bond and repo market liquidity, efficiency, and stability, particularly for less liquid bond classes. In November 2019 ICMA published an Impact Study of the MBI regime's consequences for European bond and repo markets.

(iii) Raising market awareness of the scope and requirements of CSDR-SD, especially with respect to buy-sides and members located in non-EU jurisdictions who are likely to be impacted.

Recent communication with the European Commission

In May 2020, ICMA, on behalf of its members, wrote to the European Commission and ESMA outlining the industry concerns related to timely implementation of the CSDR mandatory buy-in provisions. The letter highlighted the ongoing lack of regulatory clarification required by the industry to facilitate successful implementation, as well as asking the authorities to review the design and application of the buy-in framework in light of recent market events.

Potential amendments to the MBI framework that have been put forward include: (i) delaying implementation until the authorities have undertaken a comprehensive and robust impact study; (ii) phasing in implementation based on underlying asset class; (iii) introducing a longer extension period (perhaps calibrated to suit particular asset classes). In all scenarios, additional revisions to the Level 1 framework will still be required to minimise adverse market impacts.

ESMA Review of CSDR

Following a request from the European Commission, *ESMA is conducting a review of CSDR*. ESMA is looking to garner information from national competent authorities (NCAs), relevant authorities (RAs), the EBA, and a limited number of relevant trade associations (including ICMA). The Survey covers all of CSDR, but importantly includes Article 7 (Settlement Discipline). This provides an opportunity for ICMA, on behalf of its members, to submit suggested amendments to the original Regulation, along with justification, including evidence and data. The deadline for responses was 10 July.

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The UK and CSDR Settlement Discipline

On 23 June 2020, the UK Treasury published a Written Ministerial Statement from the Chancellor of the Exchequer, Rishi Sunak. The Statement outlines a number of areas where the UK is looking to tailor the application of EU financial regulation. Of note, the UK has stated that it will not implement the EU CSDR-SD regime from February 2021:

"The Government is committed to regulation that supports and enhances the functioning of UK capital markets. It will therefore consider the future approach to the UK's settlement discipline framework, given the importance of ensuring that regulation facilitates the settlement of market transactions in a timely manner while sustaining market liquidity and efficiency. As such, the UK will not be implementing the EU's new settlement discipline regime, set out in the Central Securities Depositories Regulation, which is due to apply in February 2021. UK firms should instead continue to apply the existing industry-led framework.[1] *Any future legislative changes will be developed through dialogue with the financial services industry, and sufficient time will be provided to prepare for the implementation of any new future regime."*

It is important to note, however, that UK trading entities, along with all third country trading entities, are still likely to be brought into scope of the EU CSDR as it applies at EU settlement level and requires trading parties to put enforceable contractual arrangements in place importing the mandatory buy-in regime.

ICMA published a statement on the UK's decision not to implement the EU CSDR-SD regime on 24 June 2020, restating ICMA's support for integrated capital markets, and recommending that in the interests of avoiding fragmentation of regulatory requirements in Europe, as well as the functioning of markets in the EU27, the EU authorities take positive steps to amend the current CSDR-SD framework, particularly with respect to the mandatory buy-in regime.

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MiFID II/R consultations

Both the European Commission and ESMA published consultations regarding MiFID II/R earlier this year. The submission dates were subsequently delayed by one or two months due to COVID-19. The key messages for both consultation responses follow.

On 12 June 2020, the ICMA MiFID II Transparency Taskforce submitted its response to ESMA's consultation on *MiFID II/MiFIR Review Report on the Transparency Regime for Non-Equity Instruments and the Trading Obligation for Derivatives.* ICMA responded solely in relation to cash bonds. The major transparency MiFID II/R points that the Transparency Taskforce wished to communicate to ESMA follow.

Pre-trade transparency

The ICMA Transparency Taskforce considered that there would be no benefit for either institutional or retail market participants in increasing MiFIR-based pre-trade transparency (SI and trading venue published quotes). Most market participants, particularly institutional, source liquidity through axes and inventory.

In addition, illiquid waivers used by institutional market participants, masking prices for pre-trade transparency, are not detrimental to retail end users. Most retail investors trade "liquid" bonds and therefore can access the available liquid bond pre-trade quote information.

Furthermore, the overwhelming view of the Transparency Taskforce was for ESMA to focus on MiFIR post-trade transparency, as post-trade transparency would benefit institutional investors and retail investors more. Retail investors could have access to a consolidated view of prices in bond markets, and institutional investors could have an important tool in their toolbox for price formation and transaction cost analysis.

Post-trade transparency

Regarding post-trade transparency, the Taskforce agreed that there should be a uniform post-trade deferral regime under MiFID II/R and is in favour of a MiFID II Level 1 change to create a harmonised EU deferral regime, which protects liquidity providers and investors, provides price discovery and is consistent with CMU goals. However, the Taskforce believes ESMA should administer the post-trade deferral

1. ICMA's emphasis

regime, as the view is it would be easier to manage if it were managed centrally.

The Taskforce noted further that any harmonisation of deferral regime should not be uniformly set at the lowest level of available post-trade transparency thresholds under MiFID II/R. Instead, the uniform deferral regime should be based on the existing MiFID II/R deferral regime experienced by most market participants today.

But the Taskforce also considered that industry participants should be allowed, as an exception, to set up agreements whereby transparency levels are set at higher levels of transparency exposure than the uniform post-trade MiFID II/R based transparency regime across the EU. For example, the banking industry in Denmark has reached an agreement to "maintain the level of transparency available before MiFID II" for some instruments.

Accurate and verifiable data sets

The Taskforce agreed that any ESMA decisions relating to modifications to the existing transparency regime should be coordinated with ESMA's Data Advisory Group (DAG). This would allow time for the DAG to study and *independently verify* ESMA's transparency data in order to work with ESMA to mutually agree with the industry that the bond market is ready for any proposed changes to transparency practices.

- ESMA's DAG is set up but has yet (to date) to launch. This industry-based ESMA working group consists of industry operational level EU experts, including trading venues, APAs, data providers, sell-side banks (global and EU headquartered), Institutional Investors (global and EU headquartered) and intermediaries. It is important to note that ICMA's Taskforce recommended that the DAG should ensure APA representatives are from the top APA providers as set out on ESMA's website, as those data repositories will most likely have the most accurate data sets.
- The Taskforce believes no liquidity stage advancement should be considered before the liquid bond data universe, data set and liquidity output are verified as accurate by the DAG.

If the DAG reviewed the liquidity data output and worked with ESMA to dynamically rectify and correct the data (by detecting outliers/data quality errors and taking action against those outliers etc) and then verified the data was correct, the industry could rely more on ESMA's list of liquid bonds. This would lead industry to potentially feel more comfortable with simplifying the transparency regime, including lowering thresholds and deferral periods.

Liquidity and transparency assessment

There was agreement amongst Taskforce members that the best transparency regime is one that is not overly complicated or overengineered and is in fact a transparency regime that works in practice.

ICMA has proposed working with its members to produce a study for ESMA (and the Commission if requested) into an investment grade/non-investment grade-based liquidity assessment regime. Ideally, this would analyse liquidity bond threshold levels (granular IG: corporate, sovereign, financial; and non-IG: emerging markets, high yield). This methodology could potentially prove to be more accurate and easier for both industry participants and regulators to work with.

The aim of the study would be to find a more accurate, viable, and easier to implement liquidity assessment system. The result would be a balanced bond liquidity determination regime, which protects liquidity providers while providing investors with necessary information for price formation, thereby benefitting EU bond markets.

As the IG/non-IG rating assessment methodology would be based on credit rating and sub-asset class thresholds, the scope of the study would disregard the average daily number of trades and trade percentiles found in the current more complex liquidity assessment and transparency methodology regimes.

The scope of the proposed study would be both pre- and post-trade. In addition, the analysis would cover the impact on technology costs for market participants for migrating from the current IBIA/COFIA methodology to a potential credit rating-based methodology.

In future, after proper analysis is carried out by a representative group (banks and buy-sides, using their data) and analysis proves IG/non-IG based liquidity assessment meets the needs of EU bond markets better and is more trustworthy than existing liquidity assessment methods, MiFIR liquidity calculation methodology could migrate from IBIA/COFIA liquidity determination to credit rating based MiFID II/R liquidity-based determination. More importantly, if the industry agreed with ESMA's liquid bonds list, they would feel more comfortable with changes to the transparency regime, such as lowering of thresholds and shortening of deferral periods.

Nevertheless, any future ICMA Taskforce recommendation for a migration to IG/non-IG-based liquidity determination regime from the current IBIA/COFIA regime would require clear evidence of significant benefits for bond markets.

On 15 May 2020, ICMA's MiFID II Working Group (MWG) submitted its response to the European Commission's MiFID II/R review consultation paper. ICMA responded solely in relation to cash bonds.

Regarding the MiFID II/R deferral regime, some ICMA working group members were in favour of shorter deferral periods than the regime we have today, while some were in favour of keeping the current deferral regime. However, all agreed there should be a uniform harmonised MiFID II/R deferral regime in order to lessen the current post-trade fragmented deferral approach and make it easier for a consolidated tape to emerge, ensuring a level playing field for all EU market participants.

MiFID II/R and consolidated tape

The MWG agreed that a key goal of a consolidated tape is to level the playing field with respect to access to information. The MWG believes a post-trade consolidated tape could remove existing information asymmetries, where certain market participants may have greater visibility regarding ongoing trading activity than other investors. A consolidated tape could enable investors to assess more accurately current market dynamics, increasing overall investor confidence, particularly during times of market volatility.

Regarding a timeline for a bond consolidated tape, the MWG considered a view, shared by some, that an equity consolidated tape should be developed and delivered first, followed by a bond consolidated tape. This view was not shared by ICMA's MWG, which believes that IT development paths should have parallel equity and bond asset class commencement and not sequential. It is understood that equity and bond consolidated tapes will both face technical implementation challenges, but it is the MWG's impression that bond markets have particularly challenging data quality issues to overcome. Time and investment will be required for data quality and complex deferral regime improvements, before a reliable consolidated tape for bonds can be realised. There should be no delay. Commencement of IT development for a bond CT should be parallel to equity consolidated tape.

On the subject of what post-trade data should be in the consolidated tape, the MWG agreed that the consolidated tape should have raw post-trade bond data and it should cover: ISIN, date, time of execution, reported date & time [taking into account current publication and deferral obligations under MiFID II], price, venue, cancel or correction. While the consolidated tape should have execution prices as a mandatory data item in the consolidated tape, additional data items such as yields, will in all likelihood be required by market participants. Therefore, once there is a consolidated view of prices in the consolidated tape, the consolidated tape provider (CTP) could then derive yields which are fundamental data points in the relative valuation of bonds and comparative analysis of best execution.

Finally, ICMA's MWG wanted to make clear the difference between the consolidated tape and the MiFID II/R transparency regime:

- Consolidated tape = aggregation of transparency from trading venues, (approved) self-reporting investment firms and APAs.
- Transparency regime = rules governing transparency and deferral regimes, SSTI and LIS (size specific to the instrument and large in scale, respectively) thresholds and list of liquid instruments.

Regarding best execution obligations and the consolidated tape, the MWG view was that there is no regulatory best execution obligation link with the consolidated tape. Indeed, mandatory consumption of post-trade execution data does not equal "best execution". Proving buy-side best execution (or "achieving the best possible result for customers when executing their orders via execution venues or OTC") should not be overly simplified to just observing post-trade pricing. The best execution process is a complex matrix of pre-trade decision making and tools and much more than execution "prices".

It was evident to MWG members that MiFID II/R does not have the necessary flexibility and complexity to analyse quantitative and qualitative judgments for best execution of bonds. The concept of best execution as set out in the MiFID II/R is not fit for purpose. For example, credit is usually analysed on a spread basis. This is too complex to determine what exactly is the best "price" and then illustrate it simply for a best execution report.

To mitigate the quality of the sub-standard reports, some MWG firms mentioned that they provide additional information to what is asked. Many firms are providing, in addition to listing the top five venues, additional tables covering which MTFs are used and in which proportion. It is the view of these firms that, without additional explanations, the reports are confusing.

The transparency provided by the top five venues report (RTS 28 report) is considered useful as it can reveal where weighting towards one counterparty is particularly high (eg more than 50% of trading volume with the number one counterparty or venue).

