

ICMA bond market policy mind map and ecosystem

Summary

This article summarises and explains ICMA's bond market mind map and ecosystem.

The tool illustrates a selection of major international policy developments with the aim of helping visualisation of the interconnectivity of policies and main actors in the bond market and the bond life cycle. It highlights some of the main themes and includes links for further educational reading.

The goal is to illustrate the bond market in a simplified way. It can serve a variety of purposes, such as an educational tool for introducing key technical terms; explaining the functioning of fixed income markets, its actors and the main policy initiatives that govern the activities and relationships among the players. It is furthermore a reference document, highlighting some of the key activities and initiatives in which ICMA is involved on behalf of its 630-plus members internationally, as well as an entry portal into further thought-leadership contributions and publications. It offers themes for engagement with policy makers and members, intended to prompt an exchange of views for them to learn more about the opinions and activities of ICMA stakeholders.



Part I. The ecosystem

I. 1. Bond life cycle

The graph at the centre describes the bond life cycle from issuance to settlement.

A bond is a financial debt instrument that allows investors (creditors) to allocate money (principal) to sovereigns and corporates (borrowers) so as to receive a fixed, or sometimes variable, return (interest income or coupon), over an agreed period of time (maturity or duration), after which the capital is returned to the investor. An equity, in contrast, represents a share of a company, either a publicly listed company following an (initial public offering) IPO on the stock exchange or a privately held company.

The bond issuance process is referred to as the primary markets, meaning the creation of a bond instrument. Depending on the issuer institution, it is identified as either a sovereign bond, if issued by a public sector agency, or government or a corporate bond, if issued by a private sector company or financial institution.

Once issued, the bond instrument can be traded, ie bought and sold on the secondary markets on an exchange, multi-lateral trading facility (MTF) or bilaterally. Repo and collateral activities are a core function to ensure liquidity in the markets as they allow market-makers to fund their long and short positions. Repos are repurchase agreements where one party sells an asset and commits to repurchase the same at a different price in the future. The asset therefore acts as collateral and mitigates the credit risk that the buyer has on the seller.

After trading, the bond is cleared either bilaterally or centrally, then settled within a depository, which together are referred to as post-trading activities. Clearing is the process of calculation of net obligations by the trading parties. In the bond market this takes place mostly bilaterally (over-the-counter, or OTC) or sometimes centrally. A central counterparty (CCP) is used, for example, for US Treasuries or other government bonds in the cash and repo markets, whereby the CCP becomes the seller to every buyer and buyer to every seller, a process referred to as novation. Settlement is the transfer of legal title from the seller to the buyer within a central securities depository (CSD) acting as the registry taking care of the asset safekeeping.

I. 2. Main market actors

The main players in the bond market are listed to the right of the lifecycle graph. The soft copy is interlinked with ICMA's member committees, leading to further information on the key topics. The actors access the value chain at different stages of the bond life cycle.

The value chain begins with the issuers. They can be either private sector corporates and financial institutions launching corporate bonds, or public sector issuers such as Sovereigns, Supranationals and Agencies (SSAs), such as the European Investment Bank (EIB), or governments acting through debt management offices (DMOs) or commercial and sovereign development banks (sovereign bonds). Governments and corporates issue debt to fund their projects, expansion and business needs, to raise capital from investors through non-bank financing, instead of using bank lending facilities.

Investors buy bonds either in the primary or secondary market. There are two basic types of investors, retail investors and institutional investors, which are referred to as the 'buy side'. There are a variety of institutional types in the private sector such as asset managers, traditional mutual funds, non-traditional or alternative hedge funds, pension funds, banks, insurance companies, as well as in the public sector like sovereign debt management offices (DMOs), central banks and Sovereign Wealth Funds (SWFs).

Intermediaries provide various enabling functions for issuers and investors, including the syndication, ie underwriting of bonds. They are referred to according to the services they offer and clients they serve, for example issuer agent banks, corporate investment banks (financing), syndicate banks (underwriting) etc. Broker-dealers and investment banks' key activities are trading in secondary markets representing the 'sell side'. Large financial institutions often offer a combination of these services along the value chain.

Intermediaries guide issuers in designing the parameters of the bond including deal size, bond price, yield, duration, risk grade etc. They have a network of investors and expert understanding of the market and its trends, hence are well placed to design issuer product supply so to match with investor demand through so called 'road shows', 'book building' and an auction process.

Market infrastructures, such as issuer platforms, trading venues, CCPs, CSDs and the ECB's T2S, act as central-type utilities, whereas the term intermediaries is used for actors that perform substitute-type activities. The two International Central Securities Depositories (ICSDs), differ from other Central Securities Depositories (CSDs) as they primarily support the international Eurobond market. Eurobonds can be denominated in any currency including US dollar or Japanese yen, not only the euro. They are sold internationally and named Eurobond after the first such issuance in Europe in 1963.

Vendors and service providers offer a range of services to the issuers and investors across various stages of the bond

life cycle. These include credit rating agencies (CRAs), data providers, vendor platforms, professional services firms specialised in law, accounting, auditing and consulting.