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ICMA report on EU bond consolidated tape

On 17 April 2020, ICMA submitted its final *Report to the European Commission on EU Consolidated Tape for Bond Markets.*

The key elements for establishing a workable and ultimately successful EU bond consolidated tape are governance, data ownership, mandatory contribution, reporting design, revenue sharing, usage based tiered pricing and data quality. These elements and proposed solutions were presented as a study to the European Commission. The Commission is considering next steps, but this is in the context of priority planning for COVID-19 recovery.

What follows is a summary of key themes, concerns, and recommendations from ICMA's consolidated tape taskforce. Please refer to the full report on ICMA's website.

There was consensus agreement amongst Taskforce members that a trustworthy, affordable and centralised EU bond consolidated tape would not only improve transparency but also assist decision-making and provide market insights to end-investors, large or small, professional or retail. Adoption of an appropriate centralised post-trade market structure (which is currently fragmented across the different APAs and trading venues) would enhance investor confidence. This would result in better bond liquidity and more resilient EU capital markets, both CMU goals.

More specifically, with a fully functioning post-trade bond consolidated tape, benefitting from good quality data, optimised liquidity assessment and fine-tuned transparency regime, market participants would have the confidence to successfully use post-trade bond data for pre-trade price discovery.

The Taskforce considered that any consolidated tape governance model should have ESMA working closely with industry participants (buy-side, sell-side, trading venues, data providers and retail), who are best positioned to advise with collective market functioning expertise and stewardship, to enable the CTP to become a successful "going concern".

In order to determine the best governance model for the CTP and CT operation, it is necessary to assess the likelihood of the CTP becoming a successful "going concern". This involves assessing potential funding, stewardship, management structure and IT operation models. The Taskforce set out a number of potential models for CTP governance along with the perceived positives and negatives of each model and a view from Taskforce members as to the percentage chance of success for the governance model or combination of models.

According to the Taskforce, there are a few potential governance model options which could in all probability deliver a CT for EU bond markets. Any of the model options outlined could be achieved with strong EU leadership and the will to surmount any associated negatives in relevant option models:

- A limited company working with ESMA in a close public-private partnership with outsourced IT operations, could take out a loan to be paid back on a cost recovery basis from user fees, to provide a CTP.
- ESMA could govern through an SRO data entity mechanism, recovering costs through subscription/ membership fees to provide a CTP.
- ESMA could work with the industry (stewarding day to day operations) but have overall governance, recovering costs through NCA increased contributions, to provide a CTP.
- APAs could converge on technical standards and a single business model, recovering costs through industry accepted user fees, in order to work together to provide a CTP.

Regarding data ownership, buy-side and sell-side Taskforce members all agreed that trading venues, APAs and self-reporting firms should not retain any claim or ownership for the raw post-trade data and therefore should not be able to "licence" the reported post-trade raw data to the CTP. However, it should be noted this was not Taskforce "consensus" view. APA and trading venue members were not supportive of this position, as they viewed this as a significant change to existing business models and a departure from existing MiFID II/R publication requirements.

It is essential that the responsibility for data feed provision should be changed from the CTP's obligation to "obtain" data to stating that trading venues and APAs have an obligation to "provide" data to the CTP in MiFID II Level 1. This mandatory contribution obligation could be extended to self-reporting firms if applicable. Taskforce members expect all post-trade data to be reported to the CTP as soon as technically possible, taking into account deferrals.

In addition to APAs and trading venues reporting to the CTP, the Taskforce suggests MiFID II (Title V) language could be modified to allow investment firms to have the option to self-report to the CTP. The Investment firm would have to be approved and register first as a "self-reporting" investment firm with ESMA. The self-reporting firm would then be subject to similar regulatory requirements as APAs (eg data quality cleansing), and would have the obligation for correctly applying the MiFID II transparency regime: eg ESMA liquid bond list, post-trade deferrals, daily quantitative transparency reporting to the regulator (ESMA) etc.

Revenue sharing for APAs and trading venues was recommended by Taskforce members in order to incentivise timely and reliable post-trade data and to share the costs of producing good quality post-trade data with the CTP. The Taskforce idea would be for revenue, in the form of revenue sharing, to be derived through the concept of a "data quality score card" and the share should be proportionate to the volume of data provided by the contributing firm and data quality provided. The higher the data quality scorecard "score", the greater the revenue share.

The CTP would collect the raw data and make it available to all market participants, through a minimum-cost model. Firms and/or vendors (including the CTP) would be permitted to purchase the (intraday, one week or full historical) raw post-trade data at a reasonable price and for some, possibly, a discounted price in order to repackage/enrich the raw data for client use or to sell as a value added service. Tiered pricing based on usage (or proportion of usage) would also apply. The enriched data sets for example could be broken out by tenor, credit rate etc.

In addition, it is important to note that the raw data version of the consolidated tape is in an easily analysed useful form to ensure the tape can be a utility for all market participants. ESMA would monitor data availability and reasonable pricing through oversight and supervision from January 2022.

Clear, concise and unambiguous instructions for individual MiFID II reporting fields would be needed. Reference codes that are used also must be absolutely correct. Currently, data fields in MiFID II are open to ambiguous interpretation, leading to, incorrect data downstream in many instances. Taskforce members recommended that, for a consolidated tape to be useful, more concise instructions followed correctly by reporting parties would need to be implemented.

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Extension of bond market transparency directory

ICMA has expanded its Bond Market Transparency Directory to include pre-trade reporting obligations, in addition to post-trade obligations across multiple jurisdictions from Europe, the Americas and Asia-Pacific. The purpose of the mapping is to provide a consolidated view to compare both regulatory rules and best practice guidance on bond trade reporting transparency regimes, as well as details on reporting fields and exceptions. The directory is a non-exhaustive overview and is intended to be a living document with periodic reviews.

Pre-trade transparency: Pre-trade transparency for bonds generally involves the dissemination of price and size of bids and offers to market stakeholders. While most regulators require some form of post-trade transparency, a smaller number of jurisdictions include pre-trade transparency requirements. The variance in pre-trade reporting is lower compared to post-trade reporting, given the inherently smaller data set available (namely, bid/ask quotations, product ID, volume, participant). However, contrasts in pre-trade reporting is predominantly seen in the areas of regulatory requirements, quotation information, and timing.

Regulatory requirements: Notable jurisdictions with pre-trade requirements for bonds, as set out by relevant regulatory authorities, currently include the EU's MiFIR regime, Switzerland's FMIA rules, and Australia's Securities Markets rules for Commonwealth Government Securities (CGS). The UK to date still follows EU MiFIR reporting obligations. However, for bonds traded on exchanges, most available pre-trade information is disseminated following exchange rules such as the NYSE, TMX IP in Canada, ASX in Australia and SGX in Singapore. ICMA Taskforce members for the recent ESMA MiFID II/MiFIR review have observed from an investor perspective, market pre-trade transparency data such as axes and inventory are used for price discovery and not pre-trade quotes required under MiFIR.[2]

Quotation Information: Most jurisdictions require bid/ask prices and depth of trading interests to be publicly disseminated. Several jurisdictions also calculate and display Reference Statistical Prices (RSPs) or yields for bonds based on reported indicative pricing such as Japan, Hong Kong and Indonesia. In Japan, for example, JSDA calculates RSPs based on median prices between best bid/offer quotations reported by Designated Reporting Members and only disseminates if at least five quotations have been obtained.

Timing: Most pre-trade bid/ask information is disseminated real-time to market participants either through an exchange, other trading venue or directly on an SI's webpage or via an APA under MiFIR. Small timing windows are evident for dissemination (generally up to 15 minutes) and more commonly seen in the OTC market when only RSPs are provided (such as Japan's EOD RSP publications for corporate and non-corporate bonds at 6:30 pm and 5:30 pm respectively).

The Bond Market Transparency Grid is available on ICMA's website. This overview complements ICMA's previous brief on post-trade transparency.

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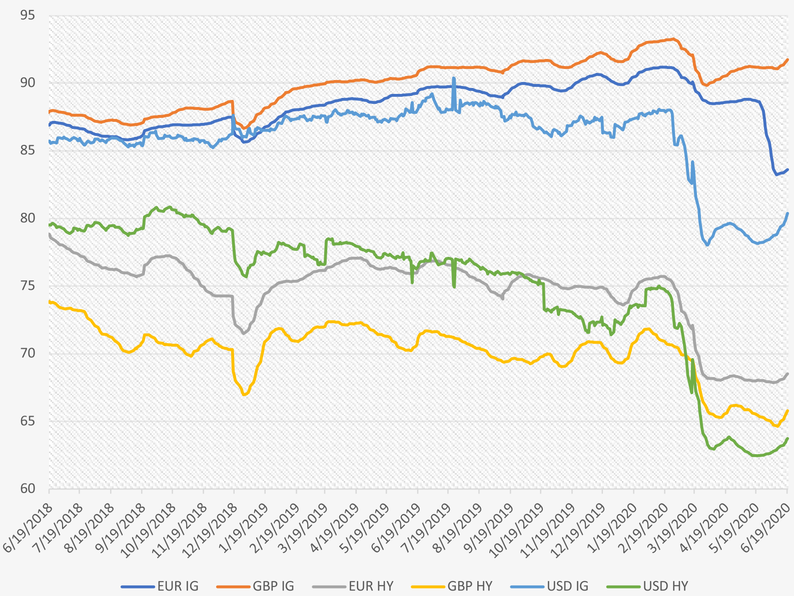
2. ICMA Taskforce for ESMA Consultation Paper MiFID II/ MiFIR review report on the transparency regime for non-equity instruments. The response is available here.

ICE Data Services Corporate Bond Market Liquidity Indicators™

Tracker indicates slight improvements in credit market liquidity during COVID-19 crisis - July 2020

ICE Liquidity Indicators™



Commentary

Following an unprecedented fall in credit market liquidity in the wake of the COVID-19 pandemic, liquidity across IG and HY levelled off at the beginning of April and showed signs of recovery. Liquidity subsequently decreased again before rising gradually. Liquidity levels in US IG and HY appeared to be severely impacted, while EUR IG recorded its steepest decline toward the second half of May only. In contrast, GBP IG liquidity reached levels last seen at the beginning of the year by mid-June. HY liquidity remained generally at record lows but has increased in recent weeks.

Central bank intervention across the globe clearly appears to have had a stabilising effect on corporate bank market liquidity, notably the ECB's Pandemic emergency purchase programme (PEPP), the Fed's unlimited US Treasury and agency MBS bond-buying scheme, and the BoE's rate cut and purchases of UK government and non-financial corporate bonds, amongst a range of other, targeted support measures (which can be found in the Monetary Policy section of ICMA's dedicated COVID-19 information hub). That said, as the long-term impact of the COVID-19 pandemic on the real-economy becomes visible only gradually, it remains to be seen to what extent monetary policy, alongside relevant fiscal policy measures, will be able to support a sustained recovery of credit market liquidity.

Developments prior to COVID-19

As discussed in previous Quarterly Reports, corporate bond market liquidity recovered throughout Q1 2019 but then followed a downward trend in Q3 2019 before improving again towards year-end. US HY liquidity is an exception with a marked decline from Q2 2019, reaching a new low in Q4 2019.

At the beginning of 2019, monetary policy and tightening CDS spreads seem to have countered the decrease in liquidity. Meanwhile, the continued economic uncertainty arising from Brexit, global geopolitical tensions and a "flight-to-quality" appear to have had a continued adverse impact on HY liquidity throughout Q2 and Q3 2019, notably for GBP HY, a segment dominated by UK retailers. A sell-off in global bond markets in Q4 2019 does not appear to have had a material impact on liquidity.

Liquidity levels across IG and HY declined towards the end of Q4 2019, before following an upward trajectory at the beginning of Q1 2020. It remains unclear as to whether those improvements may have benefitted from the third rate cut by the FED and the ECB's relaunched asset purchase programme in 2019, or whether it is a "usual" recovery as observed in previous years following a slump at year-end.

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ICE Liquidity Indicators™
ICE Liquidity Indicators™ are designed to reflect average liquidity across global markets. The ICE Liquidity Indicators™ are bounded from 0 to 100, with 0 reflecting a weighted-average liquidity cost estimate of 10% and 100 reflecting a liquidity cost estimate of 0%. The ICE Liquidity Indicators™ are directly relatable to each other, and therefore, the higher the level of the ICE Liquidity Tracker the higher the projected liquidity of that portfolio of securities at that point in time, as compared with a lower level. Statistical methods are employed to measure liquidity dynamics at the security level (including estimating projected trade volume capacity, projected volatility, projected time to liquidate and projected liquidation costs) which are then aggregated at the portfolio level to form the ICE Liquidity Indicators™ by asset class and sector. ICE Data Services incorporates a combination of publicly available data sets from trade repositories as well as proprietary and non-public sources of market colour and transactional data across global markets, along with evaluated pricing information and reference data to support statistical calibrations.

Repo and Collateral Markets

by Andy Hill, Alexander Westphal, Gabriel Callsen and Rowan Varrall




The European repo market and the COVID-19 crisis

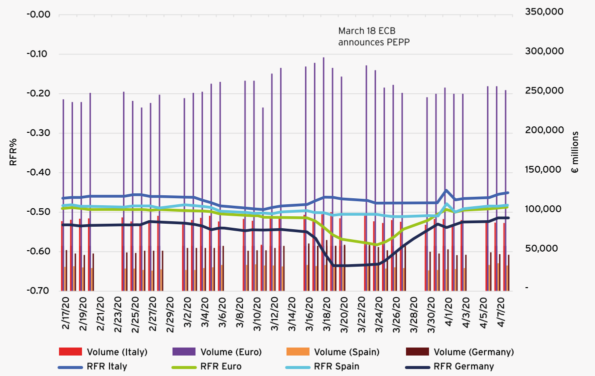
In April 2020, the ICMA European Repo and Collateral Council published a market report documenting how the European repo market performed during the COVID-19 crisis, based on input and market intelligence provided by sell-side and buy-side members, as well as market data.

The headline feedback from market participants is that the European repo market, for the most part, has "held up well" during the market turbulence stemming from the global COVID-19 pandemic that began in late February/early March 2020. However, this was not without some strains. In particular, as the demand for repo increased, banks' capacity to intermediate remained constrained. Meanwhile, the market had to deal with the disruption of operating remotely, with implications for both the supply of collateral and operational efficiency.

Market performance

As the crisis accelerated, and as countries went into lockdown, in the first two weeks of March, repo market activity increased, driven partly by flows out of risk assets into the safety of short-term secured markets as well as collateral transformation to meet margin requirements or to cover fund outflows. The flight to quality was most felt in German general collateral (GC), which became richer in the third week of March by as much as 20 basis points to pre-crisis levels, while Italian GC saw some minor cheapening, of between 5-8 basis points, which seems to be partly off the back of hedge funds unwinding leveraged long BTP exposures.

Repofunds rate



Source: ICMA analysis using CME Group and MTS Markets data

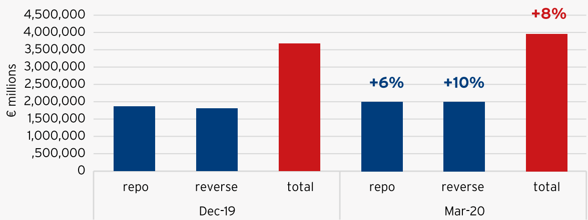
The announcement of the ECB's Pandemic Emergency Purchase Programme (PEPP) on 18 March marked the nadir of the crisis (and followed a record day of volumes for very short-dated German GC), and as the sell-off in risk assets took pause, so Euro GC levels began to normalize, heading back to the ECB Deposit Rate, with Germany cheapening relative to other euro area sovereign credits. Italian GC did see some temporary cheapening over quarter-end, but nothing abnormal.

Market access

While the demand to access the repo market increased during the height of the crisis, banks' capacity to intermediate that access did not. Buy-side participants report an increased reliance on the repo market as fund outflows drove the need to generate cash against holdings, as well as to meet margin calls against derivatives positions as volatility increased. However, it would seem that banks struggled to keep pace with client demand. Many report limiting business to top tier clients, with no capacity for new business. Banks further report that in light of the heightened volatility, it was more a case of RWA (risk weighted assets) limits becoming the binding constraint on business, rather than the Leverage Ratio, particularly for one-directional business flows (such as net borrowers of cash).

ICMA's ERCC conducted a snap repo survey at the end of March to ascertain changes in banks' balance sheets during the crisis. While only 22 of the usual 60 or more participants provided data, this nonetheless helps to corroborate the anecdotal reports. The data suggests that most larger banks did increase their balances through March, although many smaller banks tended to reduce their repo footprint, in some cases dramatically. The sample data points to an overall increase in outstandings of about 8% from the December 2019 survey, but a median adjustment of -4% across the sample, suggesting a greater concentration of liquidity with fewer dealers.

ERCC European repo survey (sample outstandings)



Source: Survey data from ERCC members

Buy-sides suggest that, while they were successfully able to manage their liquidity through the early part of March (offsetting fund outflows with positive margin inflows), as this became more challenging, and as access to the repo market became more imperative, they report that banks simultaneously began to reduce their repo capacity. Partly this was due to the approaching quarter-end (when banks ordinarily wind-down their repo books), but potentially also the result of banks increasing their direct lending to corporate clients (as the commercial paper market dried up), reducing the cash available to lend through the repo market. They note that it was ultimately ECB (and other central bank) intervention that helped to ease the mounting tension, reversing the ongoing sell-off in risk assets and freeing up banks' credit lines. They are also keen to emphasize that as helpful, and necessary, as the central bank actions were, a timelier response would have been preferred, not least as by this point some firms report having run down their liquidity buffers and were struggling to generate cash against their assets to meet margin calls.

Settlement fails

There are widespread reports of a significant increase in settlement fails during the peak of the turbulence, with some reporting average daily fails increasing by a factor of four-to-five times normal rates, and spread across a broad range of asset classes. While settlement fails are not in themselves driven by repo or securities lending activity, repo desks tend to be closer to settlement issues than most trading functions given that it is usually part of their responsibility to borrow securities (both for their firms and clients) in order to avoid settlement fails.

The marked spike appears to be attributable to two main factors: first, reductions in the supply of specific securities as the crisis deepened, and secondly, operation challenges as firms adjusted to working remotely. Participants talk of problems contacting clients to confirm settlement instructions and technical delays in processing trades as a result of more manual intervention. Another observation relates to issues with outsourced middle- and back-office functions, particularly those based in India where the lockdown has been more severe. However, ICSDs report that lending programmes remained operational during this time, and were successful in minimizing fails rates, which otherwise could have been much higher. While there are suggestions that buy-ins have been issued in certain cases, there is a realization that in these market conditions their effectiveness is relatively limited.

Conclusion

The European repo market functioned relatively well through the COVID-19 crisis, although this is in the face of a number of constraints, not least on banks' capacity to intermediate at a time of heightened demand, and which again highlights the dependence of market functioning on central bank intervention. The market disruption has also thrown out a number of technical and operational challenges, including collateral bottlenecks, increased settlement fails, and challenges managing intraday liquidity and collateral, that may need to be addressed in the longer term.

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EU pension scheme arrangements and the EMIR clearing obligation

On 15 June, ICMA's ERCC submitted a response to the ESMA consultation on its *First Report on Central Clearing Solutions for Pension Scheme Arrangements.*

EMIR Refit, which entered into force in June 2019, introduced a number of amendments to EMIR, one of them being a further extension of the exemption from the clearing obligation for pension scheme arrangements (PSAs). This extension was introduced because of the challenges that PSAs would face to provide cash for the variation margin calls related to their cleared derivative contracts. However, this extension goes hand in hand with the EMIR Refit objective of also ensuring that progress is made by the relevant stakeholders in addressing these challenges and for PSAs to clear their contracts. As part of this latter objective, EMIR Refit provides that the European Commission should prepare a report assessing whether viable technical solutions have been developed for the transfer by pension scheme arrangements of cash and non-cash collateral as variation margins and the need for any measures to facilitate those viable technical solutions.

As a first milestone of that monitoring, and in order to provide input for the report from the European Commission, the European Securities and Markets Authority (ESMA) is required under EMIR Refit to produce, in cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB), a first report to the European Commission, within six months from the entry into force of EMIR Refit, documenting the progress made towards clearing solutions for PSAs. In addition, in preparation for the second report due in a year's time and in order to get input from a wide range of stakeholders, this report also serves as the basis for a public consultation, and thus also includes a range of questions.

While the report covers a range of relevant issues with respect to the ability for PSAs to comply with the clearing obligation, the ERCC focused its response on the market-based repo solution, and the ability for PSAs to undertake collateral transformation in order to meet variation margin (VM) requirements.

In its response, the ERCC discusses the suggestion of balance sheet relief for bank intermediaries when trading with PSAs, the opportunities presented by sponsored client clearing for repo, as well as the related challenges, liquidity for same-day repo settlement, the use of triparty solutions, and the possibility for a central bank backstop lending facility for PSAs.

The ERCC response further examines the size and depth of the European repo market, drawing on previous analysis and reports of market performance during stressed conditions, such as 2016 year-end and the recent COVID-19 crisis. The response concludes that, while the repo market functions sufficiently well most of the time, for PSAs to support the access and liquidity they require to undertake the necessary collateral transformation to manage their cash variation margin requirements, there will be times when the market cannot be relied upon. Most significantly, the timing and extent of such stressed market conditions cannot be predicted.

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GMRA CSDR-SD Annex

As well as supporting implementation of the CSDR mandatory buy-in (MBI) regime for non-cleared cash bonds (see Secondary Markets section), ICMA is also looking to support implementation with respect to the repo market. The regulation brings SFTs into scope of the MBI provisions where they have a term of more than 30 business days (this is understood to apply to both start- and end-legs). Open-SFTs are also thought to be in-scope, further to requested clarification from ESMA.

ICMA is working with Clifford Chance to develop an Annex to the GMRA to help support implementation in the case of in-scope repos. This is being done in coordination with ISLA who are producing a similar CSDR-SD Annex for the GMSLA.

As with the Buy-in Rules, the original intention is to provide contractual enhancements to the MBI provisions to help mitigate the additional risks and anomalies arising from the Regulation: in particular, the ability to settle the buy-in or cash compensation differential symmetrically and the inclusion of a pass-on mechanism. However, given the ongoing lack of regulatory guidance on supplementary features and the limited time to complete this work (the SD framework is expected to go live on 1 February 2021), the scope of the SD Annex will be refined, focusing primarily on supporting compliance with Article 25 of the Regulatory Technical Standards and accommodating commercial enhancements where appropriate.

Furthermore, ICMA, through the ERCC, will look to develop market best practice, potentially as part of the Guide to Best Practice in the European Repo Market, to support implementation. In the meantime, ICMA has also produced FAQs on MBIs and SFTs.

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The current version of the ICMA recommendations incorporates the latest ESMA guidance received on 25 May.

SFTR implementation

On 23 March, ESMA granted a three-month delay to the SFTR reporting go-live, initially scheduled for 13 April. In the current circumstances, this came as a great relief to the industry, in particular as it was accompanied by ESMA's clarification that the backloading requirements under SFTR, ie the reporting of legacy trades, will not be enforced. ICMA issued its own statement to summarise the ESMA announcements.

Despite the COVID-19 related difficulties, firms have made active use of the additional time to engage in cross-industry testing with trade repositories and vendor platforms. At the same time, the discussions within the ERCC SFTR Task Force have continued unabated. In the final run-up to the go-live on 13 July, the group is now meeting (virtually) on a weekly basis. The key focus remains on developing industry best practices to complement the regulatory framework to help ensure a minimum level of consistency across firms. Good progress has been made but there are still many moving parts and it can be expected that the implementation will be an iterative process with data quality and consistency gradually improving over the first months of reporting. ICMA's detailed best practices have already played an important role in speeding up this process and will continue to do so.

On 24 February, the *ICMA Recommendations for Reporting under SFTR* were first published, providing over 250 pages of detailed guidance on around 100 topics. Since the first (public) edition, the document has evolved further, along with the discussions in the SFTR Task Force, but also to reflect important additional clarifications received from ESMA. On 30 June, ICMA published the second update of the recommendations, together with revised versions of the two complementary best practice documents, ICMA's SFTR sample reports and the related overview of lifecycle event reporting.

Importantly, the current version of the recommendations incorporates the latest ESMA guidance received on 25 May, a long-awaited written response to ICMA's outstanding queries on the final SFTR Guidelines which were first submitted to ESMA in late January. Unfortunately, ESMA's responses on the two key issues raised by ICMA were disappointing. In relation to settlement fails, ESMA insisted on the need for firms to modify reports following a fail, despite a clear industry consensus that this is not appropriate in the context of repos as it misrepresents the contractual and legal reality of the product. Similarly, on the question of variation margining for uncleared repos, ESMA insisted on reporting strictly in line with the examples in the Guidelines, which conceals the fact that repos are individually collateralised, as pointed out by ICMA. Over the past weeks, the SFTR Task Force has considered the implications of this guidance. The latest version of the recommendations now takes into account ESMA's clarifications, although ICMA separately also followed up with ESMA to reiterate its concerns with the guidance.