I. 3. Key policy themes

Policy developments and regulatory reform play a key role in this eco-system, as they represent a decisive factor in the design of financial products, their distribution to investors, market operations, and the interactions and relationships among market players overall in the ecosystem.

A selection of three key policy themes is outlined to the left of the bond life cycle, including resilience, efficiency, and competitiveness. These overarching objectives inform the design of regulatory initiatives. They address primarily the aim to 1) ensure the stability of the financial system and the safety of its individual actors, 2) design operationally sound and efficient market processes from an operational perspective, and 3) promote the financing of economic growth and the transition towards a circular economy through competitiveness initiatives.

I. 4. Legal & documentation

Voluntary international, standardised legal and documentation agreements increase the safety and soundness of the global bond market, encouraging all actors to adhere to the same terms and conditions within the ecosystem.

Part II. The mind map

The individual themes around the ecosystem are a selection of key developments impacting the global bond market.

II. 1. Market Practice and Regulatory Policy (MPRP)

On the left side of the chart, the dark blue box illustrates Market Practice and Regulatory Policy themes. The central diagram reflects the bond life-cycle process with a focus on issuance (primary markets), trading (secondary markets), repo and collateral, and post-trading (clearing and settlement) topics.

This includes the revitalisation of the securitisation market in primary markets, bond market transparency and liquidity in secondary markets and best practices in the repo and collateral market. Key themes include possible central clearing policies and the shortening of the settlement cycle to T+1.

Across the bottom, the chart illustrates two cross-cutting themes of

- FinTech and Digitalisation
- Sustainable Finance.

II. 2. FinTech and Digitalisation

FinTech and Digitalisation initiatives are illustrated at the bottom left in the red box under three categories:

- 1) regulatory initiatives, 2) standards and best practices, and 3) public policy

These include recent initiatives in topics such as in artificial intelligence (AI), bond data taxonomy (BDT) and digital bonds.

II. 3. Sustainable finance

Sustainable finance initiatives are illustrated at the bottom right in the green box comprising the same three categories of 1) regulatory initiatives, 2) standards and best practices, 3) public policy.

A small selection of the many initiatives in this area are highlighted, including a) the recent ESMA guidelines on fund names, b) the Green, Social, Sustainability & Sustainability-Linked Bond Principles; and c) global intra-governmental policy agreements.

II. 4. Strategic policy goals

Strategic policy goals are illustrated in the vertical light blue box at the right of the chart.

The focus here is on three aspects:

1) capacity building, 2) capital markets and asset management and 3) instruments and product types.

Capacity building is very broadly defined and comprises a wide range of initiatives, from building skills, networking and transferring knowledge from developed to frontier markets. The bond market has a key role in supporting economic growth globally by helping governments and supranational agencies raise capital to finance growth.

The optimal design of policy frameworks like the EU Capital Markets Union (CMU)/Savings and Investment Union (SIU) and a sound asset management framework are key to helping mobilise cash deposits into capital markets, as well as incentivising retail and institutional savings and investments into sustainable corporates and projects. Some basic product terminology supports the better understanding of the wider policy goals.

These strategic policy tools assist the achievement of macro-objectives.

In summary, the visual arrangements of the mind map are arranged so that:

- the left and bottom-left side of the chart focuses more on operational control, reliable and innovative technology and technical market functioning aspects, protecting market systems and its actors.
- the right and bottom-right side of the chart focuses more on strategic aspects, financing the economic transition and ways to stimulate economic growth.

The initiatives are however highly interlinked and not restricted to their individual boxes, for example:

- “sustainable repo” interrelates the repo initiatives with the sustainable finance agenda
- securitisation in the primary connects with asset management initiatives and capital markets objectives

within the CMU/SIU to revitalise economic growth through diversified sources of funding and risk transfer; there is also a working group on green securitisation interlinking it with sustainable finance

- sustainable finance is also believed to be accomplished more efficiently through FinTech and Digitalisation
- the capacity building initiatives are embedded across all activities on the mind map

II. 5 Data

At the centre of the smooth functioning of capital markets and achieving policy goals is obtaining and using accurate data. Data is a key driver of markets (liquidity, stability), products (pricing), players (resilience) and policy (business case for regulation).

In order to identify ‘the right data’ in the debt capital markets, highlighted by the diamond shaped graphic there are some important aspects to consider:

- integrity / quality.
- comparability / standardisation.
- consistent terminology / reference data.

II. 6 Professional training & investor education

The underlying foundation of all the above initiatives and objectives, however, rests on knowledge. Education empowers consumers, market actors and policy makers to achieve their financial goals, economic growth and market stability.

The yellow box at the foot of the chart shows ICMA Education and Training courses and certification for professionals across all bond market product areas.

On the right-hand side of the yellow box are some important investor education initiatives from a public policy perspective, with links to resources for financial literacy, bond issuers, and bond investors.

III. Conclusion

ICMA's bond market mind map and ecosystem provides a snapshot of some key features of the bond market. It does not purport to be complete, nor to provide legal or other advice, but rather it is aimed at inspiring discussion with stakeholders and members on policy developments in the fixed income markets. We would be delighted to exchange views on these aspects.



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