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MiFIR reporting of repos with EU central banks

Under SFTR, SFTs transacted with one of the 27 EU central banks that are part of the European System of Central Banks (ESCB) are exempted from the reporting obligation. However, these trades have in turn been included in the scope of MiFIR transaction reporting. This requirement will apply at the same time as SFTR goes live. However, there has been only limited additional guidance as to how repos and other SFTs can be reported under MiFIR, considering that the reporting framework has not been designed to cater for SFTs and their specific characteristics. Following extensive discussions with members, ICMA developed a proposal to report repo trades under MiFIR, consisting of two sample reports and an explanatory note. Both documents were submitted to ESMA in November 2019 for consideration. On 8 May 2020, ESMA responded to the ICMA query, providing some helpful clarifications which essentially confirmed all the key aspects of the ICMA proposals and also addressed two open questions that had been submitted alongside the proposals.

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Publication of legal opinions on the GMRA

ICMA obtains and annually updates legal opinions on the GMRA from numerous jurisdictions worldwide. In April 2020, ICMA published legal opinions on the GMRA 2000 and 2011 versions, as well as the 1995 version as amended by the Amendment Agreement to the GMRA 1995 and the 1995, 2000 & 2011 versions as amended by the 2011 ICMA GMRA Protocol (Revised) for 64 jurisdiction. A new GMRA legal opinion has been obtained for Argentina.

The 2020 GMRA opinions cover both the enforceability of the netting provisions of the GMRA, as well as the validity of the GMRA as a whole (subject to certain limitations). Furthermore, the 2020 GMRA opinions address the issue of recharacterisation risk (in respect of both the transfer of securities and the transfer of margin). While all 2020 GMRA opinions cover, as a minimum, companies, banks and securities dealers, the opinions for 51 jurisdictions additionally cover insurance companies, hedge funds and mutual funds as parties to the GMRA. Where relevant, each 2020 GMRA opinion also covers the central or national bank of the relevant jurisdiction as a party to the GMRA.

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CDM for repos and bonds

ICMA is in the process of formalising the collaboration with ISDA and Regnosys to extend the Common Domain Model (CDM) to repos, and by extension, bonds. The CDM is essentially a model for trade processing that is machine-readable and executable. It was initially developed for derivatives by ISDA and can be used by all businesses and processes within a firm, and across the entire industry, to ensure consistency in the way lifecycle events are represented in different systems. The CDM can be considered an interface between existing messaging protocols and standards such as FIX, FpML, and ISO20022.

ICMA has created a working group of sell-sides, buy-sides, trading venues and technology providers to help support the development of the CDM for bond and repo markets. The working group includes front office, middle/back office, IT and legal experts. From July, a series of further workshops will be held to define the scope of the repo model in the CDM and outline the deliverables, which will serve as a basis for the technical implementation.

Further information on the CDM, including previous workshop materials and a podcast recorded with Regnosys in April, are available on ICMA's dedicated CDM webpage. Member firms who would like to be involved and contribute to this cross-industry initiative are welcome to get in touch.

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Extension of repo trading technology directory

In its latest revision, the scope of ICMA's repo trading technology directory has been extended to include all technology solutions for repo trading such as Order Management Systems (OMSs) and Aggregators. The mapping now includes 17 solutions for electronic repo trading and is available from ICMA's website.

As outlined previously, the directory is intended to help market participants understand what execution venues and other technology solutions are available for repo trading (D2D or D2C, for instance), product scope, as well as differences in trading protocols, clearing and collateral configurations. The directory also provides information on venues' regulatory status, market identifier codes (MIC) and additional services on offer such as regulatory reporting under SFTR.

The mapping directory does not constitute an exhaustive list of providers in the market. Relevant providers that are not yet covered by the mapping directory and wish to join are very welcome to do so.

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Sustainable Finance

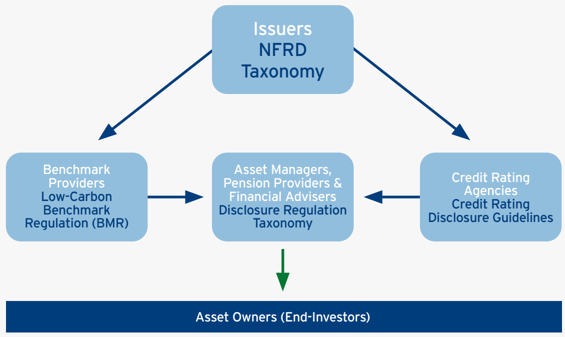
by Nicholas Pfaff, Valérie Guillaumin, Simone Utermarck and Ozgur Altun

The EU's "sustainability disclosure regime"

New and amended EU legislation is introducing significant sustainability and ESG-related disclosure requirements that will impact all participants in the European capital markets. This is arguably leading to what we are referring to as an "EU sustainability disclosure regime" in the ICMA memorandum released on 30 April 2020 (alongside a related podcast). With this publication we aim to provide the market with an initial and practical overview of these developments including in annex a summary of disclosure requirements for issuers (ie large listed companies under the scope of NFRD), asset managers and pension providers, benchmark administrators and credit rating agencies.

The Commission indeed launched in the wake of its Action Plan, *Financing Sustainable Growth*, in March 2018 legislative initiatives leading among other things to significant new disclosure requirements that form the basis of this regime (illustrated in the diagram to the right). They include (i) Disclosure Regulation, (ii) Low Carbon Benchmark Regulation (amending Benchmarks Regulation or BMR) and (iii) the Taxonomy Regulation. The Low Carbon Benchmark Regulation and Disclosure Regulation were both published in the *Official Journal of the EU* on 9 December 2019 and will apply from 30 April 2020 and 10 March 2021 respectively. The Taxonomy Regulation was adopted by the European Parliament on 18 June 2020.

The EU's sustainability disclosure regime: regulations and reporting requirements



The main aim of the Disclosure Regulation is to provide more transparency to end-investors on whether and how the buy-side and financial advisers take into account ESG aspects. Our memorandum considers the implications of both the Disclosure Regulation and the Low Carbon Benchmark Regulation for investors. Furthermore, it explains what the Taxonomy Regulation, which is closely linked to the Disclosure Regulation, will mean for both investors and issuers.

The Non-Financial Reporting Directive (NFRD) already aims to provide data for investment decisions but both the Disclosure Regulation and the Taxonomy Regulation can only fully meet their objectives if relevant non-financial information is available from investee companies. To address this, the European Commission launched in February a public consultation on possible revisions to NFRD that closed in June 2020 (see ICMA's response). Our memorandum paper also explains requirements for issuers under NFRD, and lastly, looks at the guidelines on disclosure requirements applicable to credit rating agencies.

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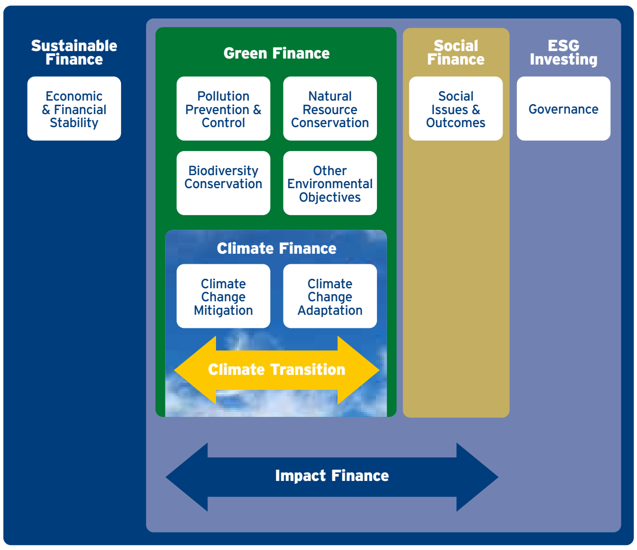
High-level definitions for sustainable finance

On 11 May 2020, ICMA's Sustainable Finance Committee released a paper on high-level definitions for sustainable finance. In this publication, ICMA is proposing high-level definitions building on current market usage and existing official sector terminology to address the need for convergence among market participants and wider stakeholders. The publication covers the most commonly used terms in the sustainable finance field such as climate finance, impact finance, green finance and social finance. We also invite you to listen to the related podcast and webcast.

ICMA's objective is to clarify the debate and to ensure that all participants and stakeholders have a common and transparent vocabulary to refer to. The ICMA definitions are also designed as a contribution to other ongoing efforts in the financial industry to develop a consensus around key terms and definitions in sustainable finance.



The diagram below from the publication illustrates the interaction between key high-level definitions and especially how the wider definitions incorporate narrower ones. For example, Sustainable Finance is the widest definition incorporating ESG Investing, Green Finance, Social Finance and Climate Finance. White boxes aim to identify key differentiating themes between the definitions eg social issues and outcomes in relation to Social Finance. Double-arrowed boxes identify definitions that interact dynamically with themes or other definitions eg Impact Finance in relation to Green Finance and Social Finance.

This is the second publication from ICMA's Sustainable Finance Committee, which brings together representatives from various ICMA committees, including our Asset Management and Investors Council, Corporate Issuer Forum and Legal and Documentation Committee, as well as the Executive Committee of the Green Bond Principles and Social Bond Principles, to address cross-cutting sustainable finance developments. The Bank of China has also kindly provided the Chinese translation.

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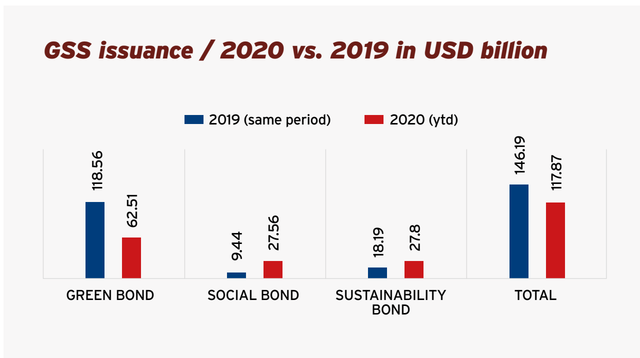
Social bond issuance on the rise

The social and sustainability bond market has experienced significant growth year on year, with increases respectively of +191% and +53% led among others by multilateral development banks such as the IFC, AfDB, EIB and CEB. This dynamism has contained the decline of the overall green, social and sustainability (GSS) bond market to just under 20% with issuance to date of USD118 billion. The COVID-19 crisis has conversely clearly impacted the green bond market, with year on year issuance down by 47.5% in line with the trend of the overall bond markets during that period.



Source: ICMA analysis based on Environmental Finance database

Social and sustainability bonds are indeed being issued to finance projects that can mitigate the socioeconomic consequences of the pandemic. In this respect, the GBP SBP Executive Committee issued at the end of March supporting guidance on the immediate applicability of social and sustainability bonds in the context of the COVID-19 crisis. As of 23 June 2020, bonds aligned with the Social Bond Principles (SBP) or Sustainability Bond Guidelines (SBG) and targeting the effects of the COVID-19 pandemic amounted to USD36.11 billion.

In March, the International Finance Corporation (IFC) issued a USD1 billion 3-year social bond that aims to "support the private sector and jobs in developing countries affected by COVID-19 outbreak". Later that month, the African Development Bank launched a USD3 billion 3-year "Fight COVID-19 Social Bond" to help alleviate the economic and social impact that the COVID-19 pandemic will have on livelihoods and Africa's economies.

In April, the European Investment Bank launched a SEK3 billion 3-year Sustainability Awareness Bond (SAB) to combat COVID-19. The proceeds from the issuance are earmarked for EIB's lending activities contributing to sustainability objectives, including Universal Access to Affordable Health Services (UN Sustainability Development Goal 3). In the same month, there were issues from the Council of Europe, and the largest yet, a USD8 billion sustainability bond from the World Bank with the proceeds being dedicated to employment generation. Also in the supranational space, the European Stability Mechanism (ESM) released its Social Bond Framework for future issuances aligned with the Social Bond Principles (please listen to our podcast with the ESM).

It is not just supras, however, that are accessing the social bond market. In April, Guatemala issued a USD500 million sovereign social bond where the proceeds will finance COVID-19 prevention, containment and mitigation efforts. In May, Bank of America issued a USD1 billion social bond to fight COVID-19, the first such offering by a US commercial bank, and Mitsubishi UFJ Financial Group in June came out with Japan's first corona virus bond. In the non-financial corporate space, Pfizer is using proceeds from a sustainability bond to improve access to essential services. The world's two largest ever social bonds were issued by French unemployment agency Unédic in May and June, each raising EUR4 billion. Furthermore, we witnessed another first when the Ford Foundation took unprecedented action to increase grantmaking for not-for-profits fighting COVID-19 by USD1 billion raised through social bonds.

Returning to the green bond space, there have been landmark transactions nonetheless in this period such as Deutsche Bank's inaugural issuance of a EUR500 million bond, as well as RBS' USD600 million transaction, Hungary's inaugural sovereign green issuance of USD1.5 billion, and a convertible green bond of EUR170 million issued by Neoen, the French renewable energy company.

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Review of deliverables from the 2020 GBP SBP AGM

The sixth Annual General Meeting of the Green & Social Bond Principles was held on the virtual platform of the London Stock Exchange (LSEG) on 9 June 2020 with over 420 delegates joining from GBP SBP members or observers. The most noteworthy developments of this year's AGM were the release of the Sustainability-Linked Bond Principles and the update to the Social Bond Principles. The Advisory Council also presented an overview of its recommendations.

The Sustainability-Linked Bond Principles

The Sustainability-Linked Bond Principles (SLBP) are voluntary guidelines for Sustainability-Linked Bonds (SLBs) defined as forward-looking performance-based bond instruments where the issuer is committing to future improvements in sustainability outcomes within a predefined timeline. The financial and/or structural characteristics of SLBs can vary depending on whether the issuer achieves those predefined sustainability/ESG objectives. Within these parameters, the use of funds for SLBs are intended for general purposes rather than for underlying sustainable projects as in the case of existing green, social and sustainability bonds.

The SLBP outline best practices for SLBs with the aim of guiding market participants on potential issuances and establishing a high level of integrity and ambition for this developing market. The SLBP are described in depth in the accompanying feature in this edition of the Quarterly Report.

The 2020 Social Bond Principles and other related deliverables

An update of the Social Bond Principles was also released on the day of the AGM. This provides expanded social project categories, additional target populations, a definition of what constitutes a "social issue", and also incorporates recent guidance for social bonds addressing the COVID-19 crisis. Separately, a collection of Social and Sustainability Bond Case Studies from 18 issuers in various sectors was published.

> The most noteworthy developments of this year's AGM were the release of the Sustainability-Linked Bond Principles and the update to the Social Bond Principles.

The following publications have also been updated:

- *High-level Mapping of Green, Social and Sustainability Bonds to the Sustainable Development Goals*: the document now includes a recommendation that where possible, issuers reference their methodology for alignment with the SDGs, where applicable incorporate this in their external review process, and report on SDG-related indicators and any potential contradictory negative.
- *Working Towards a Harmonized Framework for Impact Reporting for Social Bonds*: the document now includes more robust definitions of output, outcome and impacts, and reflects the expansion of target population in the SBP. The working list of sample indicators is restructured.

Climate Transition Finance Working Group progress

Following its launch with over 70 organisations in January 2020, the Climate Transition Finance Working Group conducted a broad consultation to garner wider consensus from market participants on key points of discussion such as the link between climate transition and the Paris Agreement and to confirm elements that would need to be disclosed in order to evidence an issuer's transition strategy.

Going forward, the Working Group is planning to distill its findings into a guidance note on best practices, focusing on:

- requirements and recommendations on the level of disclosure on an issuer's transition strategy; and
- the scope of expenditures/type of instrument that can be considered as climate transition finance.

The Guidance Handbook update

Having already been reorganised and updated with new Q&As on fundamentals, governance and membership, core components of the Principles, and market and technical issues in April 2020, the Guidance Handbook now also includes additional input from the Social Bonds Working Group: new Q&As regarding target populations as well as impact reporting and the difference between a social issue and a social outcome were added, and the document has now a new separate section on Social Bonds related to COVID-19 with new Q&As.

The Harmonised Framework for Impact Reporting update

In April 2020, the *Harmonised Framework for Impact Reporting* was updated with the addition of a new chapter on biodiversity. Going forward, the Impact Reporting Working Group will focus on climate change adaptation as well as developing guidance for impact reporting database providers.

Sustainability Standards and Labels

In June 2020, the Green Project Eligibility Working Group published a report on *Sustainability Standards and Labels* which provides an overview for green bond market participants of various sustainability standards or labels that they could consider as a suitable reference when assessing green eligibility.

The Green Bond Principles have encouraged the standard setting bodies (including relevant standards, schemes or labels) to fill out the *Green Bond Market Information on Sustainability Standards Form* to support the gathering of green bond market relevant information on third party sustainability standards in a consistent and streamlined way.

Advisory Council 2020 Report

The Advisory Council (AC) of the GBP SBP produced recommendations under its three workstreams on green bond data quality, social and sustainability bonds and External Review Guidelines. The GBP SBP Executive Committee has already actioned the AC proposal to update the External Review Guidelines with which a list of major external reviewers have agreed to publicly confirm their voluntary alignment.

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Asset Management

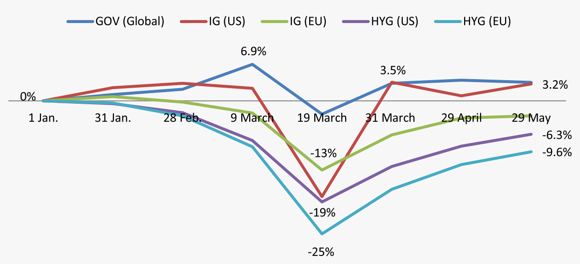
by Arthur Carabia

COVID-19: initial lessons for bond fund managers

Market update

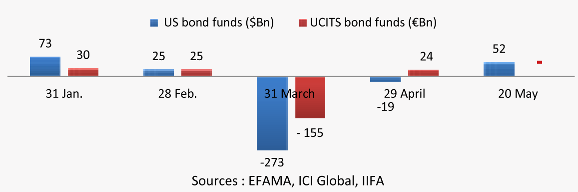
Euro bond funds were able to recoup at least partially their losses of the first quarter as flows stabilized and credit market rallied in the second quarter (see Figures 1 and 2), following the announcements of unprecedented policy measures to counter the economic impact of COVID-19 pandemic and with the gradual easing of lockdown measures.

Figure 1: YTD performance of index bond funds



Source : Bloomberg

Figure 2 : Bond fund flows



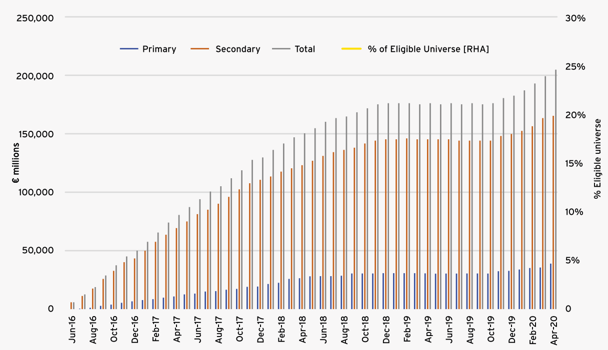
Source : EFAMA, ICI Global, IIFA

Potential risks ahead

Despite a much improved situation since the end of the first quarter, bond fund managers remain cautious, as the shape of the economic recovery remains uncertain and second waves of infections are not yet completely excluded. In that context, market illiquidity and fallen angels will remain important areas of vigilance:

Market liquidity: If volatility seems now under control, market liquidity, which was the main challenge during the peak of stress in first quarter, will remain a point of attention for fund managers as managers may still find it more difficult and costly than before the Crisis to find buy/sell positions and settle trades. Respondents to the ICMA study on *The European Investment Grade Corporate Bond Secondary Market and the COVID-19 Crisis* signalled only a partial recovery of liquidity, and one buy-side respondent shared their analysis suggesting that the generic bid-ask spread for European IG credit by the end of April was still at 21 basis points: twice the pre-crisis level. Asset purchases by central banks initially improved liquidity, but subsequently, as they buy and hold bonds to maturity, the bonds become scarcer, which could explain why the improvement in liquidity could remain capped in the medium-term.

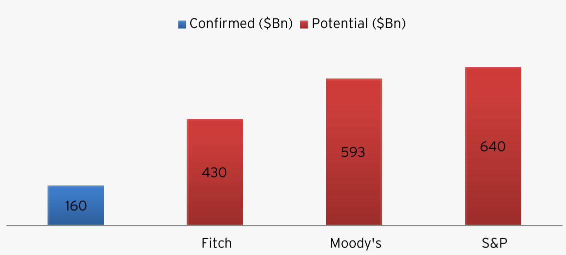
CSPP cumulative purchases



Source: ICMA analysis using ECB data

Fallen angels: Credit rating agencies have reacted promptly to the COVID-19 crisis, already downgrading $160 billion worth of bonds from investment grade to speculative grade during the first half of 2020. But this could only be the tip of the iceberg according to estimates (see Figure 3). If fallen angels usually present good opportunities for HY fund managers, they can potentially trigger forced sales and the realization of losses for funds or mandates, which are exclusively supposed to hold IG bonds. In reality, IG fund managers try to avoid this scenario, if it is in the best interest of investors and if they believe the bond in question is still in line with their strategy. Likewise, IG ETFs providers are not automatically forced sellers as fund prospectuses can allow them to hold a portion of out-of-index securities. Active and passive IG bond fund managers have therefore room for manoeuvre to handle fallen angels, provided that downgrades are done gradually and are not ballooning. ESMA, which supervises directly credit rating agencies, has already recommended the need to be mindful of the "timing between taking into account the increased risks of poorer credit quality and not acting pro-cyclically". Many other elements will need to be considered by credit rating agencies, including central bank measures and sectorial support programmes announced by governments, which may limit or smoothen the materialization of fallen angels by the end of the year. The Fed is buying junk bonds, so long as they were deemed investment grade on 22 March, offering a lifeline to riskier credit markets. Furthermore, the ECB is accepting corporate bonds that have been downgraded by ratings agencies to speculative grade since 7 April as collateral and is not required to sell its holdings in the event of a downgrade below the IG credit quality rating.

Figure 3: Fallen angels 2020



Policy observations

If central banks and government policy measures were instrumental in stabilizing markets, this crisis also highlights the resilience of European bond funds in a very difficult context:

- Despite the redemption shock (equivalent to 5-6% of total NAV of US and UCITS bond funds), the significant deterioration of market liquidity and operational constraints (home working), the vast majority of bond funds were able to meet redemption requests and operate.
- When available, the use of Liquidity Management Tools (LMT). such as swing pricing, temporary gates, anti-dilution levies, contributed to absorb the redemption shock and limited impact on asset prices by encouraging investors to stay in the fund.
- Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA), suggested in early April on Reuters that, looking across all asset classes, less than 0.7% of AUM of EU domiciled investment funds were subject to either redemption halts or LMT.
- Looking specifically at bond funds, it was estimated that only 30 bond funds with €11 billion of AUM had temporarily to suspend dealings. The majority of suspensions were driven by issues in pricing of HY corporate bonds. It also mostly involved bond funds managed from Denmark, where funds have to price several times throughout the day, or from Sweden, where LMTs are not available.

In light of the above and following our January 2020 report on fund liquidity, AMIC continues to encourage policy makers to make LMT available at global and European level and to support the call emanating from other ICMA constituencies to reconsider the implementation of regulatory provisions which could be detrimental to market liquidity and bond fund liquidity such as the mandatory buy-in regime under CSDR.

We are pleased to see that: (1) the crisis has already contributed to accelerate the adoption of LMT tools in jurisdiction where they were not yet available (e.g. Germany); (2) some national supervisors have encouraged and facilitated the use of LMT, which proved again to be very helpful to tackle redemption shocks; and (3) that efficiency of these tools were once again recognised by the ESRB on 14 May: "management tools available to fund managers can help to mitigate first-mover advantage dynamics and the risk of asset fire sale".

Finally, AMIC welcomes the intensified dialogue between policy makers and asset managers since the beginning of the crisis. This allowed supervisors to monitor fund liquidity continuously, while flexing the deadlines of

> **We would welcome further flexibility when it comes to upcoming implementation deadlines such a the Liquidity Stress Test guidelines.**

some reporting and prudential rules in order to prioritize business continuity and the orderly functioning of capital markets. Given that established dialogue and as much of the resource (frontline traders and risk managers, IT, operations, policy, legal, compliance and management) that would normally have been devoted to implementing legislation in the near term was fully deployed in fighting the crisis and not available, we would welcome further flexibility when it comes to upcoming implementation deadlines such as the Liquidity Stress Test guidelines due for September 2020.

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Summary of AMIC activities in the second quarter

ICMA's Asset Management and Investors Council (AMIC) work related to COVID-19:

- AMIC has published a COVID-19 regulatory grid, which provides an overview of policy measures related to the buy-side taken by several European securities regulators in the context of the global pandemic. The document is regularly updated.
- AMIC has published a series of weekly podcasts in which Bob Parker, Chair of AMIC, reviews market events in the context of the COVID-19 pandemic, with a specific focus on central bank policy measures, economic data and investors positioning. AMIC also published a podcast on the impact of COVID 19 on the covered bond markets on 2 July.
- AMIC ExCom met on 9 June to discuss among others the impact of COVID-19 from a fund liquidity perspective.
- AMIC held on 18 June a virtual event on the *First Lessons of the COVID-19 Crisis for the Asset Management Industry.* Panellists took stock of recent market events and responses in the context of the global pandemic and explored in particular the resilience and weaknesses revealed by this crisis, the responses by policy makers, and the investment outlook for 2020-2021.

AMIC Sustainable Finance Working Group met on several occasions to prepare responses to key consultations:

- *Consultation on the EU Ecolabel:* AMIC published on 17 April its response to the European Commission consultation on the EU Ecolabel for financial products. While AMIC supports the idea of a quality stamp for ESG retail investment funds, it also warns that some important changes are required to ensure the success of this new label. In particular, AMIC recommends broadening the list of eligible assets for diversification purposes, and also to further support companies transitioning to a lower-carbon business model.
- *NFRD review consultation:* ICMA submitted on 11 June its response to the NFRD review consultation. Both ICMA's Corporate Issuer Forum and AMIC support the review of NFRD, which provides the opportunity to achieve a greater level of standardisation of ESG disclosures by issuers, a perequisite to deliver on the EU sustainable finance action plan and allow buy-side members to comply with their new disclosure requirements under SFDR.
- *The integration of sustainability risks in UCITS, AIFs, investment firms (MiFID II/R) and product governance:* AMIC published on 6 July its response. While AMIC supports the integration of sustainability risks as part of risk management policies, it is opposed to other amendments singling out this risk in several general articles. AMIC also calls the European Commission to use this legislative vehicle to clarify that the assessment of sustainability risks could be done on a qualitative basis given that there is, at this stage, no standardized methodology nor reliable data to anticipate the potential impact of these risks on the performance of investment funds. Finally, AMIC urged the Commission not to use the retail distribution rules to restrict access to ESG products.
- *European Commission's Renewed Sustainable Finance Strategy*: AMIC intends to contribute to ICMA's response by covering several policy options considered by the

Commission, including among others: disclosure of portfolio's temperature scenario, investor engagement and divestment, distribution rules.

- *Draft technical standards of the Disclosure Regulation:* According to the Disclosure Regulation, asset managers will have to disclose their ESG footprint at company and fund levels. The implementing measures proposed by the ESAs would require asset managers to consider 32 indicators at company level and up to 50 indicators at fund level when reporting on their ESG footprint. These indicators would need to be reviewed by sustainable investments when assessing the "Do Not Significant Harm" (DNSH) objective, as foreseen under the Disclosure Regulation. The AMIC response is in progress and due to be published on 1 September.

AMIC Risk management Working Group met on April 9 to discuss the impact of COVID-19 and consider responses to key consultations:

- *ESMA guidelines on leverage:* The consultation is part of the ESMA response to the recommendations of the European Systemic Risk Board (ESRB) in April 2018 to address liquidity and leverage risk in investment funds. It proposes a series of indicators (eg risks of market impact, fire sale, contagion to other institutions, disruption of credit intermediation) to be considered when NCAs assess on a quarterly basis leverage-related systemic risk in funds. The second part of the guidelines proposes to set some high-level principles for NCAs when considering imposing leverage limits (eg effectiveness, procyclicality). An AMIC response is in progress and is due to be published on 1 September.
- *ESMA call for evidence on availability and use of credit rating information and data*: The purpose of this call for evidence is to gather information on the specific uses of credit ratings as well as how the users of credit ratings are currently accessing this information. AMIC is planning to issue a response on 15 August.

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FinTech in International Capital Markets

by Gabriel Callsen and Rowan Varrall

FinTech regulatory developments in the second quarter

IOSCO: consultation on AI/ML guidance for market intermediaries and asset managers

On 25 June 2020, IOSCO issued a consultation report on *The Use of Artificial Intelligence and Machine Learning by Market Intermediaries and Asset Managers*. The use of these technologies may benefit firms and investors, such as by increasing execution speed and reducing the cost of investment services. However, it may also create or amplify risks, potentially undermining financial market efficiency and causing harm to consumers and other market participants. In 2019, the IOSCO Board identified AI and ML as an important priority. The report proposes six measures to assist IOSCO members in creating appropriate regulatory frameworks to supervise market intermediaries and asset managers that use AI and ML. The deadline for responses is 26 October 2020.

BIS: central banks and payments in the digital era

On 24 June 2020, the BIS published a special chapter on *Central Banks and Payments in the Digital Era* of its Annual Report. Central banks play a pivotal role in maintaining the safety and integrity of the payment system. They provide the solid foundation by acting as guardians of the stability of money and payments. The pandemic and resulting strain on economic activity around the world have confirmed the importance of central banks in payments. Digital innovation is radically reshaping the provision of payment services. Central banks are embracing this innovation. They promote interoperability, support competition and innovation, and operate public infrastructures - all essential for easily accessible, low-cost and high-quality payment services. Central banks, as critical as ever in the digital era, can themselves innovate. In particular, central bank digital currencies (CBDCs) can foster competition among private sector intermediaries, set high standards for safety and risk management, and serve as a basis for sound innovation in payments.

ESMA: consultation on draft guidelines on outsourcing to cloud service providers

On 3 June 2020, ESMA published its consultation paper on *Guidelines on Outsourcing to Cloud Service Providers*. The purpose of these draft guidelines is to provide guidance on the outsourcing requirements applicable to firms where they outsource to cloud service providers. These draft guidelines are intended to help firms identify, address and monitor the risks that may arise from their cloud outsourcing arrangements (from making the decision to outsource, selecting a cloud service provider, monitoring outsourced activities to providing for exit strategies). The deadline for responses is 1 September 2020. ESMA aims to publish the Final Report on the Guidelines by Q1 2021.

IOSCO: consultation on outsourcing principles to ensure operational resilience

On 28 May 2020, IOSCO launched a consultation on *Outsourcing Principles to Ensure Operational Resilience*. IOSCO prepared this report before the COVID-19 outbreak. However, on 8 April 2020, the IOSCO Board agreed to delay publication of its reports to allow firms and financial institutions to redirect their resources to focus on the challenges arising from the pandemic. As the initial stages of this crisis pass, the IOSCO Board has decided to publish this report now because the outbreak of COVID-19 has highlighted the need to ensure resilience in operational

The BIS Innovation Hub and the Saudi G20 Presidency have published high-priority RegTech/SupTech operational problems and invite private firms to develop innovative technological solutions.

activities and to maintain business continuity in situations where both external and often unforeseen shocks impact both firms and their service providers. The consultation period will end on 1 October 2020.

ECB: a regulatory and financial stability perspective on global stablecoins

On 5 May 2020, the ECB published its Macroprudential Bulletin (Issue 10) on *A Regulatory and Financial Stability Perspective on Global Stablecoins*. Stablecoins with the potential for global reach ("global stablecoins") could help to address unmet consumer demand for payment services that are fast, cheap and easy to use and can operate across borders. Stablecoins provide an alternative to volatile crypto-assets. Depending on their asset management function, they may fall under different regulatory regimes or – with certain design features – under none at all. Given their potential size, global stablecoins could pose risks to financial stability. Such arrangements need a robust regulatory framework.

Saudi G20 Presidency and BIS: launch of G20 TechSprint Initiative

On 29 April 2020, the Saudi G20 Presidency and BIS Innovation Hub launched the G20 TechSprint initiative to highlight the potential for new technologies to resolve regulatory compliance (RegTech) and supervision (SupTech) challenges. The BIS Innovation Hub, through its Singapore Centre, and the Saudi G20 Presidency have published high-priority RegTech/SupTech operational problems and invite private firms to develop innovative technological solutions. The problem statements identify challenges in regulatory reporting, analytics, and monitoring and supervision, and have been developed from submissions received from Financial Stability Board (FSB) member jurisdictions. Selected participants will be invited to present their proposals in a virtual TechSprint Touchpoint workshop for national authorities and other stakeholders in July 2020.

World Bank: how regulators respond to FinTech: evaluating the different approaches – sandboxes and beyond

On 24 April 2020, the World Bank published the paper *How Regulators Respond To FinTech: Evaluating the Different Approaches – Sandboxes and Beyond*. This paper provides an overview of different regulatory approaches to FinTech and provides guidance for policymakers to understand the benefits and limitations of each. While some FinTech activities can often be covered within existing regulatory frameworks, the majority of jurisdictions are taking or planning to take additional regulatory measures to respond to emerging FinTech services, the scope and scale of which vary substantially including new laws, Innovation Offices, Regulatory Sandboxes and even reskilling to respond to transforming environment. The report provides context on the relative appropriateness of each approach within jurisdictions, including relevant variables for consideration, and uses country case studies where appropriate to showcase and enable policy makers to draw from lessons learned across the globe.

World Bank: how countries can expand access to digital financial services

On 22 April 2020, the World Bank released a *report on Digital Financial Services*. Powered by FinTech, digital financial services have the potential to lower costs by maximizing economies of scale, to increase the speed, security and transparency of transactions and to allow for more tailored financial services that serve the poor. This report describes the tools of digital finance, the successful business models and policies for encouraging their growth. It explores risks and challenges of new types of services and the legal and regulatory frameworks needed for confronting them. Finally, it includes country experiences with promoting the expansion of digital financial services and the obstacles along the way.

FSB: consultation on effective practices for cyber incident response and recovery

On 20 April 2020, the FSB published a consultation report on *Effective Practices for Cyber Incident Response and Recovery*. The toolkit of effective practices aims to assist financial institutions in their cyber incident response and recovery activities. Cyber incidents pose a threat to the stability of the global financial system. In recent years, there have been a number of major cyber incidents that have significantly impacted financial institutions and the ecosystems in which they operate. A major cyber incident, if not properly contained, could seriously disrupt financial systems, including critical financial infrastructure, leading to broader financial stability implications. The toolkit lists 46 effective practices, structured across seven components: governance, preparation, analysis, mitigation, restoration, improvement, coordination and communication. The deadline for responses is 20 July 2020.

BIS-IFC: computing platforms for big data analytics and artificial intelligence

In April 2020, the Irving Fisher Committee on Central Bank Statistics published a report on *Computing Platforms for Big Data Analytics and Artificial Intelligence*. Public authorities, and central banks in particular, are increasingly realising the potential of big data sets and analytics – with the development of artificial intelligence (AI) and machine learning (ML) techniques – to provide new, complementary statistical information (Hammer et al (2017)). Yet the question remains: how should institutions organise themselves to benefit the most from these opportunities? Two areas appear particularly important for central banks. The first is how to organise their statistical information in relation to their IT infrastructure. The second is to think strategically as to how to use appropriate techniques to further process and analyse the new information collected.

FSB: consultation on regulatory, supervisory and oversight recommendations for "global stablecoin" arrangements

On 14 April 2020, the FSB published for consultation *10 High-Level Recommendations to Address the Regulatory, Supervisory and Oversight Challenges raised by Global Stablecoin Arrangements*. So-called "stablecoins", like other crypto-assets, have the potential to enhance the efficiency of the provision of financial services, but may also generate risks to financial stability. The activities associated with "global stablecoins" and the risks they may pose can span across banking, payments and securities/ investment regulatory regimes both within jurisdictions and across borders. These potential risks may change over time, and so challenge the effectiveness of existing regulatory, supervisory and oversight approaches. Ensuring the appropriate regulatory approach within jurisdictions across sectors and borders will therefore be important. The deadline for responses is 15 July 2020.

FSB: enhancing cross-border payments - stage 1 report to the G20

On 9 April 2020, the FSB released the *Stage 1 Report of the FSB's Project to Develop a Roadmap to Enhance Cross-Border Payments.* Enhancing cross-border payments is a G20 priority during the Saudi Arabian Presidency. Faster, cheaper, more transparent and more inclusive cross-border payment services, including remittances, would have widespread benefits for citizens and economies worldwide, supporting economic growth, international trade, global development and financial inclusion. Enhancing cross-border payments requires addressing frictions in existing cross-border payment processes. These frictions include: fragmented data standards or lack of interoperability; complexities in meeting compliance requirements, including for anti-money laundering and countering the financing of terrorism (AML/ CFT), and data protection purposes; different operating hours across different time zones; and outdated legacy technology platforms.

CPMI/WB: payment aspects of financial inclusion in the FinTech era

On 9 April 2020, the Committee on Payments and Market Infrastructures (CPMI) and the World Bank released the report *Payment Aspects of Financial Inclusion in the FinTech Era*. The report builds on the guidance on Payment aspects of financial inclusion (PAFI), issued by the CPMI and the World Bank in 2016. The new report shows that FinTech can be used to underpin access and usage of transaction accounts. Yet it is not without challenges, and if risks are not properly managed, they can undermine financial inclusion. Payment aspects of financial inclusion in the FinTech era sets out key actions, helping the relevant stakeholders to strike the right balance between increasing efficiency and ensuring safety.

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ICMA FinTech Advisory Committee

ICMA's FinTech Advisory Committee (FinAC) held its third virtual meeting on 26 May 2020. Given that regulation plays an important part in driving standardisation and electronification in capital markets, a focus of the meeting was on regulatory developments at global level. The FSB Secretariat presented some of the latest aspects of the FSB's work in relation to FinTech, notably implications of BigTech in finance, the use of RegTech and SupTech, as well as the potential implications of COVID-19.

Electronification in both primary bond markets and repo markets is evolving rapidly. Building on the discussions in previous meetings on data standards and electronic messaging protocols, FinAC members led a discussion on trends, new initiatives and electronification within each area. The purpose was to share views on latest developments, identify gaps in terms of straight-through-processing (STP) and common standards, as well as potential common threads between primary and repo markets.

From an investor's perspective, new issue processes generally remain relatively manual and repetitive. There are a small number of incumbent technology providers and a large number of small players lacking critical mass who target different pain points of investors, issuers, and underwriters. ICMA's primary markets technology mapping directory provides a useful overview of currently over 30 technology solutions for a range of different functions in the debt issuance process.

Current challenges for investors include, for instance, the limited use of machine-readable deal announcement terms. ICMA's template, which was released in December 2019, has generally improved completeness but does not envisage machine-readability. Efficiency could further be increased if ISINs for new bonds were created more rapidly, which is a topic ICMA continues to address with the ICSDs. Accessing bond prospectuses and relevant documentation on the website of issuers, regulators or exchanges can also be a time-consuming process, which is further discussed in the article *Finding Prospectus Information Online* in this Quarterly Report.

In repo markets in Europe, electronic trading has grown significantly since its introduction two decades ago. Generally, electronic execution has increased in less complex inter-dealer transactions ie short-term, moderate trade sizes, and plain vanilla government bond collateral. Cost and access to CCP clearing were major drivers. Dealer-to-dealer (D2D) platforms have recently expanded to include request-for-quote (RFQ) functionality which allows for negotiation. Complaints about slow take-up of electronic trading tend to refer to dealer-to-client (D2C) transactions.

Electronic D2D repo trading benefits from almost full STP, except for confirmations of general collateral allocation and CCP novations which require a manual step. As regards electronic D2C trading venues, one of the obstacles to STP is limited automation of collateral management to support tri-party agents, in addition to the more fundamental challenge of constructing widely accepted standard collateral baskets.

Reporting requirements under SFTR have arguably been a key driver of electronification in terms of workflow and communication, which accelerates cost pressures and facilitates greater STP but may not increase electronic execution. In light of diverse communication channels and messaging protocols, the Common Domain Model (CDM) can play an important role as a universal standard and enabler of interoperability. Further information on ICMA's collaboration with ISDA to extend the CDM to repos and bond markets can be found on ICMA's dedicated CDM webpage.

The COVID-19 pandemic and the resulting shift towards working from home has posed obvious challenges for market participants, for example in terms of connectivity but also in terms of compliance, surveillance and privacy. Implementing change seemed to be more challenging given reduced physical interaction, but conditions under COVID-19 can also be a catalyst for innovation, for example, to promote the use of digital signatures.

Further background on the current composition of the FinAC and its mission statement is available on ICMA's dedicated FinTech webpage.

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A new digital finance strategy for Europe

On 25 June 2020, ICMA submitted its response to the European Commission's consultation on a new digital finance strategy for Europe/FinTech Action Plan, notably to questions on the use of identifiers (LEI, UTI, UPI), access to publicly available financial and supervisory data, areas for AI-applications in the financial sector, and standardising concept definitions and reporting obligations. The detailed response is available on ICMA's website.

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FinTech webinar for Asia-Pacific

On 24 April 2020, ICMA held a webinar on *FinTech Developments in the Debt Capital Markets and Potential Implications for Asia Pacific*, which was attended by over 100 participants. Building on ICMA's research on FinTech and electronification, the topics addressed include ICMA's current engagement on FinTech, the evolving landscape in primary, secondary, repo and collateral markets, as well as DLT-related regulatory guidance. The recording and the presentation can be accessed from the ICMA website.

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Revised FinTech mapping directory

ICMA has conducted a review of its FinTech mapping directory covering technology solutions for repo and cash bond operations. The directory now includes over 160 solutions, compared to 130 solutions last year and 87 solutions when it was first launched in November 2017. It is divided into 10 categories comprising collateral management, corporate actions, exposure agreement, intraday liquidity monitoring and reporting, matching, confirmation & allocation, reconciliations but also ancillary areas such as static data and SSI, workflow and communication and KYC onboarding.

ICMA has launched a new FinTech Newsletter focusing on our work from a FinTech and market electronification perspective.

There has been a marked increase in the number of solutions listed, though only a minority represent new entrants or firms not previously listed. The majority of new solutions originate from known providers extending their services across other market segments. The review shows an increased focus on matching, confirmation & allocation (6 additions), collateral lifecycle management, exposure agreements and reconciliation services (4 additions each). Ancillary categories such as workflow & communication have also seen an increase in diverse tools to manage operational and legal processes (8 additions).

To make the directory more user friendly, the latest revision includes a brief "at a glance" tab which provides an overview of listed solutions and helps filter each category.

The mapping directory does not constitute an exhaustive list of providers in the market. Relevant providers that are not yet covered by the mapping directory and wish to join are very welcome to do so.

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Updates to DLT regulatory directory

ICMA has updated its DLT regulatory directory with several new regulatory and legislative developments, national blockchain initiatives, publications and consultation papers. The directory was initially published in December 2019 and seeks to provide a non-exhaustive overview of recent DLT regulatory guidance, legislative initiatives, as well as related strategy papers and publications in selected jurisdictions across Europe, North America, and Asia-Pacific.

Notable additions include: the introduction of H.R.6938 (19 May 2020) in the US House of Representatives requiring the Secretary of Commerce and the Federal Trade Commission to conduct a study on blockchain technology; the official launch of China's Blockchain Service Network (BSN) initiative (25 April 2020); AMF's publication of Position DOC-2020-02 (6 March 2020) on market infrastructure; clarifications regarding the notion of trading venue, applicable in particular to financial instruments registered in a distributed ledger; and the release of Australia's Department of Industry, Science, Energy and Resources National blockchain roadmap (February 2020).

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Inaugural FinTech newsletter

ICMA has launched a new *FinTech Newsletter* focusing on our work from a FinTech and market electronification perspective. We intend to bring our members up to speed on the cross-cutting technology initiatives across our key market areas and provide insights into regulatory updates, consultation papers, news and other publications, and upcoming meetings and events. It is to be published on a 4-6 weekly basis, depending on content load. The first edition of the newsletter was launched on 2 June 2020.

To receive future editions of this newsletter, please subscribe or update your mailing preferences and select FinTech, or contact us at FinTech@icmagroup.org.

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ICMA Capital Market Research

ICMA SMPC Market Report: The European Investment Grade Corporate Bond Secondary Market and the COVID-19 Crisis
Published: 28 May 2020
Author: Andy Hill, ICMA

Sustainable Finance: High-Level Definitions
Published: 11 May 2020
Author: Simone Utermarck, ICMA

EU Consolidated Tape for Bond Markets: Final Report for the European Commission
Published: 29 April 2020
Author: Elizabeth Callaghan, ICMA

ICMA ERCC market report: The European Repo Market and the COVID-19 Crisis
Published: 21 April 2020
Author: Andy Hill, ICMA

Time to Act: ICMA's Third Study into the State and Evolution of the European Investment Grade Corporate Bond Secondary Market
Published: 4 March 2020
Author: Andy Hill, ICMA

A Quick Guide to the Transition to Risk-Free Rates in the International Bond Market
Published: 24 February 2020
Author: Charlotte Bellamy and Katie Kelly, ICMA

Sustainable Finance: Compendium of International Policy Initiatives and Best Market Practice
Published: 20 February 2020
Author: Nicholas Pfaff, ICMA

Managing Fund Liquidity Risk in Europe: Recent Regulatory Enhancements and Proposals for Further Improvements
Published: 22 January 2020 (update to the original 2016 report)
Authors: ICMA/EFAMA Joint Report

ICMA ERCC Briefing Note: The European Repo Market at 2019 Year-End
Published: 14 January 2020
Author: Andy Hill, ICMA

MiFID II/R and the Bond Markets: The Second Year
Published: 20 December 2019
Author: Gabriel Callsen, ICMA

ICMA Impact Study: Mandatory Buy-Ins under CSDR and the European Bond Markets
Published: 27 November 2019
Author: Andy Hill, ICMA

ICMA Briefing: The Importance of Integrated Capital Markets and CMU
Published: 29 July 2019
Author: David Hiscock, ICMA

A Comparative Review of Practices and Procedures in the Russian and International Primary Debt Capital Markets
Published: 5 June 2019
Authors: ICMA/NFA Joint Report

ICMA ERCC Briefing Note: The European Repo market at 2018 Year-End
Published: 15 January 2019
Author: Andy Hill, ICMA

ICMA AMIC/EFAMA Report on Liquidity Stress Tests in Investment Funds 2019
Published: 8 January 2019
Authors: ICMA/EFAMA Joint Report

We will shortly be launching our virtual events programme for the second half of 2020 visit events/icmagroup.org for regular updates.

A range of interactive virtual events and webinars across the full range of our activities are available on demand to view online now. Some of the most popular are listed here.

ICMA Asset Management and Investors Council (AMIC): First lessons of the COVID-19 crisis for the asset management industry

Speakers take stock of recent market events and responses in the context of the global pandemic and explore in particular the resilience and weaknesses revealed by this crisis; the responses from European supervisors and central banks; as well as the investment outlook for 2020-2021.


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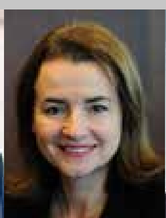
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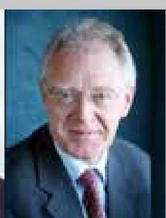
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01. Massimiliano Castelli, UBS / **02. Joanna Cound,** Blackrock / **03. Christian Kopf,** Union Investment / **04. Robert Parker,** Chairman of AMIC /

Transition to risk-free rates - An official sector panel discussion

This webinar recorded on June 25 presents a unique opportunity to hear from the European Central Bank, the European Investment Bank, the Financial Conduct Authority, the Federal Reserve Bank of New York and the Swiss National Bank about progress on the transition away from LIBOR and other IBORs and towards risk-free reference rates, with a focus on the international bond market.


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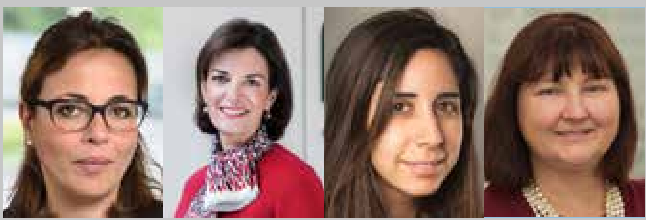
01. Paul Richards, Managing Director, Head of Market Practice and Regulatory Policy ICMA (Moderator) / **02. Edwin Schooling Latter,** Director of Markets and Wholesale Policy, UK Financial Conduct Authority / **03. Nathaniel Wuerffel,** Head of Domestic Markets, Markets Group Federal Reserve Bank of New York / **04. Cornelia Holthausen,** Deputy Director, General Directorate, General Market Operations, European Central Bank / **05. Roman Baumann,** Head of Money Market, Swiss National Bank / **06. Bertrand de Mazières,** Director General Finance, European Investment Bank

Key deliverables from the Green and Social Bond Principles AGM 2020

Following the Green Bond Principles (GBP) and Social Bond Principles (SBP) Annual General Meeting, members of its executive committee and working groups presented to the wider market the key deliverables that were recently announced, namely the new Sustainability-Linked Bond Principles and the updated Social Bond Principles, as well as report on the status of the work on climate transition finance.



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01. Orith Azoulay, Natixis / **02. Julie Becker,** Luxembourg Stock Exchange / **03. Farnam Bidgoli** HSBC Bank / **04. Marilyn Ceci,** JP Morgan / **05. Tanguy Claquin,** Crédit Agricole CIB / **06. Lars Eibeholm,** Nordic Investment Bank / **07. Christopher Flensborg,** SEB / **08. Johanna Köb,** Zurich Insurance / **09. Denise Odaro,** International Finance Corporation / **10. Paul O'Connor,** JP Morgan / **11. Nicholas Pfaff,** ICMA / **12. Martin Scheck,** ICMA / **13. Francesca Suarez,** Mirova / **14. Yo Takatsuki,** AXA Investment Managers / **15. Isabelle Vic-Philippe,** Amundi

Sponsored by LUXEMBOURG GREEN EXCHANGE

The impact of COVID-19 on the debt capital markets in South Africa

Starting with a brief overview of the state of the economy before the COVID-19 crisis, this webinar considers the effect of the pandemic on the debt capital markets in South Africa. Speakers include:

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01. Katie Kelly, ICMA (Moderator) / **02. Robyn MacLennan,** Standard Bank Group / **03. Bruce Stewart,** Nedbank CIB / **04. Monwabisi Zukani,** The Standard Bank of South Africa Limited

Creating an EU Bond Consolidated Tape - a conversation

Following the publication ICMA's in depth report on the issues around creating a EU consolidated tape for bond markets, produced in response to a request from the European Commission, ICMA hosted an interactive virtual discussion with senior market participants to hear their views on this industry led initiative.

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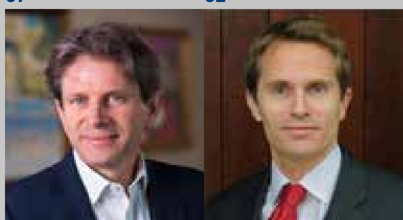

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01. Eric Boess, Allianz Global Investors / **02. Elizabeth Callaghan,** ICMA / **03. Liz Carter,** Tradeweb / **04. Stephane Malrait,** ING / **05. Daniel Mayston,** Blackrock

ICMA Podcast

The ICMA Podcast series has over 80 episodes under its belt on a full range of current topics, from tips on working from home to the effect of the COVID-19 crisis on all aspects of market activity. With 4 new episodes released each week during the height of the crisis, there have been almost 30,000 downloads of the podcast already.

Beatriz Martin, Global Chief Operating Officer, UBS Investment Bank and UK Chief Executive shares how UBS IB fared during the pandemic. COVID-19 crisis – the view from UBS

Christophe Roupie, CEO of EMEA and APAC at MarketAxess on electronic trading platforms and how they have coped during the COVID-19 crisis. Electronic trading, performance during the crisis and future developments

As Clearstream celebrates 50 years in the market, Arnaud Delestienne, Head of Eurobonds Business, speaks to ICMA about its role in the value chain as a major global ICSD. Perspectives from a global ICSD on COVID-19 and changing markets

Kalin Anev Janse, Chief Financial Officer and Member of the Management Board of the European Stability Mechanism (ESM) on the ESM Pandemic Crisis Support, a credit line for the 19 countries of the eurozone, representing up to €240 billion of assistance covering direct and indirect health costs. The ESM's Pandemic Crisis Support

Amy Clarke, CEO of Tribe Impact Capital, is interviewed by ICMA's Lisa Cleary about whether the momentum behind Gender Lens Investing has been slowed by the market impact of COVID-19 in Impact investing is just good investing – has COVID-19 changed market sentiment?

Each week Bob Parker of the ICMA Asset Management and Investors Council shares his views on the current state of the market in the COVID-19 AMIC weekly market update.

Follow our podcast channel or listen on your podcast provider (iTunes, Spotify and Podbean) – search "ICMA Podcast".

ICMA Education

In May this year, we made the difficult decision to cancel our entire public schedule of classroom-based courses, as well as postpone all face to face in-house training until 2021. While scary at the time, this has also presented us with an incredible opportunity to think about what a new normal might look like from a training perspective.

Over the course of the pandemic, ICMA Education has focused on three things: the creation of a digital infrastructure that enables us to deliver training anywhere, at any time, to (virtually) anyone; the development of series of self-study and livestream online courses that continue to provide benchmark training courses for professionals in capital markets; and the accreditation of our portfolio of courses by CPD to further the professional development requirements of our delegates.

Self-Study Online Courses

ICMA Education now offers four assessed self-study foundation-level courses that cover the fundamentals of the capital markets - the Financial Markets Foundation Qualification ; Introduction to Primary Markets Qualification ; Introduction to Bond Markets Qualification ; and the Securities Operations Foundation Qualification. We also over the advanced level Fixed Income Certificate as a self-study option - recently named as number three in *Qualifications that will get you a banking job after lockdown* in eFinancial Careers - and will be releasing the Introduction to Sustainable Bonds workshop as a fully self-study online in October.

Livestream Online Courses

From July to December, ICMA is planning to run a portfolio of workshops and Executive Education courses that cover the full range of ICMA training. Courses will be delivered over Zoom using interactive instructional approaches that ensure all delegates are active participants and not simply casual observers. Training will be delivered in three hour sessions a few times a week, and courses will range from two consecutive mornings (for example the Introduction to Sustainable Bonds course on 23 + 24 July) to over a month (for example the Operations Certificate Programme). Registration will be restricted to a maximum of 20 delegates and they will be hosted by our regular ICMA trainers. Virtual delivery of our courses will not simply be a temporary measure either - we anticipate continuing to offer this format of training as a regular service into 2021 and beyond.

To ensure we continue offering our delegates the experience they have come to expect, all workshops and executive education courses will be hosted from our digital learning platform Canvas. In addition to the advanced functionality of this platform, we have added a whole host of supplementary resources designed to support your training and wider industry knowledge. We also offer fully online assessments with live invigilation plus digital certification that provides verifiable, trustworthy credentials for all eligible delegates.

***ICMA Education** - the training provider for professionals in capital markets.*

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
ADB	Asian Development Bank
AFME	Association for Financial Markets in Europe
AI	Artificial Intelligence
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
AMI-SeCo	Advisory Group on Market Infrastructure for Securities and Collateral
APA	Approved publication arrangements
APP	ECB Asset Purchase Programme
ASEAN	Association of Southeast Asian Nations
AUM	Assets under management
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BMCG	ECB Bond Market Contact Group
BMR	EU Benchmarks Regulation
bp	Basis points
BRRD	Bank Recovery and Resolution Directive
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CFTC	US Commodity Futures Trading Commission
CGFS	Committee on the Global Financial System
CICF	Collateral Initiatives Coordination Forum
CIF	ICMA Corporate Issuer Forum
CMU	Capital Markets Union
CNAV	Constant net asset value
CoCo	Contingent convertible
COP21	Paris Climate Conference
COREPER	Committee of Permanent Representatives (in the EU)
CPMI	Committee on Payments and Market Infrastructures
CPSS	Committee on Payments and Settlement Systems
CRA	Credit rating agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
CSDR	Central Securities Depositories Regulation
DCM	Debt Capital Markets
DLT	Distributed ledger technology
DMO	Debt Management Office
D-SIBs	Domestic systemically important banks
DVP	Delivery-versus-payment
EACH	European Association of CCP Clearing Houses
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Redevelopment
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
ECPC	ICMA Euro Commercial Paper Committee
EDDI	European Distribution of Debt Instruments
EDGAR	US Electronic Data Gathering, Analysis and Retrieval
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Financial Stability Facility
EFSI	European Fund for Strategic Investment
EFTA	European Free Trade Area
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ELTIFs	European Long-Term Investment Funds
EMDE	Emerging market and developing economies
EMIR	European Market Infrastructure Regulation
EMTN	Euro Medium-Term Note
EMU	Economic and Monetary Union
EP	European Parliament
ERCC	ICMA European Repo and Collateral Council
ESAs	European Supervisory Authorities
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESG	Environmental, social and governance
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
ETP	Electronic trading platform
EU27	European Union minus the UK
ESTER	Euro Short-Term Rate
ETD	Exchange-traded derivatives
EURIBOR	Euro Interbank Offered Rate
Eurosystem	ECB and participating national central banks in the euro area
FAQ	Frequently Asked Question
FASB	Financial Accounting Standards Board
FATCA	US Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FCA	UK Financial Conduct Authority
FEMR	Fair and Effective Markets Review
FICC	Fixed income, currency and commodity markets
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FMSB	FICC Markets Standards Board
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FRTB	Fundamental Review of the Trading Book
FSB	Financial Stability Board
FSC	Financial Services Committee (of the EU)
FSOC	Financial Stability Oversight Council (of the US)
FTT	Financial Transaction Tax
G20	Group of Twenty
GBP	Green Bond Principles
GDP	Gross Domestic Product
GFMA	Global Financial Markets Association
GHOS	Group of Central Bank Governors and Heads of Supervision
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
G-SIIs	Global systemically important insurers
HFT	High frequency trading
HMRC	HM Revenue and Customs
HMT	HM Treasury
HQLA	High Quality Liquid Assets
HY	High yield
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IBA	ICE Benchmark Administration
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositaries
IFRS	International Financial Reporting Standards
IG	Investment grade
IIF	Institute of International Finance
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commissions
IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
ITS	Implementing Technical Standards
KfW	Kreditanstalt fur Wiederaufbau
KID	Key information document
KPI	Key performance indicator
LCR	Liquidity Coverage Ratio (or Requirement)
L&DC	ICMA Legal & Documentation Committee
LEI	Legal Entity Identifier
LIBOR	London Interbank Offered Rate
LTRO	Longer-Term Refinancing Operation
MAR	Market Abuse Regulation
MEP	Member of the European Parliament
MiFID	Markets in Financial Instruments Directive
MiFID II/R	Revision of MiFID (including MiFIR)
MiFIR	Markets in Financial Instruments Regulation
MMCG	ECB Money Market Contact Group
MMF	Money market fund
MOU	Memorandum of Understanding
MREL	Minimum requirement for own funds and eligible liabilities
MTF	Multilateral Trading Facility
NAFMII	National Association of Financial Market Institutional Investors
NAV	Net asset value
NCA	National competent authority
NCB	National central bank
NPL	Non-performing loan
NSFR	Net Stable Funding Ratio (or Requirement)
OAM	Officially Appointed Mechanism
OJ	Official Journal of the European Union
OMTs	Outright Monetary Transactions
ORB	London Stock Exchange Order book for Retail Bonds
OTC	Over-the-counter
OTF	Organised Trading Facility
PCS	Prime Collateralised Securities
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-Based Investment Products
PSEs	Public Sector Entities
PSI	Private Sector Involvement
PSIF	Public Sector Issuer Forum
QE	Quantitative easing
QIS	Quantitative impact study
QMV	Qualified majority voting
RFQ	Request for quote
RFRs	Near risk-free rates
RM	Regulated Market
RMB	Chinese renminbi
RPC	ICMA Regulatory Policy Committee
RSP	Retail structured products
RTS	Regulatory Technical Standards
RWA	Risk-weighted asset
SBBS	Sovereign bond-backed securities
SEC	US Securities and Exchange Commission
SFT	Securities financing transaction
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SMEs	Small and medium-sized enterprises
SMPC	ICMA Secondary Market Practices Committee
SMSG	Securities and Markets Stakeholder Group (of ESMA)
SARON	Swiss Average Rate Overnight
SOFR	Secured Overnight Financing Rate
SONIA	Sterling Overnight Index Average
SPV	Special purpose vehicle
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
STS	Simple, transparent and standardised
T+2	Trade date plus two business days
T2S	TARGET2-Securities
TD	EU Transparency Directive
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss-Absorbing Capacity
TMA	Trade matching and affirmation
TONA	Tokyo Overnight Average rate
TRs	Trade repositories
UKLA	UK Listing Authority
VNAV	Variable net asset value

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